

PRODUCTION SHARING CONTRACTS IN THE NIGERIAN PETROLEUM INDUSTRY: REFLECTIONS ON THE LEGAL REGIME*

Abstract

The issue of legal regime is central to the petroleum sector's sustainability and diversification of economic resources of any country. In this regard, laws and regulations are put in place in line with the peculiarities of each country, which aims to boost the needed resource development and management. This study investigates the necessity for the regulation of the petroleum sector to tackle shortfalls and to enhance quantities of petroleum commodities in Nigeria. This work employed doctrinal methodology in the presentation and analysis of information gathered from primary and secondary source materials. The findings made from this article include the fact that production sharing agreement is better suited for the developing economies than alternative legal arrangements for exploitation of hydrocarbons, because these developing economies lack the technical expertise and finances to exploit and develop natural resources. It gives the government a decree of control over the operation of the oil companies. This agreement favours the state government because without putting their own resources, manpower, technology and finances, the state government gets the revenues, taxes and share in profits and without losing the ownership of the area concerned. The study recommended that a suitable audit provision should be made available in the Production Sharing Contract in order to determine the actual cost the contractor can recover. The work also moved for effective monitoring of the operations of the contractors to ensure that the venture is profitable and that there are no violations such as execution of work programme outside the approved budget, poor reporting of drilling expenditure, poor accounting for bank transactions and over-estimation of capital expenses, funding massive cost overrun without seeking the required management committee approval, over capitalisation of capital expenses and the ultimate write off of non-existent capital assets. It was further suggested that government should give immediate attention to the indigenes of the region where crude oil is being extracted from. The study ultimately recommended that all these measures and policies be encapsulated in a legal regime necessary for peace and socio-economic development in Nigeria.

Keywords: Petroleum Industry, Production Sharing Contract, Legal and Institutional Framework, Nigeria

1. Introduction

The petroleum sector is classified into three sections; the upstream which encompasses exploration, production and the downstream which consists of trades on refined petroleum products, retailing and haulage while the midstream transacts business on natural gas. The federal government controls the industry through its agencies that asserts domination of distribution or provision of refined petroleum. Legal and Institutional enactments are therefore, essential for the purpose of regulating the petroleum industry. Considering the fact that the oil industry is one of the primary bases of the country's revenue, it is therefore important that framework is put in place for the regulating of petroleum products and how effective these have been in achieving the purpose for their enactment.

2. The Legal Framework

Constitution of the Federal Republic of Nigeria 1999 (as amended)

The constitution forms the foundation for all enactments of other laws aimed at regulating the affairs of the country. Its provisions are supreme and binding on all persons and authorities in Nigeria including the government. Section 44 (3) provides that the entire property in and control of all minerals, mineral oil and natural gas in, under or upon any land in Nigeria, or in, under or upon the territorial waters and the government of the federation and shall be managed in such manner as may be prescribed by the National Assembly. This section offers the Federal Government of Nigeria exclusive control over extractive resources as it vests the Federal Government with the sole right to conduct exploration, exploitation and development of petroleum resources.

Petroleum Act¹

This Act bestows full proprietorship and management of energy resources on the Federal Government. The act provides a frame work for the licensing of oil and gas companies to engage in activities with the exploration, production and transportation of crude oil. Under the Act, the Minister and the Ministry of Petroleum resources have a role in environmental protection in the oil and gas sector. This role includes making regulations that provide for matters relating

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¹ Cap P10 Laws of Federation of Nigeria 2010

to licenses and leases granted under the Act and operations carried out thereunder including the prevention of pollution of water courses and atmosphere².

Oil Pipeline Act³

This Act makes provision for licenses to be given to form and preserve oil fields pipelines. The law empowers the minister for Petroleum and energy to award a permit to any person to transport mineral through oil pipelines. Also, section 8 provides for revocation of oil license by the Minister for non-adherence to the Acts requirements. The law regulates petroleum pipelines being the medium of transporting petroleum products. The minister grants licenses for the formation and preservation of oil pipelines.

Petroleum Profit Tax Act⁴

This law provides the framework under which the Federal Government of Nigeria obtains revenue from oil and gas operators by ways of signature bonus, royalties and taxes. It provides for the collection of taxes imposed on the profit made from petroleum operators. The act is meant to apply to the taxation of the assessed income profits of companies engaged in petroleum operations be it crude oil or natural gas as held in *Shell Petroleum Company of Nigeria v. Federal Board of Inland Revenue (FBIR)*⁵ where the supreme court held that any company engaged in petroleum operations is liable to pay profit tax. It contains provision relating to the definition of the operations of companies that are subject to the Act. It slots dearly factors to be considered in calculating tax payable by any affected company with the provisions for effecting petroleum profit tax payment.

Exclusive Economic Zone Act⁶

This Act vests on the Federal Republic of Nigeria, the sovereign and exclusive rights in respect to the exploration, the seabed, subsoil and waters in the exclusive economic zone. In the zone, Nigeria's Sovereignty and exclusive rights are not for all purposes but limited to exploration and exploitation of natural resources such as mineral, mineral oil and natural gas.

Petroleum Industry Act (PIA) 2021

The Act seeks to provide legal, governance, regulatory and fiscal framework for the Nigerian petroleum industry, the development of host communities and related matter. The Act which vests the property and ownership of petroleum within Nigeria and its territorial waters, continental shelf and Exclusive Economic Zone in the Government of the Federation of Nigeria is divided into five chapters. They are: A. Chapter one: Governance and Institutions B. Chapter two: Administration C. Chapter three: Host Communities Development D. Chapter four: Petroleum Industry Fiscal Framework E. Chapter five: Miscellaneous Provisions. The key objectives of the PIA are as follows: to create efficient and effective governing institutions, with clear and separate roles for the petroleum industry; to establish a framework for the creation of a commercially oriented and profit-driven national petroleum company; to promote transparency, good governance and accountability in the administration of the petroleum resources of Nigeria; to foster a business environment conducive for petroleum operations; and to deepen local content practice in Nigeria oil and gas industry

3. The Institutional Framework

Nigerian National Petroleum Corporation (NNPC)⁷

The NNPC is a statutory corporation that engages in commercial oil and gas activities. It participates in all stages of the upstream and downstream sector to enhance the petroleum industry efficiency and to commence other undertakings that are beneficial in actualizing the aims of the Act. The scope of activities of the NNPC ranges from exploration, production, refining, transportation, distribution and supply of oil and gas sector. In relation to Production Sharing Contract NNPC co-ordinates the distribution of petroleum products in the country through its dealers. It supervises the oil companies in their exploration, drilling and production of crude oil. NNPC arranges components like petrol, diesel and kerosene.

Nigerian Content Development and Monitoring Board (NCDMB)

Its primary duty is to promote local investment and participation in the oil and gas sector. It supervises and manages the growth of the Nigerian content in the oil sector through the board's approval. It registers and monitors companies participating in the upstream sector to ensure such a company has the requisite, indigenous participation under the Act. It is involved in the implementation of the provisions of the Nigerian Oil and Gas Industry content Development Act

² Section 9 (1) (b) (III) Petroleum Act, Cap P10 Laws of Federation of Nigeria 2010

³ Cap 07 Laws of the Federation of Nigeria 2004

⁴ PPTA Cap P13 Laws of the Federation of Nigeria 2004

⁵ (1996) 8 NWLR (Pt 446) 256

⁶ Cap E116 Laws of the Federation of Nigeria 2004

⁷ Cap 320 Laws of the Federation of Nigeria 2004

2010, with respect to supervising, coordinating, administering, monitoring and managing the development of Nigerian content in the industry.

National Oil Spill Detection and Response Agency

In a bid to the government responding to the continuing environmental pollution in Nigeria and the inefficient regulation framework thereto was the promulgation of The National Oil Spill Detection and Response Agency Act 2006. The agency is responsible for surveillance and ensuring compliance with all existing environmental Legislation in the industry. The agency plays a necessary role introduction sharing contract in Nigeria as it seeks to create zero tolerance for oil spill incidence in Nigeria, restoration and preservation of the environment by ensuring good practices in oil exploration, storage and production, with the aim of achieving sustainable development.

Petroleum Equalization Fund Management Board

It is empowered to harmonize the pump price of fuel commodities across Nigeria. The agency is to oversee the reimbursement of petroleum marketing firms for cost incurred for selling petroleum commodities at homogenous prices in the country.

Federal Ministry of Environment

This ministry is principally charged with the responsibility of environmental sustainability. It is also the window through which the international treaties and conventions on Environment entered into by the government of the federation is honoured. In carrying its functions of environmental sustainability, it establishes specialized agencies to carry out certain function. The ministry plays a vital role the national goals of dissertation and deforestation, pollution and waste management. The ministry also supervises climate change and clean energy issues.

4. Critique of the Legal Regime

For a successful petroleum regime, the Nigerian government must design and implement an appropriate legal regime comprising special petroleum laws, and regulations. It should be noted that most of the time the appears to be a conflict on the roles of the NNPC and petroleum product pricing regulatory agency on pricing, supply and marketing of petroleum commodities which has hindered the efficiency of the price regulatory agency in the sector. There is need to eliminate bureaucracy among the various institutions regulating the sector to combat corruption and inefficiency. The inefficiency in the product transportation system has through ageing petroleum pipelines, pipelines vandalisation activities, low road networks and poor remuneration of most petroleum truck drivers, occasioned sharp practices, ineptness and corruption. As a result of many regulatory bodies in the sector, the efficiency in the sector may be affected due to over regulation leading to excessive bottle necks. There is need to eliminate bureaucracy among various institutions regulating the sector to combat corruption and inefficiency. There is also the need for strong political will to entrench openness and accountability in the sector through stringent enforcement of the petroleum laws. There is also the challenge of weak enforcement and lack of clear enforcement and lack of clear guidelines on the exercise of some powers such as consent on oil transactions or licenses transfers and absences of time frame for the exercise of such power thereby giving room for abuse of power. The penalties imposed for non-compliance with regulations appears not to commensurate with the offence

5. Conclusion and Recommendations

The petroleum industry in Nigeria is a very robust one. It is of utmost importance that there should be an enabling legal and institutional framework to act as a catalyst and more importantly as a surety for the inflow of new investments and the maintenance of existing investment. In order to see a positive improvement in the economy, it is recommended the audit provision in the Nigerian production sharing contract should be reviewed and properly couched so as to enable the NNPC use it in the cost recovery process. Audit provision is necessary to monitor the operations of the contractors to ensure that the venture is profitable. The contractors should be closely monitored to ensure that there is no violation such as execution of work programme outside the approved budget, poor reporting of drilling expenditure, poor accounting for bank transactions and over estimation of capital expenses, funding massive cost overrun without seeking the required management committee approval, over capitalisation of capital expenses and the ultimate write off of non-existent capital assets.

In the light of the above, it is inevitable to provide a set of policy recommendations that would be applicable to the Nigerian economy: The NNPC should diversify its export baskets through downstream production; this will enhance the refined petroleum for exports. The government should encourage more private company participation, so that better equipped refineries can be built and the cost of refining crude oil will be reduced. The Federal government should be a regulator and enforcer of petroleum laws. If Nigeria must have the full benefit of its natural resources and probably economic, political and social stability natural resources (including oil and gas) should be privately owned. Government must; of course, collect royalties, taxes and profit. Security should be boosted on the high sea where crude oil products are being smuggled. This will help reduce loss from illegal export of crude oil products. Government should establish an institution that will ensure that the multinational oil companies are socially responsible to their host communities. Government should give immediate attention to the indigenes of the region where crude oil is being extracted from. This will reduce the unrest of in that region.