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A CONSIDERATION OF THE AMENDMENTS TO THE DEEP OFFSHORE AND INLAND BASIN PRODUCTION SHARING CONTRACT ACT

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1. INTRODUCTION

1.1. On the 4th of November, 2019, President Muhammadu Buhari signed the Deep Offshore and Inland Basin Production Sharing Contract (PSC) Amendment Bill into law. The amendment introduced major changes to the Deep Offshore and Inland Basin Production Sharing Contract Act (the PSC Act or the Act). Before considering the amendments in detail, we give a little background to the Act for full appreciation.

2. Background to the PSC Act

2.1. The Act in its long title captures its full intent:

An Act ... to give effect to certain fiscal incentives given to the oil and gas companies operating in the Deep Offshore and Inland Basin areas under production sharing contracts between the Nigerian National Petroleum Corporation or other companies holding oil prospecting licenses or oil mining leases and various petroleum exploration and production companies.

2.2. The act became operational on 1st January 1993 when the average annual oil price was around $16per barrel. At that time, it was necessary for government to give incentives to International Oil Companies (IOCs) involved in oil production activities in the Deep Offshore and Inland Basin (DOIB) areas, which were considered very high risk and capital intensive. The "Deep offshore area" is defined as an area with a water depth beyond 200 metres, while the states of Anambra, Benin, Benue Chad, Gongola, Sokoto are clustered under the umbrella of "Inland Basin Areas".

3. Fiscal Incentives under the PSC Act

3.1. The Act provides the following fiscal incentives to operators in the DOIB areas:

i. Long duration oil prospecting license: a minimum period of five years and an aggregate period of ten years

ii. Significantly reduced petroleum profit tax: 50% flat rate of chargeable profits for the duration of the PSC ;

iii. Application of Investment Tax Credit : a flat rate of 50% of the qualifying capital expenditure incurred wholly, exclusively and necessarily for the purposes of petroleum operations deductible from assessable tax and applicable to companies under the PSC arrangement that entered into their PSC prior to 1st July 1998; for companies that entered into their PSC after 1st July 1998 this is called an Investment Tax Allowance;

iv. Lower royalty regime based on a graduated scale percentile dependent on water depth as follows :

Area Rate

In areas from 201 to 500 metres water depth - 12 percent

a. From 501 to 800 metres water depth - 8 percent

b. From 801 to 1000 metres water depth - 4 percent

c. In areas in excess of 1000 metres depth - 0 percent

e. The Inland Basin - 10 percent

4. Amendments

4.1. To fully appreciate the need for the amendment of the Act, we should understand that its purpose was to attract investors and provide interim fiscal incentives to companies willing to invest in the highly volatile deep offshore and inland basin areas. The said incentives were meant to be interim and subject to periodic reviews. As the now deleted Section 16 provided;

1. The provision of this Act shall be subject to review to ensure that if the price of crude oil at any time exceeds $20 per barrel, real terms, the share of the government of the federation in the additional revenue shall be adjusted under the production sharing contracts to such extent that the production sharing contracts shall be economically beneficial to the government of the Federation.

2. Notwithstanding the provisions of subsection (1) of this section, the provisions of this Act shall be liable to review after a period of fifteen years from the date of commencement and every five years thereafter.

4.2. The conditions for review of the Act provided in the deleted Section 16 have long been satisfied. The price of crude oil exceeded $20 per barrel a long time ago. Between 2003 and July 2008 (the year the PSC Act reached the 15 year review mark), prices steadily rose, reaching $100 per barrel in late 2007 and culminated in an all-time high of above $145 per barrel in July 2008 before plummeting in the later part of the year bringing the average annual oil price for 2008 to about $94 per barrel. By the second half of 2009 and 2010, oil prices maintained an average of between $70 - $80 per barrel going as far as about $100 dollars per barrel in late 2010. Between 2011 and 2014 we saw prices above $100 per barrel and even at the eye of storm of the collapse in oil price between 2015 and 2016, prices never went below $20 per barrel. Today it hovers between $60 to $62 per barrel. It is anyone's guess as to why the government never made the necessary reviews. The failure to amend the Act has cost the country millions of dollars in revenue.

4.3. Section 5 on royalty which prior to the amendments provided for computations based on a graduated scale now provides for royalty payment based on a flat rate per field basis as set out below:

5(1) Royalties shall be calculated on a field basis. The royalty shall be calculated at a ratepercentum of the chargeable volumes of the crude oil and condensates produced from the relevant period as follows;

(a) in deep offshore, greater than 200metres water depth - 10 percent

(b) in frontier/inland basin - 7.5 percent

4.4. Section 5 further introduces a royalty by price mechanism. The royalty by price mechanism ensures that whenever the price of crude oil exceeds $20 per barrel, the royalty due to the government automatically increases in proportions set out below:

5(4) The royalty price shall be based on increase that exceeds US$20 per barrel, and shall be determined separately for crude oil and condensates as follows;

(a) from US$0 and up to US$20 per barrel - 0 percent

(b) above US$20 and up to US$60 per barrel - 2.5%

(c) above US$60 and up to US$100 per barrel - 4%

(d) above US$100 and up to US$150 per barrel - 8%

(e) above US$150 - 10%

4.5. The amendment introduced a new Section 17 which mandates the Minister of Petroleum Resources to call for a review of all PSCs every eight years. This of course is necessary in order to align with the economic realities of such period.

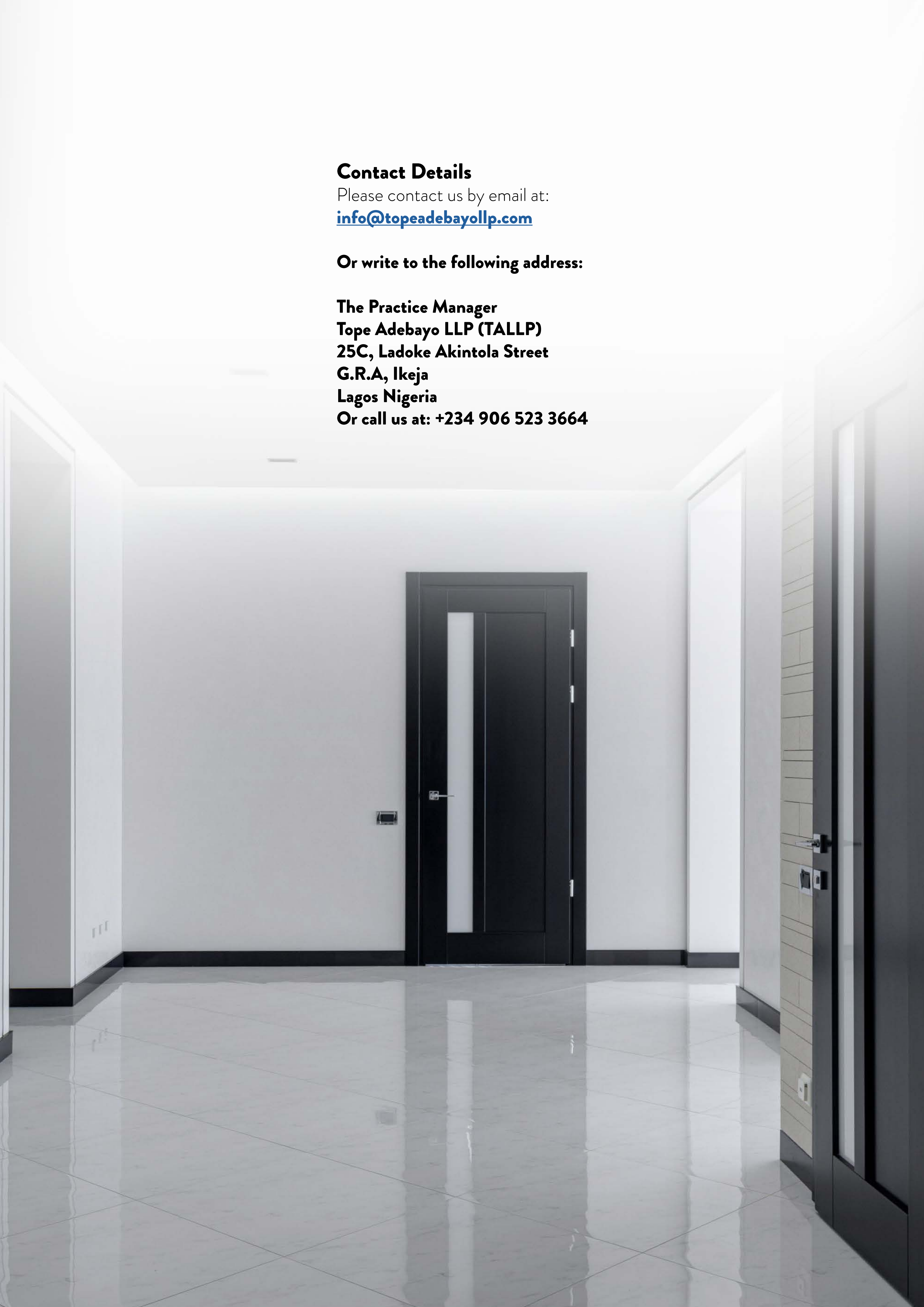
4.6. Before the amendments were introduced, there was no penalty for failure to comply with the provision of the Act. The new amendments by its Section 18 now provides:

Any person who fails or neglects to comply with any obligation imposed by any provision of this bill commits an offence and is liable on conviction to a fine not below N500,000,000.00 or to imprisonment of not less than 5 years or both.

5. Conclusion

5.1. The changes introduced by the amendments have serious business implications for companies operating in the DIOB areas. First, the penalties introduced mean the failure to comply with royalty obligations under the new terms has grave consequences. The quantum of the penalty as reflected by Section 18 makes it clear that the government is dedicated to implementing the law to the letter.
5.2. These amendments would definitely affect the bottom line for companies operating under the PSC arrangement and operational and business adjustments would need to be made.

5.3. It would be interesting to see if this Amendment Act makes it to the first eight year review mark considering the ongoing process of overhauling our petroleum laws and the current treatment of the PSC fiscal regime under the Petroleum Industry Fiscal Bill.



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