Introduction

Exploration for oil and gas in Nigeria began in 1908, with the first discovery being made in the Niger Delta in 1956. Nigeria’s first refinery began operations in 1965, with a capacity of 38,000 bbl/day; enough to meet domestic requirements at the time. The demand and production of oil in Nigeria has since increased tremendously, such that Nigeria’s current daily production is estimated at about 2.5m bbl/day, with a domestic consumption level of 279,000 bbl/day. At the end of 2010, Nigeria’s proved oil reserves were estimated to be 37.2bn barrels, which amounts to 2.68 per cent of the world’s reserves. Key participants in the Nigerian upstream sector include Shell, Exxon, Chevron, Eni and Total.

The crude oil produced in Nigeria is classified as ‘sweet’, as it is largely sulphur-free. 80 per cent of production wells are located in the Niger delta region in the southern part of the country, with notable projects including the Afam Integrated Oil and Gas Project operated by Shell and the Bonga Deep Water Project, Nigeria’s first deep-water oil discovery.

Due to the lack of gas infrastructure and the widespread flaring of associated gas, the Nigerian gas sector has been relatively underdeveloped and surveys have put the country’s proved natural gas reserves at about 5.29 trillion cubic metres – about 2.82 per cent of the world’s gas reserves. In a bid to tackle this underdevelopment, the federal government prepared a Gas Master Plan in 2008, the implementation of which is currently underway. The initiative is geared at promoting natural gas production, and encouraging the supply of natural gas to domestic power stations so as to alleviate the country’s energy shortage. As part of the Gas Master Plan, the National Gas Supply and Pricing Policy (Gas Pricing Policy) and the National Domestic Gas Supply and Pricing Regulations (Policy Regulations) have been issued by the government and both instruments impose obligations on gas producers to set aside a predetermined portion of their gas production for supply to the domestic market.
Key legislation and regulatory structure

Key legislation relating to the sector includes the Petroleum Act Cap P10 LFN 2004 (the Petroleum Act), the Nigerian National Petroleum Corporation Act Cap N123 LFN 2004 (the NNPC Act), the Associated Gas Re-injection Act 2004 and the Associated Gas Re-injection (Amendment Act) 2004 (the Associated Gas Acts), the Petroleum Profits Tax Act Cap P13 LFN 2004 (the PPTA) and the Nigerian Oil & Gas Industry Content Development Act 2010 (the NCDA).

In recent years, the country has sought to overhaul the legislative framework relating to the oil and gas industry. This has resulted in the draft of the Petroleum Industry Bill (PIB), which is currently before the Nigerian parliament. The draft contains changes to taxation regimes, improved economies for small, onshore developments and an amended royalty structure. Whether or not the PIB passes into law remains to be seen, but any legislative overhaul is likely to have a significant impact on the Nigerian oil and gas industry.

The Federal Ministry of Petroleum Resources (the Ministry) has overall regulatory oversight of the Nigerian oil and gas industry. The Ministry acts primarily through the Department of Petroleum Resources. Other regulatory bodies include the Petroleum Products Pricing Regulatory Agency, which regulates the rates for the transportation and distribution of petroleum products; the Federal Ministry of Environment, Housing and Urban Development, which is responsible for approving environmental impact assessment reports in respect of oil and gas projects; the Nigerian Content Development and Monitoring Board, which is responsible for ensuring compliance with the NCA; and the Joint Development Authority, which is responsible for the supervision of petroleum activities within the Nigeria–São Tomé and Príncipe Joint Development Authority. The Nigerian National Petroleum Corporation also has regulatory roles that it performs through the Department of Petroleum Resources (see below).

According to the Constitution of Nigeria, ownership and control over natural resources in Nigeria, including the territorial waters and exclusive economic zones, vests in the government. The Petroleum Act stipulates that all petroleum in, under or on any land is vested in the government.

The role of the ministry includes:

- initiation and formulation of the broad policies and programmes on the development of the oil and gas sector;
- administration of government joint venture interests in the petroleum industry in order to maximise the economic benefits from Nigeria’s oil and gas resources and optimise the government interests in all oil and gas arrangements; and
- licensing of all petroleum and gas operations and activities.

The department through which the ministry exercises its regulatory functions in relation to the petroleum industry is the Department of Petroleum Resources (DPR). The DPR was formerly known as the Petroleum Inspectorate, which was part of the NNPC. However, following the commercialisation of the NNPC, the inspectorate was removed from the NNPC and renamed as the DPR. The responsibilities of the DPR include issuing permits and licences for all activities connected with petroleum exploration and the refining, storage, marketing, transportation and distribution thereof. The DPR is responsible for the day-to-day monitoring of the petroleum industry. It supervises all the petroleum industry operations carried out under licences and leases in the country, with a view to ensuring compliance with the applicable laws and regulations in line with good oil field practices. The DPR also establishes and enforces environmental regulations.
The Nigerian National Petroleum Corporation (NNPC) is the state oil corporation through which the Nigerian government participates in the petroleum industry. NNPC implements the government’s policy on petroleum through the acquisition of participation interests in major oil companies' working interests.

In addition to its regulatory role, NNPC is vested with the exclusive responsibility for upstream and downstream development, which entails exploiting, refining and marketing Nigeria’s crude oil. The NNPC, through the National Petroleum Investment Management Services, supervises and manages government investment in the oil and gas industry. Under the NNPC Act, NNPC is vested with, among others, the following powers:

- exploring for or otherwise acquiring, possessing and disposing of petroleum;
- refining, treating, processing and generally engaging in the handling of petroleum for the manufacture and production of petroleum products and its derivatives;
- purchasing and marketing petroleum, its products and by-products;
- providing and operating pipelines, tankers or other facilities for the carriage or conveyance of crude oil, natural gas and their products and derivatives, water and any other liquids or other commodities related to the NNPC’s operations;
- doing anything required for giving effect to agreements entered into by the government with a view to securing participation by the government or the NNPC in activities connected with petroleum; and
- generally engaging in activities that would enhance the petroleum industry in the overall interest of Nigeria.

The NNPC is a fully integrated petroleum company and as such conducts its operations in its own right as well as through its several subsidiaries and through its joint ventures with other petroleum companies.

Before 1999, gas exploration activities in Nigeria were limited and the majority of associated gas was flared. Recognising the financial loss resulting from the flaring of associated gas and the resultant damage to the environment, the Associated Gas Acts were passed into law. These statutes impose an obligation on all oil producing companies in the country to submit detailed plans for gas utilisation. It also prohibits the flaring of associated gas without the written permission of the Minister for Petroleum Resources (the Minister). Major gas utilisation projects that are currently operational or under development are: Nigeria LNG (NLNG) Project; Escravos Gas-Gathering Project; and Oso NGL Project.

### Licensing regime

To conduct petroleum operations in Nigeria, participants must first obtain from the Minister an Oil Exploration Licence (OEL), Oil Prospecting Licence (OPL) or Oil Mining Licence (OML) to explore, exploit and produce petroleum (including natural gas) within the concession area. Only a company incorporated in Nigeria may be granted such a licence. An application must contain prescribed information and be accompanied by the applicable fee.

An OPL gives the holder the exclusive right to explore and prospect for petroleum. The holder of an OPL, on successfully prospecting and discovering oil in commercial quantities, may apply for an OML. The OML is the final stage for petroleum exploration and production, giving the holder the right to explore for and dispose of any petroleum discovered within the area covered by the OML.
The duration of the licences differ. An OEL is valid for one year and is renewable for a further one year provided the licensee fulfils prescribed conditions. The maximum tenure of an OPL is five years when granted over land and territorial waters, and seven years when granted in respect of continental shelf and Exclusive Economic Zone areas. An OML has a term of 20 years but may be renewed on the written approval of the Minister.

Various arrangements have been used in the Nigerian upstream sector, as set out below.

- **Concession agreement** – this was the earliest form of petroleum arrangement in Nigeria. An international oil company (IOC) is granted an OPL and on discovery of petroleum in commercial quantities, the company is granted an OML. The IOC conducts petroleum operations on its own (subject to regulations by the appropriate authorities), and pays royalties and petroleum profit tax (PPT) to the government.

- **Joint ventures (JVs)** – these are arrangements between NNPC on behalf of the government and a counterpart IOC whereby the parties hold the OPL or OML jointly and funding for the exploration, development and production of petroleum, and the hydrocarbons produced are shared in proportion to the participating interest held by each party. This arrangement is typically governed by a joint operating agreement (JOA) between the NNPC and its IOC joint venture partner that provides for the conduct of petroleum operations. The IOC is typically the operator, with a management committee established to supervise operations. The participatory interest of NNPC is 60 per cent in all JVs, except the Shell (SPDC) operated JV, where it is 55 per cent.

- **Production sharing contracts (PSCs)** – more recently, to reduce the government’s funding obligations, the government adopted the PSC as the preferred petroleum arrangement with IOCs for onshore and offshore operations. Under the PSC arrangement, the OPL and the OML is held by the NNPC, which engages the IOC or indigenous private investor as a contractor to conduct petroleum operations on behalf of itself and the NNPC. The contractor is responsible for financing all costs of the various stages of petroleum operations – ie exploration, development and production. When the exploration is successful, the contractor will be entitled to recover its costs, together with reasonable profit when commercial production begins. If the operation is not successful, the contractor will bear all losses.

- **Risk service contracts** – under the risk service contract arrangement, the OPL is held by the NNPC, while the service company funds petroleum operations. Each service contract relates to a single concession. The primary term is for two or three years, renewable at the NNPC’s option for a further two. As the contractor only gets reimbursed from funds derived from the sale of the concession’s available oil, when oil is not discovered in commercial quantities, the contractor does not recover its costs. When oil is found, the contractor is paid its costs back in instalments, in cash or crude oil allocation. The contractor is remunerated by payment of a fixed amount, does not have a participation share and does not acquire title to any crude produced. As such, the contractor is liable to pay Companies Income Tax (at 30 per cent) and not PPT. As an incentive for the risk taken, the contractor has the first option to purchase certain fixed quantities of crude oil produced from the service contract area at market prices.
National oil company/state participation

The Nigerian government participates in the petroleum industry through the NNPC. The NNPC is charged with doing anything required to give effect to agreements entered into by the government, with a view to securing participation by the government or the NNPC in activities connected with petroleum. The NNPC is the entity that negotiates and enters into the various arrangements with IOCs and the form of its participation will vary depending on the arrangement entered into as follows:

- **concession agreements** – the government does not have any initial interest in or under the concession, but it has an option to participate at any time;
- **JVs** – the government participates through NNPC as a 60 per cent (or, in the case of the JV with Shell, 55 per cent) interest holder; and
- **PSCs** – the government participates through NNPC, which holds the relevant concession/licence and then engages third parties under the PSC to conduct petroleum operations. NNPC is entitled to a share of the profit petroleum under the PSC.

Fiscal regime

The Nigerian upstream fiscal regime consists of a combination of taxes, bonuses (signature and production), rents, fees and royalties, as well as, in the case of PSCs, production sharing arrangements.

- **PPTA** – the profits of the oil producing companies are chargeable to tax under the PPTA and are also governed by the terms of any relevant memorandum of understanding or PSC. Under the PSC regime, there is a tax oil allocation to NNPC (or holder of the OPL) in such quantum as would generate an amount of proceeds equal to the PPT liability payment during each month. The tax rate under the PPTA is 85 per cent for JV companies and 50 per cent for PSC companies operating in deep offshore sites. A special rate of 65.75 per cent applies when a company has not yet started the sale or bulk disposal of chargeable oil under a programme of continuous production, and all pre-production capitalised costs have not been fully amortised. All expenses, wholly, exclusively and necessarily incurred for petroleum operations are deductible for calculating adjusted profit under the PPTA. Capital investment in facilities to deliver associated gas in usable form at utilisation or transfer points is treated for fiscal purposes as part of the capital investment for oil development.

- **Capital allowances and investment tax credit** – there are provisions for generous capital allowances at the rate of 20 per cent per annum in the first four years, 19 per cent in the fifth year and the remaining 1 per cent retained in the books of the company. Holders of PSCs are entitled to an investment tax credit of 5 per cent.

- **Royalty** – this is payable in ranges from 0 per cent to 20 per cent of production, depending on the location and depth of the area of production. Royalty can be paid in cash or by delivery of an equivalent volume of petroleum.

- **Other taxes and levies** – other heads of taxes that are applicable in addition to the above include education tax at 2 per cent and the Niger Delta Development Commission (NDDC) levy at 3 per cent. VAT is generally applicable to oil and gas operations at a flat rate of 5 per cent. However, exports, including of hydrocarbons, are exempt from VAT. There are various other taxes, such as capital gains tax for gains arising from the disposal of assets such as buildings, plants and machinery, and levies payable to different government agencies in respect of various operational permits and licences, as well as at the state and local government levels.
Local content requirements

Local content requirements are governed by the NCDA, which applies to contracts entered into after its enactment. The NCDA is designed to enhance the level of participation of Nigerians and Nigerian companies in the country’s oil and gas industry. It applies to all transactions or operations carried out in connection with the Nigerian oil and gas industry, as well as to all operators in the industry. The NCDA established the Nigerian Content Development and Monitoring Board (the Board) and the Nigerian Content Consultative Forum to monitor, co-ordinate and implement provisions of the NCDA as well as to provide the platform for information sharing.

The NCDA requires that every bid for any licence, permit or interest in the oil and gas industry must contain provisions to ensure that first consideration is given to Nigerian independent operators, employees, goods and services.

The NCDA further states that when there is inadequate Nigerian capacity, the Minister may authorise the continued importation of the relevant items up to three years from the start of the NCDA. One per cent of the total contract sum awarded in the upstream sector is required to be paid into the Nigerian Content Development Fund and such sums are deductible at source.

Under the NCDA, approval must be obtained from the Board before making application to the Ministry of Interior for an expatriate quota. Submission of a programme of planned initiatives aimed at promoting the effective transfer of technologies from the operator and alliance partners to Nigerian individuals and companies is also required.

Contravention of the provisions of the NCDA by an operator amounts to an offence and such operator is liable on conviction to a fine in the sum of 5 per cent of the project sum or cancellation of project.

The draft Petroleum Industry Bill is likely to bring further changes to the laws regarding Nigerian content in the oil and gas industry.

Domestic supply obligations

Under the Petroleum Act, if there is a state of national emergency or war, the Minister shall have a right of pre-emption over all petroleum and petroleum products obtained, marketed or otherwise dealt with under any licence or lease granted by it. Any clear and present danger of a breakdown of public order or safety due to low levels of availability of petroleum and petroleum products may constitute a state of national emergency in this context. The Minister shall also have the right to require the holder of any licence or lease granted under the Petroleum Act to provide to the government petroleum products, and to increase, so far as is possible with its existing facilities, the supply of petroleum products.

To assure that the local demand for gas is met, the government released the National Gas Master Plan (Gas Master Plan). As part of the Gas Master Plan, the National Gas Supply and Pricing Policy (Gas Pricing Policy) and the National Domestic Gas Supply and Pricing Regulations (Policy Regulations) have been issued by the government and both instruments impose obligations on gas producers to set aside a predetermined portion of their gas production for supply to the domestic market. The Department of Gas Resources is established under the National Gas Supply and Pricing Regulations and it is expected to ensure the availability of gas supply to the domestic market.
Transfer of interests

Under the Petroleum Act, a holder of a licence or a lease granted under the Petroleum Act is prohibited from transferring such licence or lease or any right, power or interest in the same without the consent of the Minister and the payment of the prescribed fee or premium.

The consent of the Minister is granted when he is satisfied that: (i) the proposed assignee is of good reputation or a member of companies of good reputation or is owned by a company or companies of good reputation; (ii) there will be available to the proposed assignee sufficient technical knowledge, experience and sufficient financial resources to effectively carry out a programme satisfactory to the Minister in respect of the operations under the lease; and (iii) the proposed assignee is in all other respects acceptable to the government.

Such transfer will attract the payment of stamp duty, which is assessable on the basis of the amount of consideration involved. The duty is payable directly to the Inland Revenue Service. There is no capital gains tax payable on the transfer of an interest.

The Petroleum Act does not require the consent of the Minister if there is a change of control of a holder of an interest in licence or a lease. However, an applicable PSC or JV agreement may set out requirements for consents.

Stabilisation/equilibrium and dispute resolution

Under the Petroleum Act, when a dispute is to be settled by arbitration, the dispute will be settled in accordance with the law relating to arbitration in the ‘appropriate state’ as agreed, and the provision shall be treated as a submission to arbitration for the purposes of the law. If there is no such agreement as to the appropriate state, the appropriate state will be the Federal Capital Territory, Abuja.

Stabilisation/equilibrium provisions are used in Nigeria. The stabilisation provision that has raised eyebrows in the industry has been the stabilisation provision entrenched in the Nigeria LNG (Fiscal Incentives, Guarantees and Assurances) Act 1990. The stabilisation provisions in the latter statute have been challenged in the Nigerian courts as unconstitutional as they limit the power of the legislature to make laws. The court of first instance agreed with this contention and the matter remains on appeal.