

Nigerian Oil and Gas Industry Update

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Introduction

The global oil and gas industry has had a rocky start to 2020, having been hit by several challenges – the most significant of which is the effect of the COVID-19 pandemic on crude oil demand and the sharp decline in crude oil prices. Nigeria, with an oil-dependent economy, is highly vulnerable to the impact of these external shocks due to the country's increased dependency on global economies for fiscal revenues, foreign exchange inflows, fiscal deficit funding and capital flows required to sustain the country's economic activities.

This edition of the Nigerian Oil and Gas Industry Update provides information on some of the recent developments in the industry in the first quarter of 2020, how they are impacting the industry and the Government's response to these issues.

Impact of COVID-19 on Nigeria's Upstream Oil and Gas Sector

The COVID-19 pandemic does not only present a severe health crisis for Nigeria, its impact reaches far beyond the health sector to other critical sectors of the country. The country's upstream oil and gas sector, which provides a significant portion of Government revenue and foreign exchange earnings, is one such critical sector that has felt the ripple effect of the pandemic. Some key impacts of the COVID-19 pandemic to this sector are as follows:

i. Reduction of the Budget benchmark price of crude oil

One of the major impacts that the COVID-19 pandemic and resulting decline in crude oil prices have had in the country is in compelling the Government to reconsider the key budget assumptions for the 2020 federal budget – which was signed into law in January 2020.

The 2020 budget had assumed an average benchmark crude oil price of US\$57 per barrel (/bbl), while in April 2020, the Ministry of Finance and Budget Office revised this price to US\$30/bbl¹. However, in recognition of the continued decline of oil prices and the continued effect of the pandemic in the global oil industry, the Minister of Finance recently announced a further revision of this budget benchmark price to US\$20/bbl, in a web conference held on 5 May 2020².

ii. Global and local crude oil production cuts

The Nigerian federal budget was passed and signed into law based on an assumed oil production volume of 2.18 million barrels per day (mb/d). However, the onset of COVID-19 pandemic and its global spread, which resulted in a decline in oil prices due to subdued demand and the price war between Russia and Saudi Arabia, had a direct impact on this production assumption.

Therefore, the Federal Government was compelled to revise its budget estimates regarding oil production to 1.7mb/d in the Revised 2020 Budget forwarded to the National Assembly³. However, it was shortly afterwards obligated to accept further cuts to this planned production volume, as a result of the historic agreement by the Organization of Petroleum Exporting Countries (OPEC) and its allies (OPEC+) to cut crude oil output as part of its efforts to tackle the global oil crisis.

As part of this agreement, Nigeria agreed to cut its production to 1.412mb/d, 1.495mb/d and 1.579mb/d for the respective periods of May-June 2020, July-December 2020 and January 2021-April 2022. However, this does not cover the production of condensate, which is exempt from the OPEC curtailment, and which Nigeria utilizes to shore up its production capacity by about 360,000 to 460,000 barrels per day⁴.

iii. Reduced crude oil demand and unsold cargoes

Another significant impact of the COVID-19 pandemic is the dampening global demand for crude oil. This depressed demand has filtered to the demand of Nigeria's crude oil, as the country's major export destinations battle the pandemic with enforced lockdowns and reduced economic activities.

As a result, Nigeria has recently had to slash its official selling price for its crude oil, offering discounts of up to \$5/bbl in order to remain competitive in the crude oil market⁵. It has also been reported that there were about 15 to 20 million barrels of unsold Nigerian crude in April 2020, which was about 25% of the country's total oil exports⁶.

¹ https://www.linkedin.com/posts/kpmg_nigeria_coronaviruspandemic-covid19-staysafe-activity-6654107272702242816-9v53

² <https://af.reuters.com/article/nigeriaNews/idAFL0N22D02K>

³ https://www.linkedin.com/posts/kpmg_nigeria_coronaviruspandemic-covid19-staysafe-activity-6654107272702242816-9v53

⁴ https://www.facebook.com/FMPRng/posts/996985650698605?_rdc=1&_rdr

⁵ <https://af.reuters.com/article/energyOilNews/idAFL8N2BG8C7>

⁶ <https://www.spglobal.com/platts/en/market-insights/latest-news/oil/040720-nigeria-ramping-up-crude-oil-output-despite-sharp-fall-in-global-demand>

iv. impact on proposed oil licensing and marginal field bid rounds

The Nigerian Government had, in late 2019, announced plans to conduct oil licensing rounds in mid-2020 for both offshore and onshore blocks. This was with the objective of achieving its 3.0mb/d output target by 2023⁷. The last oil licensing bid round was held in 2007, about 13 years ago⁸. However, as a result of the current instability of oil prices and collapse in global demand due to the COVID-19 pandemic, the Government announced, on 5 May 2020, that it would not hold oil bidding rounds for the country's major oilfields until crude oil prices recover⁹.

Nonetheless, the Government confirmed that it is accelerating its plans to conduct marginal oilfields bidding rounds this year. It had earlier been reported that President Muhammadu Buhari approved for the Minister of State for Petroleum Resources to schedule a bid round for marginal fields in the second quarter of 2020. It was further reported that a total of 56 marginal fields would be up for auction. These fields include 45 fields that have already been earmarked by the Department of Petroleum Resources (DPR) as well as the 11 fields that the DPR recently revoked the operators' licences, due to non-performance¹⁰. The last successful marginal field bid round took place in 2002, with 24 marginal fields awarded to 31 companies in 2003 – about 17 years ago! The Government claims that the marginal oilfields – which are expected to be taken up by indigenous producers – are less impacted by low crude oil prices. However, it is arguable whether the Government will be able to command significant value for these fields, as investors may struggle to raise adequate financing to support participation in a bid round in the midst of global economic crisis and looming local economic recession.

DPR Directives on Response to the COVID-19 Pandemic

The DPR recently issued two Circulars on the management of the Covid-19 pandemic in the oil and gas sector. This is against the backdrop of the spread of the COVID-19 in the country and the Government efforts to mitigate this spread.

In a Circular issued on 29 March 2020, the DPR directed operators, contractors and service providers to reduce the workforce on offshore platforms. Based on the Circular, all travels to and from offshore or remote locations would strictly be in line with the Guidelines and Procedure for Travel to Offshore/Swamp Location and Obtainment of Offshore Safety Permit, 2019. It also suspended staff rotation of less than 28 days, which implies that staff working offshore or in remote locations are required to stay on rotation for a minimum of 28 days at these locations. The Circular further stipulated the withdrawal of non-essential staff from offshore or remote locations and mandated that representation by government agencies at these locations be limited to one person per rotation¹¹.

In another Circular issued on 30 March 2020, the DPR provided measures that are to be taken by operators, contractors and service providers on activities at project and construction sites in the Nigerian oil and gas industry.

All operators and their contractors need to ensure strict compliance with relevant Government directives regarding limiting the number of personnel at project or construction sites as well as the guidelines on social distancing, curfews, lockdowns, etc. as may be applicable. It also directed that the current situation is to be considered "force majeure" to ensure the safety and welfare of all personnel and contain the spread of COVID-19. The DPR, therefore, communicated its expectation of the demobilization of personnel from these sites to the extent required to satisfy the relevant Government guidelines and requirements¹².

The Nigerian oil and gas industry is critical to the country's economy and must be managed appropriately to ensure continuity of operations during this global health crises. Stakeholders, such as operators, contractors and service providers, must work with Government to accomplish this for the interest of the country.

Amendment of the Petroleum (Drilling and Production) Regulations

In his capacity as the Minister of Petroleum Resources (MPR), President Muhammadu Buhari recently amended the Petroleum (Drilling and Production) Regulations, 1969 ("the 1969 Regulations"). The 1969 Regulations provide, among others, guidance on the implementation of provisions of the Petroleum Act regarding applications for oil exploration licences and oil prospecting licences and guidelines on oil drilling and extraction operations.

The Petroleum (Drilling and Production) (Amendment) Regulations, 2019 (the Amended Regulations), which has a commencement date of 9 October 2019 as stated in the official gazette, amended the 1969 Regulations in order to "review certain fees payable under the Regulations and to introduce new fees for certain applications and approvals under the Petroleum Act"¹³.

The Amended Regulations revised several fees in the 1969 Regulations that were no longer reflective of current economic realities by increasing some by as much as three hundred percent (300%). For instance, the fees payable for the application for a permit to carry out geophysical or geotechnical data survey in any concession area and those for the approval to commence the drilling of a borehole or well were increased from N5,000 per the 1969 Regulations to N1,500,000 per the Amended Regulations. In addition, Regulation 59 of the 1969 Regulations that provided for the payment of fees for a total of eleven (11) types of permit, lease or licence applications was replaced with a new Regulation 59 that provides for the payment of fees for about sixty-three (63) different types of permit, lease, approval or licence applications as well as renewals of some of these permits, leases and licenses.

Furthermore, the Amended Regulations stipulates a maximum penalty of US\$250,000 to be issued by the DPR to any person (which includes a body corporate or unincorporated entity) that fails to comply with any of the provisions of the revised Regulations. In addition, any permit, license or lease granted to that person may be withdrawn or cancelled by the DPR. It is, therefore,

⁷ <https://www.spglobal.com/platts/en/market-insights/latest-news/oil/111919-nigeria-to-hold-oil-licensing-round-in-mid-2020-nnpc>

⁸ <http://petrobarometer.thecable.ng/2019/10/05/nigeria-hold-oil-licensing-rounds-2020-13-years-after/>

⁹ <https://business.financialpost.com/pmnl/business-pmnl/nigerian-oil-bid-rounds-upstream-projects-delayed-due-to-price-crash-officials>

¹⁰ <http://africaoilgasreport.com/2020/04/farm-in-farm-out/nigerias-marginal-field-bid-round-approved-may-launch-in-two-weeks/>

¹¹ <https://www.dpr.gov.ng/dpr-orders-oil-firms-to-reduce-offshore-workforce/>

¹² <https://www.dpr.gov.ng/industry-circular/>

¹³ Explanatory Note to the Petroleum (Drilling and Production) (Amendment) Regulations, 2019.

important that operators and stakeholders review the provisions of the Amended Regulations to ensure full compliance and avoid the imposition of such stiff penalties.

Revised Guidelines for the Release of Staff in the Nigerian Oil and Gas Industry

The DPR recently issued the Guidelines for the Release of Staff in the Nigerian Oil and Gas Industry, 2019 (“the 2019 Guidelines”) to establish the procedure for obtaining the approval of the MPR, through the DPR, for the release of any “Worker” in the Nigerian oil and gas industry¹⁴. A “Worker” is defined by the 2019 Guidelines as *“any Nigerian national who is employed by the holder of an oil prospecting licence, oil mining lease, or any other licence or a permit issued under the Petroleum Act or under Regulations made thereunder.”*

The 2019 Guidelines, which repeals and replaces the Guidelines No. 1 of 2015 for the Release of Staff in the Nigerian Oil and Gas Industry (“the 2015 Guidelines”), was issued pursuant to Regulation 15A of the Petroleum (Drilling and Production) Regulations, 1969 (as amended). This Regulation 15A – which was introduced by the Petroleum (Drilling and Production) (Amendment) Regulations, 1988 – provides that *“the holder of an oil mining lease, licence or permit issued under the Petroleum Act, 1969 or under regulations made thereunder or any person registered to provide any services in relation thereto, shall not remove any Worker from his employment except in accordance with guidelines that may be specified from time to time by the Minister.”*

Under the 2019 Guidelines, “Staff Release” refers to the removal of a Worker in a manner that permanently separates the said Worker from the Employer. Staff Release by way of dismissal, termination, redundancy, release on medical grounds requires the prior approval of the MPR, while an employer shall simply notify the Minister through the DPR where the Worker’s release occurs by way of voluntary retirement, resignation, death or abandonment of post. The 2019 Guidelines further reiterates that failure to adhere to its provisions will result in the assessment of the maximum penalty of US\$250,000 and possible withdrawal or cancellation of any permit, licence or lease granted to that person, as provided in the Petroleum (Drilling and Production) (Amendment) Regulations, 2019 earlier discussed in this Newsletter.

One of the fallouts of the COVID-19 pandemic as well as the fall in crude oil prices is the increased incidence of operational cost reduction across the oil and gas industry. This may likely result in staff redundancy and possible retrenchment of personnel. It is important that operators in the Nigerian oil and gas industry consider the implications

of the 2019 Guidelines in making decisions that involve the release of staff and ensuring that they comply with the provisions of these guidelines.

Fiscal Changes in the Upstream Sector of the Nigerian Oil and Gas Industry

The passage of the Finance Act, 2019 (“the FA”) introduced changes to a number of tax legislation, including the Petroleum Profits Tax Act (PPTA), which provides the legal basis for the imposition of taxes on the income of companies engaged in the exploration and production of crude oil in Nigeria.

Section 24 of the FA repealed the provisions of Section 60 of the PPTA that provided the Withholding Tax (WHT) exemption on income or dividends paid out of after-tax petroleum profits. This section of the PPTA had always been seen as an incentive for investment in the upstream sector of the oil and gas industry, given that oil producers are already heavily taxed at 85% (for Joint Venture (JV) operations) and 50% (for Production Sharing Contract (PSC) operations) of their profits. The repeal of this section, therefore, constitutes a significant tax impact on the oil and gas upstream operators – a decrease in returns to their shareholders.

The repeal of section 60 of the PPTA has put to rest the current controversy over whether this exemption extends to dividends declared by upstream petroleum operators from profits arising from their gas operations; though the Tax Appeal Tribunals have ruled that dividends declared from gas income is subject to withholding tax. However, it represents an unfavourable development for operators who are already reeling under conditions of uncertainty regarding fiscal terms that will be applicable to their operations going forward especially with the proposed Petroleum Industry Fiscal Bill (PIFB) that appears to have been jettisoned by the 9th National Assembly. This is in addition to the impact of the recently enacted Deep Offshore and Inland Basis Production Sharing Contracts (Amendment) Act (DOA), which has imposed a base line royalty of 10% on production from PSC operations beyond 200 meters water depth, the operations which hitherto had no royalty obligations

Conclusion

Undoubtedly, the need for a comprehensive reform legislation for the oil and gas industry has become much more important than ever before. Therefore, the 9th National Assembly needs to ensure that the much-delayed Petroleum Industry Bill (PIB) – in whole or as was split into smaller Bills – is passed sooner than later. However, robust engagements with the operators will help manage any potential dispute or controversy.

¹⁴ <https://www.dpr.gov.ng/wp-content/uploads/2019/10/Guidelines-on-Staff-Release-in-the-Nigerian-Oil-and-Gas-Industry.pdf>

How we can help

At KPMG, our purpose is to inspire confidence and empower change. We have an Oil and Gas Team, which comprises professionals with diverse experience and knowledge in accounting, tax, mergers and acquisitions, advisory and regulatory practices. You can, therefore, count on us as a valuable partner with respect to meeting your needs in the industry. Please contact the following for additional information:

Chibuzor Anyanechi
Partner and Head
Energy Line of Business
KPMG in Nigeria
T: +234 803 402 0965
E: chibuzor.anyanechi@ng.kpmg.com

Adewale Ajayi
Partner
Tax, Regulatory & People Services
KPMG in Nigeria
T: +234 804 202 1014
E: adewale.ajayi@ng.kpmg.com

Segun Sowande
Partner and Head
Management Consulting
KPMG in Nigeria
T: +234 803 402 0994
E: segun.sowande@ng.kpmg.com

Contributors:

Ebenezer Ibeneme
Senior Manager

Ito Adediran
Manager

home.kpmg/ng
home.kpmg/socialmedia

