AN ASSESSMENT OF THE DEEP OFFSHORE AND INLAND BASIN PRODUCTION SHARING CONTACTS AMENDMENT ACT 2019

Proem

Once a host country is considered rich in hydrocarbons, investors involved in upstream petroleum operations then become concerned about a number of other critical issues. Chief amongst these issues are, investors' rights to monetize investment(s), stability of the legal and contractual regimes together with the enforceability of their rights. These issues have been referred to, broadly, as the Security of Investments for Upstream Operations.[1] Thus, upstream oil and gas investors consider these issues as key aspects of every contractual and legal regime when investing in upstream activities or operations.

Whilst investors are concerned about those key contractual and legal issues, the host country is concerned about getting a fair share of any revenue that is derived from successful petroleum activities by any investor in the upstream petroleum sector. Nonetheless, it is difficult determining what is fair, as there is no universally accepted standard and the level of development together with the needs of each host country plays a critical role in determining what mechanism works best for such a host country. Thus, it is usually an arduous task to forge a delicate balance between the concerns of upstream investors and those of their host countries or governments.

In reality, different fiscal mechanisms evince divergent outcomes for the different host countries and the relevant investors, when there is a variance in the profitability of the specific upstream venture. Under certain regimes, the host country receives lesser royalties, bonuses, rents, etc., when profitability surges. Other regimes have a neutral system such that the host country's-take, does not change, whether or not projected profits increase. Other regimes adopt systems that cream off excess profits such that the host country either takes all of any profits beyond the projected or pre-agreed profits/profit levels or have a system that ensures that as the profits of upstream operations increase, the host country-take also increases. Finally, hybrid regimes adopt a mixture of features such as sliding scales applied to production sharing, royalties, etc. Many host countries usually modify their fiscal toolboxes as certain circumstances, such as level of economic development, need to encourage investments, level of income, level of hydrocarbons exploitation, oil prices etc., change. In this regard, Nigeria is no different as it has now modified the fiscal toolbox of its production sharing contract regime from what was previously, at best, neutral (as far as government-take is concerned) to a more progressive/hybrid fiscal model.

State of Play

On October 15, 2019, the upper chamber of Nigeria's federal legislative house passed the Deep Offshore and Inland Basin Production Sharing Contract Act Amendment Bill (the "PSC Bill").It was reported that the PSC Bill was considered and deliberated upon by the Senate upon receipt of a formal request from President Muhammadu Buhari, seeking the amendment of the Deep Offshore and Inland Basin Production Sharing Contracts Act, Cap D3, Laws of the Federation of Nigeria, 2004 (the "PSC Act"). In an accelerated process, the House of Assembly on October 29, 2019 concurred with the Senate by passing the PSC Bill. On November 4, 2019, President Muhammadu Buhari assented to the PSC Bill (the "PSC Amendment Act"). The assent was communicated by the President via his official twitter handle.

It is projected that, the Federal Government of Nigeria ("FGN") will earn an estimated sum of US$1.5 billion, upon the implementation of the PSC Amendment Act from revenue due from International Oil Companies ("IOCs") operating in the country.

1 "The Three Pillars of Security of Investment Under PSCs and Other Host Government Contracts", by Frank Alexander, Fasken Martineau LLP.

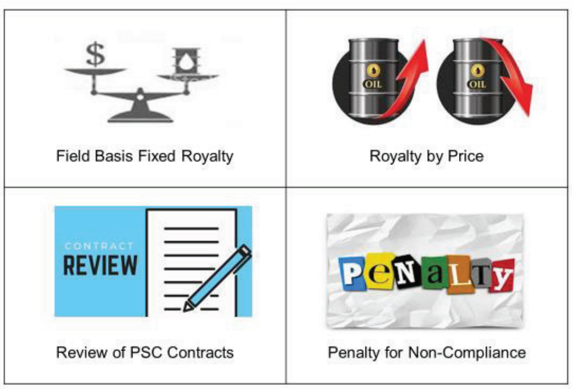
Thus, the aim of this article, is to highlight the elements of the PSC Amendment Act vis-à-vis the PSC Act (which commenced in January 1993) and highlight some of the potential impacts on PSCs specifically and the Nigerian petroleum industry together with the economy, as a whole. Basis for the New Amendment(s)

Except as provided by the PSC Act, the terms of extant PSCs may only be amended pursuant to negotiations and as mutually agreed in writing by the NNPC/FGN and the relevant IOCs. The PSC Act hitherto allowed for the adjustment of the fiscal toolbox and consequential revenue sharing formula in the PSC whenever the price of crude oil exceeds US$20 per barrel, with a view to making the PSC more economically beneficial to the FGN. Additionally, without prejudice to any change in oil prices, the PSC Act was to be reviewed, after a period of fifteen (15) years from the date of commencement and every five (5) years thereafter.

It is however important to note that the provisions of the PSC Act replicated above have now been deleted by the PSC Amendment Act (please see our analysis on the elements of the PSC Amendment Act below).
Further, it is trite that only the legislature can amend statutes. Hence, premised on the foregoing, it would appear that the FGN is well within its rights to make the requisite amendments to the PSC Act by virtue of the PSC Amendment Act.

Elements of the PSC Amendment Act

The schematic below provides a summary of the highlights of the PSC Amendment Act:



These elements are discussed in more detail below:

(a) Field Basis Fixed Royalty:

The PSC Amendment Act introduces a new royalty oil regime not provided for in the PSC Act. Under the PSC Act, the royalty to be paid to the FGN was to be at a graduated rate, depending on water depth (in the case of deep offshore area) while the royalty rate, in the case of inland basin, is fixed at 10%. This provision has been deleted in the PSC Amendment Act and replaced with a new provision which seeks to introduce a fixed royalty structure based on the oil and gas field in question. The PSC Amendment Act provides that royalty shall be at a rate of the chargeable volume of crude oil and condensates produced from the relevant area. The field-based royalty is indicated below:

S/N	Field Area	Royalty Rate
1.	In Deep Offshore: greater than 200 meters water depth	10%
2.	In frontier/ inland basin	7.5%

(b) Royalty by Price:

In addition to the royalty structure based on field area, the PSC Amendment Act also introduces royalty based on the price of crude oil, condensates and natural gas. This suggests a progressive government-take royalty regime. This structure would enable the FGN earn revenue via royalty of incremental surge in oil and gas prices in addition to other taxes applicable in the upstream oil and gas sector. According to the PSC Amendment Act, a graduated royalty payment will be due to the FGN, such that the government-take increases with price increases as is spelt-out below:

S/N	Oil Price	Royalty Rate
1.	From US$0 and up to US$20 per barrel	0%
2.	Above US$20 and up to US$60 per barrel	2.5%
3.	Above US$60 and up to US$100 per barrel	4%
4.	Above US$100 and up to US$150 per barrel	8%
5.	Above US$150	10%

With the above price-based royalty structure, the PSC Amendment Act has deleted the provision of section 16 of the PSC Act which provides that PSC fiscal terms are subject to review to ensure that if the price of crude oil at any time exceeds US$20 per barrel, real terms, the FGN's take in the additional revenue shall be adjusted to such extent that the PSCs shall be economically beneficial to the FGN.

Noticeably, the PSC Amendment Act is silent on how the dynamics of the royalty regime would be applicable in scenarios where the price of oil is upwards of US$60. It is expected that the royalty rate from the applied field area would be deducted as the first instance. However, it is unclear if a graduated royalty deduction (based on the table above) would be applicable if for example the price of oil is US$110. No doubt, the applicability of the royalty regime in such instances will be of immense concern to both the FGN and the IOCs to avoid future disputes.

(c) Review of PSCs:

The PSC Amendment Act is to the effect that the Minister shall cause the NNPC to call for a review of the PSCs after eight (8) years.

The implication of the PSC Amendment Act in this regard is that it provides a more specific term for the FGN to vary the terms of the PSCs rather than on the price fluctuation mechanism in the PSC Act.

(d) Penalty for Non-Compliance:

The PSC Amendment Act also seeks to criminalize non-compliance with the provisions of the PSC Act particularly with respect to the periodic review of the PSCs. The PSC Amendment Act indicates that non-compliance with provisions of the PSC Amendment Act (that is an offence punishable with a term of imprisonment for a term not less than five (5) year or an option of fine of Five Hundred Million Naira (N500,000,000).

Impact of the PSC Amendment Act on the Nigerian Oil and Gas Sector

- Improved Economic Benefit to the FGN

With the increased royalties which would accrue to the FGN from the activities of the IOCs, the PSC Amendment Act will ensure that the FGN has access to improved revenues which could positively impact on the Nigerian economy and shore up earnings.

The FGN has been deliberating on a number of ways to improve the revenue to its coffers as a way to improve its liquidity position, such as the proposed increase in the rate of Value Added Tax in Nigeria and the introduction of new tax regimes. The PSC Amendment Act, will allow the government to increase its cash collections from the IOCs. These receipts can then be deployed to other viable sectors of the Nigerian economy.

The President of the African Development Bank, Akinwunmi Adesina, Ph.D, recently stated that Nigeria has a liquidity problem and not a debt crisis. Thus, the increased royalties to the FGN can be seen to be seen as potential solution to the illiquidity issues currently plaguing the government.

- Increased costs to the IOCs

The royalty structure proposed under the PSC Amendment Act will no doubt result in increased cost of business to the IOCs under the PSC arrangement. Considering the fact that under the PSC framework, the IOCs will still be liable to pay signature bonuses to the FGN upon the execution of the PSCs well as other relevant taxes applicable. Thus, the increased royalty structure could impact on the cost to the IOCs' bottom line.

Conclusion

It is pertinent to note that the increased royalty liability consequent upon the PSC Amendment Act will lead to a substantial impact on the re-negotiations of some of the first set of Nigerian PSCs which are nearing the end of their primary tenures. It would most likely be the case, that IOCs would capitalize on the increased royalties to oppose the quantum of increased share of crude oil production revenue that the FGN may be aiming for. In the alternative, they may request a higher cap on cost oil than they were initially negotiating.

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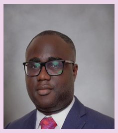

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