

# UPSTREAM LICENCE CONVERSION UNDER THE PETROLEUM INDUSTRY ACT, 2021

1. The dual regulators are now to perform the duties of the defunct Department of Petroleum Resources (DPR), Petroleum Products Pricing Regulatory Agency (PPPRA) and the Petroleum Equalisation Fund (PEF).

2. The Commission is responsible for the technical and commercial regulation of upstream operations and the issuance of licenses for the operations under the upstream sector. It is also tasked with the oversight of compliance with all the applicable laws governing the upstream sector. See sections 4 – 10 of the PIA.

3. The Authority is responsible for the technical and commercial regulation of midstream and downstream petroleum operations in the petroleum industry. It is also empowered to grant, or terminate licences, permits and authorisations for midstream and downstream petroleum operations. See sections 29 – 32 of the PIA.

4. Section 302(3) of the PIA.

5. No stamp duty or capital gains tax will be charged on the segregation of multiple-stream companies.

6. In the case of a licence for refinery operation, the licence is granted by the Minister to procure, construct, install and operate facilities to process crude oil on its own account into derivative chemicals and petroleum products and sell such chemicals and petroleum products at the exit of the refinery. Section 183(1) of the PIA.

7. Section 70(1) of the PIA

8. Section 70(4) of the PIA

9. Section 70(3) of the PIA.

10. Section 72(1) of the PIA.

11. Section 71(1) of the PIA.

12. Section 70 (1)(b)(ii) of the PIA.

13. There is an initial exploration period of three (3) years and an optional extension of three (3) years. See section 77(1) of the PIA.

14. There is an initial exploration period of five (5) years and an optional extension of five (5) years. See section 77(2), *ibid*.

15. Section 81(1) of the PIA.

16. Section 70(1)(c)(i) of the PIA

17. *Ibid*.

## 1.0 Proem:

After years of deliberation, Nigeria's Petroleum Industry Act ("PIA" or the "Act") was signed into law in August 2021, to herald a new reality for players in the oil and gas industry in Nigeria. The modifications are broad, profound and effect a revamp of the previous administrative, regulatory, and fiscal regimes.

Although the Act still categorizes the petroleum sector into the upstream, midstream and the downstream sectors, one of the notable innovations introduced is the new licensing regime for relevant upstream petroleum operations.

These salient provisions invoke key considerations amongst the upstream players to determine the implications of converting under the PIA, as against the current licenses they hold.

This article provides an insight into the licenses provided under the PIA, and the implications of licence conversion for upstream players.

## 2.0 Overview of the Upstream Licensing Regime under the PIA

The Act segregates the sector's regulatory oversight<sup>1</sup>, with the Nigerian Upstream Petroleum Regulatory Commission (the "Commission") now overseeing the upstream sector<sup>2</sup> and the Nigerian Midstream and Downstream Regulatory Authority (the "Authority")<sup>3</sup> now overseeing the midstream and downstream sectors.

The implication is that companies that engage in any of these sectors must obtain separate appropriate licenses as stipulated under the Act. Moreso, companies that intend to operate in more than one stream are expected to register and use a separate company for each of those streams of petroleum operations<sup>4,5</sup>. Consequently, this will lead to more contract realignment and asset restructuring.

The appropriate licence for midstream or downstream operations would also be sought from the Authority<sup>6</sup>.

The PIA introduces new categories of licenses to the upstream license nomenclature. Prior to the PIA, the applicable were the Oil Exploration Licence (OEL), Oil Petroleum Licence (OPL) and Oil Mining Licence (OML). Under the PIA, the term "Oil" has been interchanged with the word "Petroleum" and reflected in the new nomenclature of the licenses under the titles of Petroleum Exploration Licences ("PEL") Petroleum Prospecting Licences ("PPL") and Petroleum Mining Leases ("PML"), respectively.

### 2.1 Petroleum Exploration License<sup>7</sup>

With the PEL, the holder of the license has the non-exclusive right to carry out exploration operations within the area recognised under the license. Exploration may cover an area that is subject to PPL or PML. However, the operators of such licenses or leases have no obligation to pay for the results of any surveys conducted under PPL<sup>8</sup>. This license is valid for three (3) years and can be renewed for an additional three (3) years, subject to the fulfilment of prescribed conditions by the Act<sup>9</sup>.

### 2.2 Petroleum Prospecting License<sup>10</sup>

The PPL grants licensees the exclusive right to drill exploration and appraisal wells; and<sup>11</sup> to carry out corresponding test production. The qualified applicants are also entitled to carry out exploration operations, albeit on a non-exclusive basis.<sup>12</sup> In the case of a PPL granted for onshore and shallow water acreage, the maximum period is six (6) years<sup>13</sup>, while for deep offshore and frontier acreages, the maximum duration for this licence is ten (10) years.<sup>14</sup>

### 2.3 Petroleum Mining Lease<sup>15</sup>

The PML is granted an exclusive right to win, work, carry and dispose crude oil, condensates and natural gas for a maximum period of twenty (20) years.<sup>16</sup> The holder of a PPL can be granted a PML for each commercial discovery of crude oil or natural gas or both resources<sup>17</sup>. The holder of the lease must initiate regular commercial production within the stipulated development period (unless a valid reason has been communicated to the Commission)



18. Section 86(2) of the PIA.

19. Section 73(1) of the PIA.

20. Section 68(1) of the PIA.

21. Section 92(1) of the PIA.

22. Ibid.

23. February 2023.

24. Section 92(4)a of the PIA.

25. Section 92(3) of the PIA.

26. Section 92(3)a, Ibid.

27. Section 92(1)b of the PIA.

28. Section 93(1) of the PIA.

29. Section 93(1)a of the PIA.

30. Section 93(1)b, Ibid.

31. "Commercial Discovery" means a discovery of crude oil, natural gas or condensates within a PPL or PML which can be economically developed in the opinion of the licensee or lessee after consideration of all relevant economic factors normally applied for the evaluation and development of crude oil, natural gas, or condensate.

32. Section 93(1)c of the PIA.

33. Section 93(1)d, Ibid.

34. Section 93(1)e, Ibid.

35. Section 93(1) & (2) of the PIA.

36. Eighteen months (18) months (February 2023) from the effective date of the Act and the expiration date of the OML or date of conversion of the OPL to an OML.

37. Section 93(2) of the PIA.

38. Ibid.

39. Section 93(6)a & b PIA.

40. Section 93(4) and 95) of the PIA.

41. Section 93(7) of the PIA.

42. Section 93(7)b of the PIA.

43. Section 93(7)a of the PIA.

44. Section 92(7) of the PIA.

45. 350 square kilometres for any onshore or shallow water acreages; 1,000 square kilometres for any deep offshore acreages; and 1,500 square kilometres for any frontier acreages. See section 77 of the PIA.

46. Section 93(8) of the PIA.

47. Ibid.

48. "Marginal field" means a field or discovery which has been declared a marginal field prior to 1st January 2021 or which has been lying fallow without activity for seven years after its discovery prior to the effective date

49. "Farm-out" is an agreement between the holder of a PML or PPL and a third party, which permits the third party to explore, prospect, win, work and carry away any petroleum encountered in a licence or lease area during the validity of the licence or lease.

50. Section 94(1) of the PIA.

51. Section 94(2), Ibid.

52. Section 94(4) of the PIA.

to avoid revocation by the Minister and reversion of the title to the government.<sup>18</sup>

It must however be noted that whilst the PPL and PML are granted through a competitive bidding process, the PEL is granted on a discretionary basis<sup>19</sup>. Additionally, title to any data and its interpretation relating to upstream petroleum operations is vested in the government and are administered by the Commission.<sup>20</sup>

### 3.0 Upstream License Conversion Regime

#### 3.1 Involuntary Conversion

Given the introduction of new licenses under then PIA, it is not mandatory for the holders of an existing OPL or OML to convert to the new PIA regime where the licence/lease is yet to expire.<sup>21</sup> However, upon expiration of such right, the renewal of such unconverted licence/lease would mandatorily require that such rights be obtained under the new regime.

#### 3.2 Voluntary Conversion

The holder of an OPL or OML who wishes to convert under the PIA regime may do so through a conversion contract<sup>22</sup>. The PIA does not provide a form or structure for the conversion contract. However, the voluntary conversion contract is expected to be concluded at the earlier of eighteen (18)<sup>24</sup> months from the effective date of the Act<sup>24</sup>. Also, it is required that all arbitration and court cases are terminated through the termination clause in the conversion contract<sup>25</sup> and any stabilization provisions or guarantees provided by the Nigerian National Petroleum Corporation ("NNPC") shall be null and void<sup>26</sup>. The objective of this provision is to repeal existing investor guarantees and protect the host country from potential liabilities. Furthermore, the incentives recognised under sections 11 and 12 of the Petroleum Profits Tax Act ("PPTA") will cease to apply<sup>27</sup>.

#### 3.3 Relinquishment and Designations of Areas and Zones upon Voluntary Conversion

The Act provides that the holder of an OML (including those that are subject to Production Sharing Contracts ("PSCs") at the conversion or renewal date, are to designate each area and zone of the OML which<sup>28</sup>:

- In the opinion of the licensee, merits appraisal and for which the licensee is prepared to present an appraisal program,<sup>29</sup>
- The holder is prepared to make a declaration of a commercial discovery,<sup>30,31</sup>
- The holder is prepared to make a declaration of a significant gas discovery or a significant crude oil discovery and submit a field development plan;<sup>32</sup>
- Development of a field is underway based on prior approvals after having declared the discovery commercial or if no such declaration was made after having made a final investment decision to develop the field;<sup>33</sup> and
- Regular commercial production is occurring<sup>34</sup>.

For areas and zones not falling under the above, licensees are to relinquish up to sixty percent (60%) of the acreage and retain forty percent (40%) on the conversion date<sup>35,36</sup>. Where the total acreage of the designated areas or zones is less than forty percent (40%) of the OML area, the licensee may select additional areas to make up the forty percent (40%) to be retained and be awarded a PPL that includes such additional areas<sup>37</sup>. Where the total acreage is more than forty percent (40%), the licensee will be entitled to keep such larger areas, consisting solely of the selected areas<sup>38</sup>.

Following this, the Commission shall convert the applicable OML in respect of each area and zone designated by a holder under (a), (b), (c) above, into a PPL<sup>39</sup>, and in respect of (d) and (e) above, the Commission shall convert the applicable OML into a PML. The areas or zones within the OML that are not selected by the licensee shall be relinquished on the conversion date or the renewal date<sup>40</sup>.

A process for selection of areas and zones also applies for the conversion of OPL to PPL<sup>41</sup>. The Commission shall convert the applicable OPL of the areas and zones subject to ongoing field development and in respect of which regular commercial production is occurring into a PML<sup>42</sup>, while a PPL would be awarded for all other appraisal programs, field development plans and retention areas in the OPL<sup>43</sup>.

The Act does not however provide for a mandatory relinquishment requirement for the conversion of an OPL to a PPL. Where an OPL is converted, the term of years included in such licence shall apply to the converted PPL<sup>44</sup>. For converted PPLs that emerge from an OML, the duration ranges from five (5) years or ten (10) years depending on the area<sup>45</sup>.

Where the NNPC Limited held rights in natural gas under an OML, the OML shall be converted into a PPL and the NNPC Limited shall retain such rights<sup>46</sup>. Alternatively, where NNPC Limited relinquishes such rights, the conversion contract shall include consideration to NNPC Limited for the market value of the relinquished rights<sup>47</sup>.

The premise of such relinquishment provision is to foster effective acreage management by companies. For dormant fields that are not being actively explored by companies for petroleum resources, such companies would have to give up their fields. This approach seeks to boost the exploration of petroleum resources, resulting in increased output quantities.

#### 3.4 Marginal Fields<sup>48</sup>

For producing marginal fields, operations are allowed to continue under the pre-existing royalty rates and farm-out agreements<sup>49</sup>, but the asset is required to be converted to a PML within eighteen (18) months, from the effective date and would be subject to the fiscal terms under the PIA<sup>50</sup>. Conversely, a non-producing marginal field shall be converted to a PPL and shall benefit from the fiscal terms under the PIA<sup>51</sup>. By implication, all marginal fields would be transformed into a PML or PPL by February 2023. The PIA also provides that no new marginal field would be declared under the Act.

For an unattended field that has not been developed within seven (7) years after its discovery and is not transferred to the government, the holder of an OML is subject to the following processes within three (3) years of the effective date of the Act<sup>52</sup>:

- Present a field development plan for the marginal field.
- Farm out the discovery of the field with the consent of the Commission.
- Relinquish the field.

#### 3.5 Fiscal Regime for New Licences

The PIA introduced a dual fiscal regime that would apply to upstream companies and as such, converted licences and leases holders will be taxed under the new regime.



53. Section 260(5) of the PIA.  
 54. Section 261 of the PIA.  
 55. Section 260(3) of the PIA.  
 56. Section 267(a) of the PIA.  
 57. Section 267(b) of the PIA.  
 58. Section 302(1) of the PIA.  
 59. Section 21, Petroleum Profits Tax Act, Cap P13 LFN 2004.  
 60. Section 302(5) of the PIA.  
 61. All computation and assessment of HT shall be made in United States (US) Dollars. See section 287 (a) of the PIA.  
 62. Section 272(1) of the PIA.  
 63. Section 272(2), *ibid*.  
 64. Section 10(2)a of the PIA.  
 65. Section 10(2)b, *ibid*.  
 66. Section 10(2)c, *ibid*.  
 67. Section 10(2)d, *ibid*.  
 68. This is established where there are strategic projects in the upstream petroleum operations seeking to produce oil and natural gas to be processed or refined to finished petroleum products and supplied in wholesale solely to the domestic market.  
 69. Section 302(4) of the PIA.  
 70. Section 302(4)b, *ibid*.  
 71. Section 302(14) of the PIA.  
 72. Section 297(1) of the PIA.  
 73. Section 92(2) of the PIA.

## Hydrocarbon Tax Act ("HTA") and the Companies Income Tax Act ("CITA")<sup>53</sup>

The HTA is applicable and levied upon the profits of companies engaged in the upstream petroleum operations in onshore, shallow water, and deep offshore, payable during each accounting period<sup>54</sup>.

The Hydrocarbon Tax ("HT") shall apply to crude oil as well as field condensates and liquid natural gas liquids produced in the fields upstream of the measurement points. There are no chargeable tax rates for upstream petroleum operations in frontier and deep offshore waters until it is reclassified after a significant discovery has been made<sup>55</sup>; Nonetheless, CITA is applicable to such companies.

The Act categorises profits chargeable tax under HT as follows:

- a. Profit on crude oil for PML concerning onshore and shallow water areas, is thirty percent (30%) of the lessee's profit; and
- b. Profit on crude oil for PPL concerning onshore and shallow water areas, is fifteen percent (15%) of the licensee's profit.

Therefore, converted licences will be subject to tax under the new HT at thirty percent (30%) for PMLs<sup>56</sup> and at fifteen percent (15%) for PPLs<sup>57</sup> coupled with the general companies' income tax rate at thirty percent (30%)<sup>58</sup>.

Based on the foregoing, the maximum applicable rate under the new fiscal terms is sixty percent (60%) as opposed to the previous fiscal regime under the PPTA where companies were subject to as high as eighty-five percent (85%)<sup>59</sup>. Tax already computed under HT shall not be deducted from the CITA liability<sup>60,61</sup>.

A company engaged in upstream petroleum operations across terrains shall be allowed to consolidate costs for CITA<sup>62</sup>. Following this, the Act provides that companies engaged in upstream petroleum operations relating to crude oil terrains will be entitled to consolidate expenses and taxes for HT only across assets in which they hold licenses and leases under the two categories of chargeable tax<sup>63</sup>.

### Applicable Royalties

In addition, the Act provides for new royalty rates based on production. These royalties are calculated on a field basis on the chargeable volume of the crude oil and condensates produced from the field area in the relevant month and, in certain areas, depending on the barrels per day ("bpd") produced.

For onshore areas<sup>64</sup>, applicable royalties are as follows:

- for monthly production not exceeding five thousand (5,000) bpd - five percent (5%);
- for monthly production between five thousand (5,000) bpd and ten thousand (10,000) - seven-point five percent (7.5%); and
- For monthly production exceeding ten thousand (10,000) bpd - fifteen percent (15.0%).

For shallow waters (up to two hundred metres (200m) water depth)<sup>65</sup>, applicable royalties are as follows:

- For monthly production not exceeding five thousand (5,000) bpd - five percent (5%);

- For monthly production between five thousand (5,000) and ten thousand (10,000) bpd - seven-point five percent (7.5%); and
- For monthly production exceeding ten thousand (10,000) bpd - twelve-point five percent (12.5%).

For deep offshore (greater than 200m water depth), applicable rates are as follows:

- For monthly production not exceeding fifty thousand (50,000) bpd - five percent (5%); and
- For monthly production exceeding fifty thousand (50,000) bpd - seven-point five percent (7.5%).

For frontier basin<sup>67</sup>, the applicable royalty rate is seven-point five percent (7.5%).

### Integrated Specific Projects

The Act provides for the establishment of an Integrated Specific Project<sup>68</sup> where the capital investments associated with the midstream petroleum operations can be consolidated with the upstream petroleum operations for tax purposes<sup>69</sup>. It is important to note that capital investment in the midstream petroleum operations consolidated with upstream petroleum operations cannot be represented for capital allowances when assessing the income from midstream petroleum operations<sup>70</sup>.

### Default and Penalties

The Act provides for penalty for default of CITA, in the sum of Ten Million Naira (N10,000,000) on the first day the default occurs and Two Million Naira (N2,000,000) for every subsequent day the default continues, or as may be prescribed by the Minister of Finance<sup>71</sup>. The same applies to the default of payment of the HT<sup>72</sup>.

## 4.0 Concluding Remarks

Undoubtedly, the PIA introduced a number of remarkable changes to the oil and gas industry, which are expected to result in new developments for upstream players, especially in relation to the implications and benefits of licence conversion. Particularly, with the conversion to the new licences, the holders would enjoy more favourable tax rates. However, where conversion has not occurred, the old taxes and rates would apply to the companies.<sup>73</sup> It would however be important for the Commission to issue guidelines on model conversion contracts to provide clarity on such issues which may eventually arise in this respect. Upstream players would be required to adhere to the new PIA requirements and evaluate the extent of the improved regulatory provisions to their operational interests.



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