

Developments in Nigeria's Oil and Gas Industry

Nigeria is undoubtedly a major participant in the global oil and gas market, being the 15th¹ largest oil producer in the world, with proven reserves of around 37 billion barrels, and has the 7th largest natural gas reserves in the world, estimated at about 184 trillion cubic feet². Nonetheless, in the 53 years since oil was first discovered in commercial quantities in the country, the sector's contribution to the gross domestic product of Nigeria has been minimal, with a low level of local participation in the industry. A key reason for this was expressed by the Minister of Petroleum Resources, Mrs. Diezani Alison-Madueke, who is reported in the press³ as saying that while the Nigerian oil and gas industry spends an average of \$18 billion on annual basis, over 90 per cent of all the goods and services used in the sector is imported from other countries.

In recent years, the Federal Government of Nigeria has sought to implement policy in the oil and gas industry to deal with the key issues of:

- (a) a lack of participation of indigenous entities in the sector and resultant low level of indigenous technical skills base;
- (b) the sector's continuing low contribution to the wider national economy; and
- (c) the need to overhaul and update the legal, regulatory and fiscal framework of the sector to meet the current needs and state of the oil and gas industry.

Further to the above issues, two major pieces of legislation are set to revamp Nigeria's oil and gas sector, namely: the Nigerian Oil and Gas Industry Content Development Act and the Petroleum Industry Bill.

Nigerian Oil and Gas Industry Content Development Act

The Nigerian Oil and Gas Industry Content Development Act 2010 (the "Local Content Act") received presidential assent on 22 April 2010. This act was enacted with the aim of increasing indigenous participation in the oil and gas industry by prescribing minimum thresholds for the use of local services and materials and to promote the employment of Nigerian staff in the industry.

The quest to enhance local content has long been the policy of successive government in Nigeria. Prior to the passage of the Local Content Act, the Nigerian Government had introduced a number of policy regulations setting forth local content requirements with the aim of achieving 70% local content in the industry by 2010. The implementation of these policies attained a level of about 35% local content. It was felt that the impact of the measures was of limited success due to the absence of concrete laws, in the form of an act passed by the Nigerian legislature. The Local Content Act has been implemented to give much needed impetus to the Nigerian government's local content policy by bringing into play mandatory provisions in respect of the utilisation of local services and materials.

¹ In 2008 Nigeria was ranked the 12th largest oil producer with an average daily production of 2.4 million barrels. However production levels dropped following militant activity and pipeline vandalism in the Niger Delta region.

² These gas reserves have been discovered as a result of oil exploration and it is predicted that proven reserves could increase to 600 trillion cubic feet in the next 15 years which would place Nigeria amongst the top five biggest gas reserve holders in the world.

³ See Article entitled "Implementation of the Nigerian Content Act for the oil and gas industry" posted on 29 April 2010 by oilandgaspress.com

Key provisions of the Local Content Act

1. Scope of the Local Content Act:

The Local Content Act applies to all matters pertaining to Nigerian content in respect of all operations or transactions carried out in or connected with the Nigerian oil and gas industry. This covers all activities in both the upstream and downstream sectors of the Nigerian oil and gas industry ranging from exploration through to the sale of oil and gas and to all participants within the industry.

Section 2 of the Local Content Act states as follows:

"All regulatory authorities, operators, contractors, subcontractors, alliance partners and other entities involved in any project, operation, activity or transaction in the Nigerian oil and gas industry are required to consider Nigerian content as an important element of their overall project development and management philosophy for project execution".

The act goes on to define "Nigerian content" as the "quantum of composite value added to, or created in, the Nigerian economy by a systematic development of capacity and capabilities through the deliberate utilisation of Nigerian human, material resources and services in the Nigerian oil and gas industry". This definition, with its emphasis on the value added to the Nigerian economy entrenches the requirement that participants in the oil and gas industry utilise Nigerian human and material resources for the provision of goods and services.

It would appear that not all of the provisions of the Local Content Act apply to all participants. However, it is not always clear from a reading of the act which class of participants are subject to specific requirements and the exact scope of the obligation imposed. It is hoped that clarification will be received from regulations and guidelines to be produced by the regulatory authorities in due course.

2. Framework for implementation:

Prior to passage of the Local Content Act, authority for the implementation, coordination and monitoring of local content policy resided with various regulatory bodies for example the Nigerian National Petroleum Corporation (NNPC), acting through its Nigerian Content Division, and the Department of Petroleum Resources. The functions of these bodies now rests with the Nigerian Content Monitoring Board (the "Board") established pursuant to Section 5 of the Local Content Act.

The functions of the Board include to guide participants in the industry by publishing guidelines, as well as to monitor and implement the provisions of the act by, inter alia, reviewing and approving the Nigerian content plan of participants, pre-qualification criteria, technical bid documents, proposed bidder lists, contracts, issuing certificates of authorisation (as further explained below) and assessing and verifying of Nigerian Content Performance Report filed by operators. Mr Ernest Nwapa, the Group General Manager, Nigerian Content Division of NNPC, has been appointed as the

acting Executive Secretary of the Board and so will be responsible for execution of the Board's policies.

In addition to the Board, the Minister of Petroleum retains overriding authority to enact regulations in furtherance of the objectives of the act, such as those setting out requirements and targets in respect of utilisation of indigenous companies and services and requiring an operator to set up manufacturing facilities in Nigeria. The Minister is to also conduct a review, every two years, of the Schedule to the Local Content Act which sets out mandatory minimum content for the different categories of goods and services relating to the industry.

3. Nigerian Content Obligations:

a. Nigerian Content Plan

In bidding for any licence, permit or interest and as a pre-condition to carrying out any project in the industry, operators must submit a Nigerian Content Plan to the Board demonstrating compliance with the requirements of the Local Content Act.

The Nigerian Content Plan must contain provisions giving first consideration to utilisation of Nigerian goods and services and for the training and employment of Nigerians in the operator's work programme, as well as details of the criteria to be used by such an operator in putting this into effect.

The Board must complete its review and either deny or issue a Certificate of Authorisation within 30 days of commencing the review process. The consequences of the Board's failure to make a determination to either issue or deny a Certificate of Authorisation within this deadline are unknown as the Local Content Act is silent on this point.

b. Minimum Nigerian Content Specification

The Schedule to the Local Content Act sets out the minimum Nigerian content that must be existent in any project to be executed. These prescribed minimum levels are measured by reference to for example the number of Nigerian man hours utilised or the volume of the goods. For example, under the act 3D seismic data acquisition services has a 100% local content requirement and it is mandated that all welding and fabrication be done within the country.

An overriding consideration in the implementation of the Local Content Act is undoubtedly that acceptable quality, health, safety and environmental standards are maintained. Accordingly, there is provision in the act for operators to obtain authorisation from the Minister where local capacity is insufficient to meet the demands of the industry. However, such authorisation is for no longer than 3 years from the commencement of the act, as there is the expectation that local capacity can be built within this period. In so far as a project description does not currently appear in the Schedule, the Board will set up a minimum content level for that project pending amendment of the Schedule by the National Assembly.

c. Bid Evaluation

The Local Content Act requires all operators and project promoters to consider Nigerian content when evaluating bids, with the bid containing the highest level of Nigerian content likely to be selected. In addition, the act provides that the award of a contract must not be based solely on the principle of the lowest bidder. Indeed, where a Nigerian indigenous company has the capacity to carry out the work, the Local Content Act provides that such a company should not be disqualified solely on the basis that it is not the lowest bidder provided the value of its bid does not exceed the lowest bid price by 10%.

d. Employment & Training

Aimed at promoting the employment of Nigerian staff in the industry, operators or project promoters are required to give Nigerians first consideration for employment and training opportunities in any project. Where Nigerians are not employed because of their lack of necessary training or qualification, the act requires the operators to use reasonable effort to put the necessary training in place.

Furthermore, there is a requirement for operators to submit to the Board a succession plan under which Nigerians are to understudy positions currently occupied by expatriates for a maximum period of 4 years, with a view to the Nigerian taking over the position at the end of that period. All operators are required to employ only Nigerians in junior and intermediate roles, with the allowance of expatriates in management positions limited to 5% of management.

It is hoped that the act will boost employment of locals, particularly in the Niger Delta region where the vast majority of oil fields are located. Mrs Diezani Alison-Madueke speaking shortly after the Local Content Act was signed into law, was reported as saying that implementation of Nigerian Content would create an estimated 30,000 jobs in the next five years.

e. Technology Transfer Obligations

In aid of the development of the industry, the Local Content Act mandates the Minister of Petroleum to make regulations setting out targets to ensure full utilisation and the growth of indigenous companies engaged in various tasks such as exploration, manufacturing and fabrication of equipment and other support services. There is also the requirement that operators contribute 1% of the value of every contract awarded for upstream operations to the Nigerian Content Development Fund which is established by the Local Content Act. The Fund is to be employed by the Board for the projects, programmes and activities directed at increasing Nigerian Content in the industry.

In addition, the transfer of technology from operators to Nigerian individuals and companies⁴ is a key goal of the Local Content Act, with for example operators required to encourage and facilitate the formation of joint ventures, partnering etc between Nigerians and foreign contractors. Furthermore, the act raises the prospect of fiscal incentives for Nigerian and foreign companies that set up factories and productions units for the purposes of carrying out production or for providing services and goods that would otherwise be imported into Nigeria. The transfer of technology from multinationals to locals is important because Nigeria is hoping to become the services hub across the West African region and beyond.

f. Insurance and Shipping

Operators are mandated to insure all risks with a Nigerian insurance company. In order to place a risk offshore, an operator has to obtain the written approval of the National Insurance Commission, which is charged with ensuring that, as a pre-condition to the grant of such approval, local capacity is fully exhausted.

With regards to shipping services, the Local Content Act promotes compliance with the Nigerian Cabotage Act. The Cabotage Act was passed into law by the National Assembly in 2003 and essentially restricted the use of foreign vessels in domestic coastal trade and was aimed at promoting the development of indigenous tonnage in the Nigerian shipping sector. The Cabotage Act has been in effect since 1 May 2004 and a criticism that has been levelled is that implementation has been lax and so it has not achieved its goal of developing indigenous tonnage. By promoting compliance with the Cabotage Act, it is anticipated that the Local Content Act will help advance the development of the Nigerian maritime industry.

g. Other provisions to note:

There are further provisions in the Act regarding the utilisation of Nigerian legal practitioners, with the requirement that operators and contractors retain only the services of Nigerian legal practitioners save for project management and consultancy services where only a 50% Nigerian content is mandated.

As for financial services, operators are required to utilise Nigerian finance institutions except where, to the satisfaction of the Board, this is impracticable. The Nigerian banking industry further benefits from the requirement that operators retain 10% of their total revenue accruing from Nigerian operations in a Nigerian bank account. It is hoped that this support for the local banking industry will encourage the banks to provide greater level of financing to indigenous companies in particular with tenures of medium to long term.

⁴ A Nigerian company is defined by the Local Content Act as a company formed and registered in Nigeria in accordance with the provisions of Companies and Allied Matters Act with not less than 51% equity shares by Nigerians

4. Consequence of Non Compliance

The failure of an operator or contractor to comply with the provisions of the Local Content Act in carrying out a project amounts to an offence which is punishable by a fine of 5% of the value of the project in respect of which the offence occurs or the cancellation of the entire project.

Furthermore as an operator's eligibility for future projects, for example necessitating the award of a licence or permit, is dependent on observance of the provisions of the Local Content Act, the consequence of non-compliance extend beyond the specified penalties.

The Local Content Act will undoubtedly have a significant impact on operations in the oil and gas industry in Nigeria. All participants (to the extent that they have not done so already) will need to review their operations to ensure compliance with the provisions of the act.

Whilst the act is primarily geared at furthering the growth and expansion of indigenous participation in the industry, it does encourage foreign participation through strategic alliances and partnerships with local entities. Also, although the industry has since its inception been dominated by the major multinationals, the Local Content Act provides opportunities for new foreign businesses, especially small to medium enterprises providing support services, to participate in the Nigerian oil and gas industry through partnering with indigenous companies. The proposed favourable fiscal terms will provide for attractive investment opportunities. Furthermore, if the act succeeds in boosting employment, and in particular the post amnesty program in the Niger Delta, there will be greater security of investment.

The success of the Local Content Act in fulfilling its aims will in large part depend on the ability of the Board to effectively and efficiently encourage, monitor and ensure compliance of the operators with the provisions of the act. The implementation of the Act is very much in the early stages at the moment and so it is too early to measure the impact of the act on the industry and to properly assess whether the Board is performing as hoped or has simply created unnecessary and potentially costly bureaucracy in the system. There also remains the overarching question of whether there exists the local technical skills base to fill the immediate requirements for a larger indigenous workforce in the industry.

Petroleum Industry Bill

The Petroleum Industry Bill (PIB) is an attempt to comprehensively reform the Nigerian oil and gas sector, beyond the aims of the Local Content Act. The PIB, which is currently before the National Assembly, is intended to be a single, comprehensive piece of legislation in the Nigerian oil and gas industry. The bill has been the subject of much revision both before and during the course of its journey through the Nigerian legislature. It is therefore very difficult to say with certainty what the provisions of the bill will be once it is finally passed into law. However, the draft bill that was submitted to the National Assembly in December 2008 for their review, as well as the comments over the course of the last year from members of the government, legislature and stakeholders give an idea of the likely content of the PIB.

The key changes that are likely are as follows:

1. Regulatory Framework:

The role of regulator is currently shared between the Department of Petroleum Resources and NNPC (largely through its subsidiaries, including NAPIMS). The PIB intends to change this with the creation of new agencies, including separate agencies with responsibility for technical, commercial and cost regulation, health and safety and gas operations within the industry.

NNPC

Furthermore, the PIB aims to turn NNPC from a government owned corporation into an incorporated, fully-capitalised and commercially driven state-owned oil company similar to the likes of Statoil in Norway and Petrobras in Brazil. The new company is likely to be known as the Nigerian National Petroleum Company Ltd. A key factor in determining whether the new NNPC entity will operate as successfully as the likes of Statoil will be the level of involvement of its sole shareholder, the Nigerian state, in its management and operations. The Nigerian government has pledged its commitment to NNPC being transformed into a commercially driven and profit oriented National Oil Company, operating proficiently without government intervention in its business. Time will tell if this will be achieved.

Also NNPC's transformation is expected to have a significant impact on the wider financial planning within the country. At present, NNPC's crude oil revenues belong to the Nigerian federation (in order words the three tiers of government – federal, state and local government) as NNPC acts as an agent of the federation in respect of the sales. NNPC is required to pay this revenue on a monthly basis into the federation account and this (combined with the revenue of sale of the crude oil by the federation to NNPC) amounts to 85% of the total revenues accruing to the federation. This is supported by a provision in the Nigerian Constitution. If as it is expected the reformed NNPC pays an annual dividend to the government instead of the current monthly revenue payments, the federation would need to adapt to this change.

The question has also been raised as to NNPC's prospects of operating as a profitable enterprise. NNPC's current assets consist largely of its refineries and its interests in its subsidiaries. It is undisputed that NNPC's refineries⁵ do not operate anywhere near their combined installed refining capacity of 445,000 barrels per day and significant quantities of refined petroleum products are imported into the country. The investment that will be needed to upgrade the refineries and put in place appropriate infrastructure to support the refining and distribution of petroleum products will be substantial. Furthermore, NNPC's subsidiaries, particularly the Nigerian Petroleum Development Company (NPDC) which is engaged in exploration and production, will need to significantly improve their performance and invest in appropriate infrastructure. It could take several years for NNPC to achieve its full potential and join the list of successful oil companies on the world stage.

Incorporated Joint Ventures

It is reported that a further key reformation of the existing structures is a proposed change to the joint ventures between NNPC and multinational oil companies. Under the existing joint venture arrangements, the bulk of Nigeria's oil concessions are held in unincorporated joint ventures between

⁵ Located in Port Harcourt, Warri and Kaduna

NNPC and the multinational companies⁶. The government has cash-call obligations under the joint ventures to meet investment and operating costs and it has had repeated problems over the years in meeting its funding obligations in the manner and time prescribed under the joint venture agreements. It is expected that this issue can be resolved by having incorporated joint ventures which operate independently of government funding by being able to raise funds in their own right by accessing the financial markets. As with the proposed new NNPC structure, the success of incorporated joint ventures in operating as commercial entities will depend on the level of government control of its management and operations.

2. Fiscal Regime

A key reformation and one that has sparked considerable interest and commentary from participants in the oil and gas industry, particularly the multinational oil companies, is the proposed fiscal regime for the upstream sector. Currently, the rate of royalty paid by an operator is calculated by reference to the depth of the operations with offshore operations of over 1,000 metres subject to a zero percent royalty rate. The proposal is to introduce a new royalty assessment based on both production levels and the oil price.

Furthermore, the PIB proposes changes to the tax regime with for example the introduction of a hydrocarbon tax payable on an operator's production (and not profit as is currently the case) and changes to income tax.

From the Nigerian government's point of view, the current fiscal regime has been overly generous to the operators at the expense of the Federation. It has argued that the new fiscal terms are comparable to those of other important oil exporting countries. For supporters of the bill, the changes are long overdue and will ensure a fairer share of the cake for both the government and the operators. The multinational oil companies on the other hand warn that the new tax regime, if not set at an appropriate level, could deter investment in, and so jeopardise the development of, Nigeria's deepwater reserves in particular.

The question of whether the changes to the fiscal regime are able to achieve a balance between the aims of the government and the concerns of the multinational oil companies will be answered once the rates are published (with passage of the bill) and upon its implementation.

3. Downstream Sector & Gas

The PIB recognises and caters for a framework in respect of gas which is separate from the oil regime. It is expected to provide for separate licences in respect of oil and gas operations, with different cost and taxation regimes. The fiscal regime in respect of gas is expected to be more favourable to the operators than the oil regime in recognition of the need to incentivise investment in and development of the gas industry in Nigeria in line with the government's Gas Master Plan objectives. It is also anticipated that there will be mandatory provisions relating to the allocation of a portion of gas produced to the domestic market. This is especially important in meeting what will be

⁶ The Petroleum Act 1960 (Cap. 350) provides that ownership and control of petroleum is vested in the State

significantly increasing local demand if the government succeeds in its overhaul and development of the power sector in the country.

There has been much discussion over the years on the need for the government to deregulate the downstream sector of the industry. If enacted, the provisions of the PIB dealing with downstream products will significantly change that sector of the industry by bringing about much needed deregulation. The current system whereby the government subsidises the importation of petroleum products into the country is an expense that it cannot afford in the long term especially as there is greater need for such funds in other sectors of the economy. Also, with reliance on imported products, the availability of petroleum products has repeatedly failed to meet local demand. It is anticipated that the deregulation will encourage private sector participation which should significantly improve the availability of petroleum products. The PIB also gives operators in the refining sector access to pipelines and other logistics facilities.

As stated above, the PIB is currently before the National Assembly. Progress of the bill has been slow and consequently there has been much speculation as to whether or not there is the political will to enact the legislation. However, there has been continuous dialogue over the last year or so between the government and various stakeholders in the industry and the government has repeatedly reaffirmed its commitment to implementing the proposed reforms. It is difficult to say when the PIB will be passed into law given the progress of the bill today. Whenever the PIB is enacted a further update will follow.

Conclusion

The amnesty programme brought in late 2009 in the Niger Delta aimed at the militants in the area has brought peace, albeit a fragile one. The legislative reforms should encourage further development of the oil and gas industry in Nigeria and, if effectively implemented, generate growth in the wider economy of the nation. It is reported in the press that Nigeria unveiled the world's largest cake for its 50th independence anniversary celebrations on 1st October this year, with the aim that "the cake gets to as many Nigerians as possible". It is hoped that the reforms will ensure that a greater number of Nigerians will get a share of the real national cake – its oil and gas industry.

Grace Asemota