A LEGAL REVIEW OF THE DEEP OFFSHORE AND INLAND BASIN PRODUCTION SHARING CONTRACT (AMENDMENT) ACT 2019: ISSUES ARISING*

Abstract
In Nigeria, oil and gas contracts could be in the form of a Joint Venture agreement, a Service Contract, Concession, or a Production Sharing Contract agreement. This paper focused on the contractual arrangements captured under the Production Sharing Contract arrangement. The principal legislation regulating contractual arrangements under the Production Sharing Contract is the Deep Offshore Inland Basin Production Sharing Contract Act 2004 (DOIBPSCA). The Production sharing Contract arrangement was adopted to aid the funding constraints created by the joint venture agreements. In 2019, an amendment bill was passed by the senate amending the principal Act of 2004 which has been assented to by the president. The Deep Offshore and Inland Basin Production Sharing Contract (Amendment) Act of 2019 sought to cure the lacunae created by the Act of 2004. Over the years, there have been need to review the fiscal terms associated with the Deep offshore and Inland Basin Production Sharing Contract Act of 2004 (DOIBPA) which incentives to the International Oil Companies (IOC's) to encourage them to invest in the oil and gas sector in Nigeria. The need to reflect a more equitable and increased source of revenue is vividly captured under the amendment Act of 2019. This study therefore took a critical look at the reviews contained in the Amendment Act, the increase in the fiscal measures as contained in the Act, its implication to the IOC's and its effect on investments in the oil and gas sector in Nigeria and made recommendations thereto.

Keywords: Oil, Gas, Production, Sharing, Contract, Joint Venture, Contractual Arrangement

1. Introduction

The passage of the Deep Offshore Inland Basin Production Sharing Contract Act[1](herein referred to as 'The Act') is a major milestone in the Nigerian oil and gas sector. In the late 1980s and early 1990s the prices of crude oil were very low as well as our reserves. To increase our reserves amidst the political and economic uncertainty in the country, the inability of Government to meet up with its cash call obligations under the joint venture arrangement due to lack of funds, Production sharing Contract became the preferred option. Over the years there has been a yearn by the Nigerian government to review the fiscal terms of the Deep Offshore and Inland Basin Production Sharing Contract (Amendment) Act. The essence of the revision is to increase earning in Nigeria deep offshore wells and to reflect a more equitable source of income from its natural resources. Due to the nature of oil and gas exploration and production - the cost involved its risky nature and duration - it was not an area many investors wanted to tie up their money in investment. To encourage investments in the sector, the Federal Government enacted the Deep Offshore Inland Basin Production Sharing Contract Act 2004 and for the purpose of regulating arrangements under the production sharing contract. Consequently, massive investment was recorded in the sector. [2] The Act provides the legal framework guiding Nigeria's deep offshore oil production, covering acreages greater than 200 meters in water depth. It involves a series of fiscal incentives with a zero royalty and fifty percent (50%) flat rate of chargeable profit from oil exploration and production companies (Contractors) involved in exploration beyond 1000 meters water depth. In recent times there has been the need by the Federal Government to review this Act and the rates to increase government revenue and socio-economic development in the country. Recently, the bill amending vital sections of The Act was passed into law. The Amended Act seeks to amend, modify or increase the royalty rate due to the Federal Government from 0% to 50% with regards to offshore oil wells beyond 1000 meters water depth. This article intends to take a critical look at the reviews contained in the new Act, the increase in the fiscal measures as contained in the Act, its implication to the major players in the industry and the Nigeria economy.

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[1]Cap D3, Laws of the Federation of Nigeria (LFN), 2004
[2]Ogolo, Oghenerume, et al. "Assessing the Impact of Deep Offshore and Inland Basin Production Sharing Contract Ammendments on the Economics of Deep Offsore E&P Assets in Nigeria." *SPE Nigeria Annual International Conference and Exhibition.*Society of Petroleum Engineers, 2020.

2. Types of Contractual Arrangement Under the Nigerian Petroleum Industry

There are variety of contractual arrangement for the exploration and production of oil and gas. These arrangements arose to grant participatory interest to investors in the oil and gas industry. Such arrangements are needed because two or more parties for their mutual benefits wish to share the risk and financial burden associated with oil and gas exploration. Other agreements are needed between such parties and the third parties that provide them with services, which they are unable to provide for themselves. Below are the contractual arrangements in Nigeria oil and gas sector. The contracts could be in the form of Concession, Joint Operating Agreement (JOA), Production sharing Contract (PSC) or Service Contract (SC).

Concession: A concession is a civil agreement under which the state provides on a compensated basis and the investor purchases the exclusive right to the use of a subsoil area for agreed-upon purposes. It can be for prospecting, exploration and extraction of useful minerals. The holder bears all expenses and risks, as well as makes payments to the state for the use of the subsoil and for all other taxes and mandatory payments envisioned by law. A concession by its legal nature is a type of a lease agreement. There are two types of oil concession agreements, the traditional concession agreement and the modern concession agreement. Under the traditional concession, the oil company had the exclusive right to explore, produce, market and transport oil and gas in return for payment of a specified cost and taxes. An example of the traditional concession is the Shell Concession of 1938.Under this arrangement, the IOCs were granted extensive plenary rights to cover the entire country and for up to 75 years period, it excluded the host state from participating in the ownership, control, exploration and exploitation of its natural resources.[3] Under the modern concession, exclusive rights were granted to the IOC's to explore, extract, produce and market the natural resources. However, in modern concession, international oil companies were no longer permitted to cover large geographical area during exploration activities. Also, the lengthy period that was previously granted to the international oil companies were relatively reduced to reasonable period and majority of newly concluded concessions are based on joint and shared responsibilities between the host state and the transnational corporations[4].

Joint venture: is defined as a contract between co-tenants or co-owners of oil and gas properties that are jointly operated. A major feature of Joint Venture agreement (JV) is that ownership is shared by the participants with more or less equal distribution. It can be defined as a partnership formed by two or more companies, individuals or corporations who wish to broaden their activities for the purpose of making profit.[5] Profits and losses are shared by all the parties. Joint ventures are particularly deployed to spread risk, the resources and skills, and fulfill participation requirements. It provides the basis for sharing rights and liabilities in proportion to percentage interests and basis for conduct of operation.

Service contract: Under the service contract arrangement, the contractor provided all the funds and technical expertise needed for exploring, developing and producing the concession covered by the service agreement. The Contractor has no title to crude oil, but has the right to be repaid his investments plus an agreed mark-up usually in cash or crude oil if and when oil is discovered in commercial quantities and produced. The contractor brings the money and also the technical expertise for exploration and production and on that basis the contractor is rewarded for taking the risk and for its technical expertise.

Production Sharing Contract: this is a contract where the state, as the owner of mineral resources, engages an International 0il Company as a contractor to provide technical and financial services for exploration and development operations.[6] The state is traditionally represented by the government or one of its agencies such as the National Oil Company (in Nigeria, it's the Nigerian National Petroleum Corporation – NNPC). The IOC acquires an entitlement to a stipulated share of the oil produced as a

[3]Ajogwu, F., & Nliam, O. (2014). Petroleum Law & Sustainable Development. Centre for Commercial Law Development, 23
[4] ibid
[5]Elumelu, O. (2007). Licenses, leases and other contractual arrangements for the exploration and production of petroleum (Doctoral dissertation, uga).
[6]Onyi-Ogelle, H. O. (2016). Contractual arrangements in the Nigeria's oil industry. *AFRREV IJAH: An International Journal of Arts and Humanities*, *5*(3), 136-149.

reward for the risk taken and services rendered. The state, however, remains the owner of the petroleum-produced subject, only to the contractor's entitlement to its share of production[7]. The government (NNPC) usually has the option to participate in different aspects of the exploration and development process. It must be noted that under production sharing contract, the contractor provides the entire risk, and capital for exploration and production. If no discovery is made the contract ceases to exist with no obligation on either party, in the event of a commercial discovery expenses are recouped and the contractor is entitled to payment which is in cash, although often an option for payment to be made in crude oil is included within the contract. Countries that operate the Production Sharing Contract include Algeria, Cameroon, China, Indonesia, Libya, Nigeria, Yemen, Russia amongst others.[8] Production sharing Contract is focused on sharing of the output of the oil and gas operations in agreed proportions between the oil company as a contractor to the government and the national oil company in this case the NNPC as the representative of the government interest. Under Production Sharing Contract, the contractor bears the entire cost and risk of exploration activities and only reaps the rewards after oil is discovered in commercial quantity. Where commercial discovery of oil is made, the contractor will recover its entire cost of production and exploration from its own allocation of oil known as ‘cost oil’. Royalty is paid from the oil produced and the remainder of the production which is called the ‘profit oil’ is shared in agreed proportions between the oil company and the government (represented by NNPC) in the case of Nigeria.

3. Brief History of Production Sharing Contract

The concept of Production sharing Contract in oil and gas contractual arrangement was first adopted in Indonesia for the purpose of allowing international oil companies to carry out exploration and production activities in their country[9]. It’s been argued by several scholars that although it is believed that Production sharing Contract originated from Indonesia, the concept dates back to French Napoleonic traditions where the mineral resources was not owned by the individual but by the State for the benefit of its citizens[10]. It has over several decades gained prominence and acceptability as an upstream contracting device in different oil and gas jurisdictions such as Nigeria, Russia, Egypt, Angola, Gabon and several others. Over the years, the concept has developed into various variants for the purpose of suiting different oil and gas contractual transactions. It can thus be said that there is no universally accepted model of Production Sharing Contract as each country has developed its own variant of the contract over the years. The basic principle upon which Production Sharing Contract is hinged on is that Exploration and Production (E&P) Company carries the whole cost of exploration with regards to the contract area and will only be rewarded where commercial discovery is made[11] . In Nigeria, the first Production sharing Contract was made in June 1973 between Nigeria National Petroleum Corporation (NNPC) and Ashland oil (Nigeria) Company. It was part of the government’s effort to exercise full control over petroleum exploration and production activities in Nigeria. The rationale behind the adoption of Production sharing Contract was the funding constraints being experienced in the JV arrangement, the high geological risk associated with deep water and inland basins exploration, the desire of the Government to retain title to the oil concession and the aspiration to increase the nation’s reserve base. The 1973 Production Sharing Contract remained in operation in Nigeria for over a decade until the end of the 1980s when there was a shift in the Federal Government petroleum’s sector policy and Production sharing Contract became the preferred arrangement for most contractual arrangements in the country. In 1992 and 1993, the Federal Government through Nigerian National Petroleum Corporation (NNPC) negotiated new Production Sharing Contract with Eso, Shell, Chevron, Agip, Mobil, Elf, Bp and Ashland whose interests were subsequently acquired by Addax Petroleum Development Company Limited in 1988.

[7]Akinrele, A. (2000). Nigeria Oil and Gas Law, 159-165

[8] ibid

[9]Ogunleye, T. A. (2015). A Legal Analysis of Production Sharing Contract Arrangements in the Nigerian Petroleum Industry. *Journal of Energy Technologies and Policy,* 5(8), 1-10.

[10]Daniel Johnston, The International Petroleum Fiscal System and Production Sharing Contracts. (Tulsa, Oklahoma: Pennwell Books 1994) 22

[11]Mohammed, Sani D, ‘Technology Transfer and Economic Benefits: A Descriptive Analysis of Joint Venture and Production Sharing Contract in Nigerian Oil and Gas Industry’ *The Macrotheme Review* 7(2), Summer 2018

4. Legal Framework for Production Sharing Contract in Nigeria

Nigeria has in the past used the Joint Venture Agreement (JVA) for the exploration of crude oil in her deep offshore areas and inland basins. However, this arrangement was characterized by poor funding from the parties. This led to loss of revenue and a decrease in the production and exploration of crude and thus made the Joint Venture arrangement less desirable. Production Sharing Contract became an alternative arrangement for attracting investors for the purpose of exploring and producing oil and gas in her deep offshore and inland basin region since it was obvious that the Nigerian government could neither afford the financing of such huge project, nor do they have the technical expertise to carry out such operation. Due to the increase in the use of the Production Sharing Contract arrangement, the Federal government enacted a law to regulate their contractual arrangement with the international oil companies. This law is known as The Deep Offshore and Inland Basin Production Sharing Contract Act[12] which provides the general legal framework for the operation of Production Sharing Contract, including the applicable royalties, tax regimes and the manner in which costs and profits are allocated between parties. Under the Deep Offshore And Inland Basin Production sharing Contract Act[13], the duration of oil prospecting license relating to Production sharing Contract in the deep offshore and inland basin shall be determined by the Minister of petroleum resources and shall be for a minimum of five years and an aggregate of not less than ten years[14].The purpose of the Act is to give effect to fiscal incentives given to Oil and Gas companies operating in the Deep Offshore and Inland Basin areas under Production sharing Contracts between the Nigerian National Petroleum Corporation (NNPC) or other companies holding oil prospecting licenses (OPL) or oil mining leases (OML).

The Deep Offshore and Inland Basin Production Sharing Contract Act was enacted to demonstrate Government's commitment to the Production Sharing Contract arrangement in Nigeria. The Act backdated the commencement date of the Act to the 1st of January 1993. This is to make the Act applicable to the 1993 Production Sharing Contract executed before 1999[15]. It must however be pointed out that this Act does not apply to the 1973 Production Sharing Contract assigned to Addax as they are not located within the inland and the deep offshore areas as defined in the Act. Hence the 1973 Production Sharing Contract does not enjoy the fiscal incentives granted to the 1993 and post 1993 Production Sharing Contract. The Act only provides for fiscal incentives to oil companies operating in the Deep Offshore and Inland Basin areas. It applies to all Production Sharing Contract executed for the purpose of exploration and production of oil in the deep offshore and inland basins. It fixed the duration of the oil prospecting license between 5 and 10 years. It amended the Petroleum Profit Tax Act (PPTA) and stipulates 50% flat rate of chargeable profits as the petroleum profits tax payable under a Production Sharing Contract. However, it did not exempt the contractors from the payment of other taxes, duties or levies imposed by the Federal, State, Local Government or Area Council Authority. It granted an investment tax credit of 50% to NNPC or the holder and the contractor who have incurred capital expenditure entirely and exclusively on petroleum operation in the Production sharing Contracts executed before 1st [16]July 1998. For Companies that entered into their Production Sharing Contract after 1st July 1998 this is called an Investment Tax Allowance.[17] It also provides for the payment of royalty at a graduated rate in the deep offshore area while that of the Inland Basin is fixed at 10%, In areas in excess of 1000 metres depth it is fixed at zero percent, from 801 to 1000 metres water depth is fixed at four percent, from 501 to 800 metres water depth is fixed at eight percent, while areas between 201 to 500 meters depth is fixed at 12 percent[18]. It provides that the computation and payment of the petroleum profit tax must be in US Dollars.[19] The Act provides that royalty oil shall be allocated to the NNPC while Cost oil shall be allocated to the Contractor[20]. The negative aspect of this Act is that it has removed the flexibility that is usually associated with Production Sharing Contract and has effectively

[12]CAPD3 LFN 2004
[13] ibid
[14]Section 2 of the DOIBPSCA
[15] Section 19 of the DOIBPSCA
[16] Section 4(1) of the DOIBPSCA
[17] Section 4 (2) of the DOIBPSCA
[18] Section 5 (1) (2) of the DOIBPSCA
[19] Section 6 of the DOIBPSCA
[20] Section 7 and 8 of the DOIBPSCA

tied the hands of government by specifying rate of taxes and royalty without stipulating a convenient way to review these provisions without having to amend the Act through legislative process. In addition, the Act gives 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

5. Appraisal of the Innovations Introduced by the Review of the Production Sharing Contract Amendment Act

Over the years there has been a yearn by the Nigerian government to review the fiscal terms of the Deep Offshore and Inland Basin Production Sharing Contract (Amendment) Act 2004. The essence of the revision is to increase earning in Nigeria deep offshore wells and to reflect a more equitable source of income from its natural resource. On October 1st 2019, the senate passed a bill amending the Deep Offshore Inland Basin Act 2004. Accelerated hearing was given to the bill at the upper and lower legislative chamber because of the importance of the amendment and the lacunae it seeks to cure. On the 4th of November 2019, President Muhammadu Buhari signed the Deep Offshore and Inland Basin Production Sharing Contract Amendment Bill into law. The amendment Act which became effective from 1st January 2020 introduced major changes to the Deep Offshore and Inland Basin Production Sharing Contract Act. The principal 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[21] and Inland Basin[22] (DOIB) areas, which were considered very high risk, a volatile investment and capital intensive. To fully appreciate the need for the amendment of the Production Sharing Contract Act of 2004, we should understand that the purpose of the principal Act was to provide interim fiscal incentives to companies willing to invest in the highly volatile deep offshore and inland basin areas thereby attract investors. The said incentives were meant to be ad interim and subject to periodic reviews. The following reviews were introduced by the amendment Act.

Deletion of Section 16 of the Principal Act

The principal Act provided for a review of the Act after a period of 5 years of its commencement and subsequently every 5 years. Section 16(1) of the Act provides that:

> The provisions of this Act shall be subject to review to ensure that if the price of crude oil at any time exceeds $ 20 per barrel, in 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 Federation23.

Sub-section 2 of the Act further states that: '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. It must be clearly stated that this section never applied since the enactment of the Act. The deleted section 16 provided for a periodic review to ensure that if the price of crude oil exceeds $20 a barrel the increase will also be reflected in the allocation of revenue accruing to the Federal government. This adjustment was necessary to increase revenue accruing to the Federal Government under the Production sharing Contract arrangement to such extent that the Production sharing Contracts shall be economically beneficial to the Federal government. The Act should have been reviewed long before now in a way that will be more economically beneficial to the country.

It is hereby submitted, that the bench mark required by law for a periodic review has long been satisfied. The first bench mark was attained in 2003 when the price of crude oil exceeded $20 a barrel. The second

[21]"Deep Offshore" means any water depth beyond 200 metres;
[22]'Inland Basin" means any of the following Basins, namely, Anambra, Benin, Benue, Chad, Gongola, Sokoto and such other basins as may be determined, from time to time, by the Minister;
[23] Section 16 of the Deep Offshore and Inland Basin Production Sharing Contract Act CAPD3 LFN 2004

bench mark was attained in 2008 when the Act reached a 15-year period timeline, yet no review was carried out by the government. Over the years the cost per barrel of crude oil has steadily risen to over $145 before its present price of $ 62 per barrel. There is no doubt that Nigeria has lost a lot of money during this period of inaction.

Periodic Review of Contracts

The amended Act introduces a new section[24] which provides for a periodic review of all Production sharing Contracts every 8 years by the Minister of petroleum. This review is to be initiated by the Minister of petroleum resources. This is a good development because having a timeframe for review will help guard against price fluctuation mechanism in the Production sharing Contract arrangements. 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 Principal Act

Offences and Penalties

The amended Act introduced a new section 18. By this section, it stipulates that: ' any person who fails or neglects to comply with any obligations under the PSC Amendment Act commits an offence and is liable on conviction to a fine not below N500,000,000.00 (Five Hundred Million Naira) or to imprisonment for a period not less than five years or both'[25] It must be noted that this is a new addition as there were no penalties captured under the old Act. There was no penalty captured under the principal Act for non-compliance. This new addition is a welcomed development.

Revision of Royalty Rates

The Amended PSC Act made substitution in section 5 of the Act with a new revised royalty rate. Under the PSC Act, the royalty to be paid to the FGN was to be at a graduated rate, depending on water depth of the field (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. These new rates are 10% (for fields in the offshore greater than 200 meters water depth, while that of the frontier or inland basin is 7.5% as opposed to 10 % in the principal Act).[26]

Additional Royalty Based on Price:

The amendment also imposes an additional royalty rate to accommodate any increase in the price of crude oil in excess of $ 20 per barrel.[27] 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:

Price per Barrel	**Rate**
$0 -$20	0%
$20- $60	2.5%
$61- $100	4%
$100 - $150	8%
Above $150	10%

6. Conclusion and Recommendations

After a careful reading of the Amendments introduced in the Act, it can be observed that there is an omission of royalty rates for natural gas. The Amendment Act did not take into consideration royalty rates on natural gas. The Amended Act provides that 'royalty by price is to be adopted to allow for royalty reflexivity based on changing prices of crude oil, condensates and natural gas'. However, natural

[24] Section 17 of the Deep Offshore And Inland Basin Production sharing Contract (Amendment) Act CAPD3 LFN 2019
[25]Section 18 of the Deep Offshore And Inland Basin Production sharing Contract (Amendment) Act CAPD3 LFN 2019
[26] Section 5(1) of the Deep Offshore And Inland Basin Production sharing Contract (Amendment) Act CAPD3 LFN 2019
[27] Section 5(4) of the Deep Offshore And Inland Basin Production sharing Contract (Amendment) Act CAPD3 LFN 2019

gas is not accommodated in the list of royalty rate according to price. This omission makes it uncertain as to whether the Amendment Act will expand to royalties payable in respect of natural gas or whether the present rates in the petroleum (drilling and production) regulations will apply or subsist. In the absence of any express mention of rates for natural gas under the amendment Act creates ambiguity, and makes it appear that the rates payable for natural gas shall be as stated under the regulations as follows: 7% for onshore areas and 5 % for offshore areas. The amendment is a welcome development and a major milestone in the oil and gas sector in Nigeria as the Act has long been due for review. The innovations introduced by this review will help Nigeria receive its fair and equitable share of earnings from its oil and gas exploration and production activities in offshore and inland basin regions. It will also assist Nigeria to diversify its petroleum earnings accruing to the Federal government beyond the petroleum profit tax, the national hydrocarbon tax, company's income tax, to value adding activities in the downstream sectors. It will help facilitate a robust framework that will increase the revenue of government from its oil and gas activities.

It is recommended that natural gas should be expressly accommodated in the list of royalty rate according to price. The absence of an express mention of rates for natural gas creates uncertainty in interpretation as to whether the rates captured in the Amendment Act will apply to natural gas or the rates as contained in the Petroleum (Drilling and Production) Regulations will apply. It is expected that the revision in the royalty rates would have its impact on the contractors who entered into the production sharing contract before the bill was passed into law. It is therefore recommended that where they are aggrieved with the upward revision of rates as contained in the Amendment Act, they should avail themselves of the stabilization and renegotiation clauses contained in their contract with the Federal Government. The Federal Government should also be willing to make renegotiation where possible. It is believed that the aim of the government in carrying out this review is not just to improve revenue generation but also to encourage investments and new projects in the deep offshore and inland basins of the Nigerian oil and gas industry. This aim will only be achieved where parties are placed on an equitable equilibrium. However, the Federal Government in the excise of her sovereignty is acting within their powers in making the requisite provisions of the Act. It is further recommended, that there is a need for government to pass the Petroleum Industry governance bill into law. Petroleum is central to the Nigerian economy and accounts for 40% of its gross domestic product and its source of earnings. A good legislative framework regulating its oil and gas sector will be a welcomed development.