Federal Government of Nigeria Introduces Cost Efficiency Incentive Framework for Upstream Operators

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On 30 April 2025, the President of the Federal Republic of Nigeria, Bola Ahmed Tinubu, signed into law the Upstream Petroleum Operations (Cost Efficiency Incentives) Order, 2025 (hereafter referred to as "the Order") via Statutory Instrument No. 22 of 2025. This reform initiative, published in the Federal Gazette No. 87 Vol. 112, introduces a Cost Efficiency Incentive (CEI) framework aimed at tackling persistent inefficiencies and cost overruns within Nigeria's upstream petroleum sector.

The Order represents a key strategic policy shift by the Federal Government to reduce the operating costs of petroleum activities, enhance fiscal and operational discipline among industry players, and bring Nigeria's upstream cost structure in line with global best practices. The CEI framework provides performance-based tax credits to operators that meet or exceed cost reduction targets established by the Nigerian Upstream Petroleum Regulatory Commission (NUPRC or "the Commission"), thereby linking fiscal benefits directly to proven operational efficiency.

The Order takes effect from **30 April 2025** and remains in force until **31 May 2035**. It applies to all lessees, licensees, and their contractors operating within Nigeria's upstream oil and gas sector.

Key Provisions

1. Objective of the Order

The principal objective of the Order is to incentivise reduction in the unit operating costs of upstream petroleum activities through tax credits. Specifically, it seeks to:

i. reduce operating costs in the upstream petroleum operations through achievable cost reduction measures, strategies and targets.

ii. promote cost discipline among stakeholders in the upstream petroleum operations.

iii. iimprove operational performance and streamline contract cycles.

iv. maximise economic value from the oil and gas sector; and

v. offer tax incentives to companies which achieve or surpass costreduction targets.

2. Scope and Applicability

The Order applies to all upstream petroleum operators, i.e., lessees, licensees, and their contractors, engaged in exploration and production activities in Nigeria. Participation in the incentive framework is conditional on achieving or surpassing annual cost reduction targets determined by NUPRC.

3. Benchmarking and Performance Monitoring

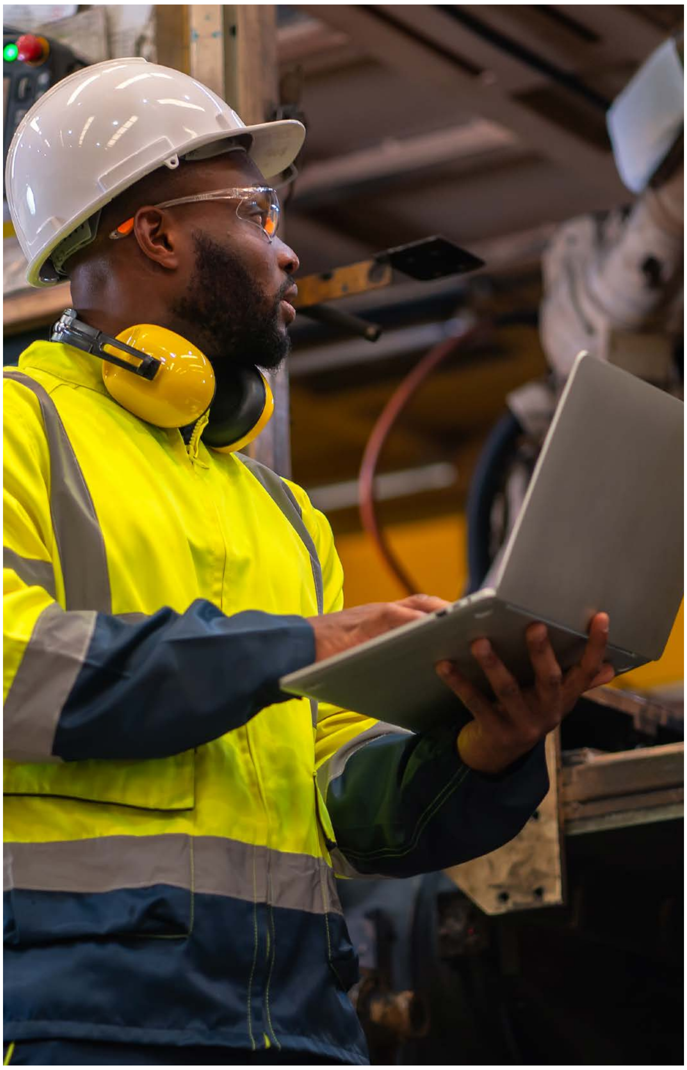
NUPRC is mandated to conduct annual terrain-based assessments to establish Target Operating Costs (TOCs) for onshore, shallow water, and deep offshore operations. Each operator's Actual Operating Cost (AOC) will be assessed against these TOCs using verified production and lifting volumes. Operators are eligible for the CEI once they meet or surpass their assigned cost targets.

To support transparency and consistency in this process, the Commission is expected to:

i. Conduct annual assessments and benchmarking studies to establish appropriate cost benchmarks for upstream operational activities and Unit Operating Costs (UOCs) across the three terrains.

ii. Determine the cost benchmarks in line with guidelines issued under the PIA, 2021. Prior to finalising the benchmarks each year, the Commission is to consult relevant stakeholders and publish the underlying benchmarking methodology.

iii. Assign annual UOCs reduction target for each terrain, with considerations for their operating environment and production volumes.



iv. Conduct annual reviews within the tax return cycle to assess each lessee's or licensee's performance against the assigned cost targets. The key metric will be UOCs.

To determine adherence, the Commission will verify production volumes and reconcile production and lifting data to eliminate discrepancies from under-lift or over-lift situations.

Operators that achieve or surpass their cost performance targets will qualify for the CEI in the year the target is met. NUPRC will forward the list of qualifying companies to the Federal Inland Revenue Service (FIRS) and provide a copy to the Minister, pending the lessee's or licensee's formal claim for the incentive.

4. Incentive Calculation and Tax Credit Formula

Eligible companies can claim a tax credit under the CEI framework when they operate below the TOC set by the Commission. The credit represents a portion of the government's incremental revenue resulting from the operator's cost savings, serving as a reward for efficient operations without reducing expected public revenue. The CEI is calculated as follows:

CEI = (TOC – AOC) × V × RTR × 50%.

or

CEI = (CS)* RTR * 50%.

Where:

- **TOC** = Target Operating Cost
- **AOC** = Actual Operating Cost
- **V** = Annual Fiscal Sales of Hydrocarbons
- **CS*** = Cost Savings = (TOC – AOC) × V
- **RTR** = Referenced Tax Rate
- **50%** = Share of the government's revenue benefit allocated to the operator

To qualify for the tax credit, CS must be a positive value. The credit is applied to the operator's tax liability for the relevant asset and is **capped at 20%** of the tax payable in any year. It must be utilised within **three years** of issuance and becomes invalid beyond the incentive's expiry date of **31 May 2035**.

5. Compliance Conditions

The Commission is tasked with aligning Nigeria's upstream petroleum operating costs with global standards by progressively eliminating the cost premium typical of the local oil and gas sector. This involves setting ambitious, yet achievable, year-on-year cost reduction targets that promote continuous improvement in operational efficiency. Importantly, any cost reduction strategies employed by operators must avoid harmful or unfair practices. Cost savings resulting from unethical dealings or prejudicial arrangements with contractors, employees, host communities, or other parties will be excluded from consideration when determining eligibility for the incentive.

To ensure fiscal consistency and maintain the integrity of the incentive program, the FIRS will validate all tax credit claims. This validation includes confirming that the UOCs used by the Commission to assess eligibility align with those applied by the FIRS when computing the lessee's or licensee's adjusted profits for tax purposes. This process is expected to ensure that the tax credits granted accurately reflect genuine cost efficiency improvements without compromising tax compliance.

6. Implementation Guidelines

To ensure a smooth rollout of the CEI framework, the FIRS and the Commission, with the Minister's approval, were meant to have issued detailed implementation guidelines within 30 days of the effective date of the order. These guidelines should explain the cost targets, how costs will be checked each year, and what information companies need to provide.

At the conclusion of each annual evaluation, the Commission will publish a list of companies that qualify for tax credits on its website before tax filing deadlines. The guidelines will also show how the tax credits are calculated, so everyone knows what to expect.

Commentaries

The introduction of the CEI Order is a timely and important step towards tackling one of the biggest challenges in Nigeria's upstream oil and gas sector i.e., high operating costs. For years, inefficiencies like slow and protracted procurement process, project delays, high security costs, pipeline and infrastructure vandalism and stringent local content requirements have driven up costs, making it harder for companies to operate profitably and for Nigeria to compete globally. Nigeria has, therefore, become one of the highest cost producers per barrel of oil equivalent (boe) in the world. Current estimate is that it costs $40 per boe in Nigeria compared to low-cost producing countries like Kuwait, Saudi Arabia, Iraq, UAE and Iran where cost per boe is less than $10!

The key question being asked is how effective the framework will be in delivering on the desired objective. In our opinion, the framework will be a game changer if properly implemented. By limiting the maximum tax credit claimable by any qualifying company to 20% of tax liability, it will help to preserve government revenue while rewarding efficiency. However, the long- term impact on government revenue will depend on the level of compliance by the companies and enforcement by the regulators. The framework may result in increase in hydrocarbon production in the long run if the companies reinvest the savings in petroleum operations rather than returning the entire savings to their shareholders by way of dividend. If this happens, it will certainly be a big boost to production growth seeing that the country has struggled to exceed 1.7million (inclusive of about 200,000 barrels of condensates) barrels per day this year.

However, there are certain areas of the framework that need to be enhanced to deliver improved performance. One area that needs to be clarified is what constitutes unit operating cost? It is important that expenses that are

not strictly subject to the control of businesses but are driven by external factors be excluded. These managed expenses, which may not be subject to strict limits, will include spending on security. The Order requires that the UOCs computed by the Commission align with that applied by the FIRS for tax purposes. In tax computation, some exploration costs are treated as tax deductible though they are not usually considered as operating cost. Would this, therefore, mean that any exploratory cost treated as tax deductible expenses may be included in UOC? There is also the issue of interest expense, which is generally considered as non-operating cost but is tax deductible. Would the UOC be limited to the operator's cost, or would it include other operating costs, which are mainly administrative and overhead costs, incurred by the non-operators? Would this also mean that the UOC computed would only be for the licence area(s) and not per company to avoid distortions? Hopefully, the proposed guidelines will provide clarity on these matters.

The government can consider introducing a tiered incentive system rather than capping the amount claimable to 20%, irrespective of the level of performance achieved. The framework can, therefore, be redesigned such that it will limit the credit to varying percentages (5%, 10%, 15% and 20%) based on the level of reduction achieved. This will encourage continuous improvement and competition among the operators.

The CEI framework only focusses on reducing operating cost and not on capital efficiency. In other words, there are no incentives for delivering relative high output per 1USD invested. Capital efficiency (whether with reference to return on capital employed or capex per boe) will be a key driver of long-term sustainability. Therefore, if government wants to incentivise smarter investment and infrastructure optimization, it should consider rewarding companies that deliver capital and operating cost efficiency. Currently, there is no such metric in the Harmonised Nigeria Tax Bill or the Petroleum Industry Act. There is also the concern that the framework is not linked to any environmental performance metrics. Integration of metrics, such as reduction in gas flaring, methane emissions and adoption of carbon capture technologies, may go a long way in strengthening the effectiveness of the framework and aligning it with leading practices.

Overall, this Order marks a shift toward a more results-driven and accountable approach to fiscal policy in Nigeria's upstream sector. It is aimed at reducing costs, improving competitiveness, and attracting long-term investment. However, to achieve these objectives, the NUPRC must be effective in its compliance and audit responsibilities by conducting the annual reviews as and when due, verifying production data and timely publication of the names of the qualifying companies. This will also help in enhancing transparency. The Order requires the NUPRC and the FIRS to issue implementation guidelines within 30 days of its effective date. The relevant guidelines must, therefore, be released without delay to provide the necessary clarifications on the potential issues that may arise. Furthermore, the government may consider the proposals discussed in this Newsletter to enhance the effectiveness of the framework.

Please click here to download a copy of the Order.

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