KPMG

Deep Offshore and Inland Basin PSC (Amendment) Act, 2019

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Introduction

On Monday, 4 November 2019, His Excellency, President Muhammadu Buhari, GCFR, assented to the Deep Offshore and Inland Basin Production Sharing Contract (Amendment) Act, 2019 ("the Amendment Act") following its passage by the National Assembly in October 2019.

The amendment is in line with the provisions of Section 16 of the Deep Offshore and Inland Basin Production Sharing Contracts Act, Cap D3, Laws of the Federation of Nigeria, 2004 (DOIBPSCA or "the Act") which requires the Federal Government of Nigeria (FGN) to review the provisions of the Act when the price of crude oil exceeds $20 per barrel in real terms, or within a fixed number of years (15 years from commencement of the Act and 5 years thereafter).

The Amendment Act introduces four key changes to the DOIBPSCA, as follows:

(i) Replacement of the royalty regime applicable to Deep Offshore and Inland Basin fields (substitution of Section 5 of the Act)

The Amendment Act introduces a combined production and price-based royalty system to replace the existing production-based royalty system, which varies according to areas of operations.

The new royalty regime specifies a baseline royalty of 10% for crude oil and condensates produced in the deep offshore (greater than 200 meter water depth) and 7.5% for the Frontier and Inland Basin. In addition to the baseline royalty, a royalty based on the applicable price of crude oil, condensate and natural gas will apply, but only when the price exceeds $20 per barrel [1]. The graduated royalty rates are shown below:

from $0 up to $20 per barrel	0%
above $20 and up to US $60	2.5%
above $60 and up to US $100	4.0%
above $100 and up to US $150	8.0%
above $150	10.0%

The level of impact the new royalty regime would have on total Government take[2] and total Contractor take[3] under existing Production Sharing Contracts (PSCs) will depend on the current royalty rate applicable to the contract area, the applicable price and the volume of crude oil/condensate produced.

(ii) Deletion of Section 16 of the Act

The Section states that: *"(1) 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, 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."

The above Section has been a subject of controversy, even resulting in a consent judgement delivered by the Supreme Court of Nigeria in the case instituted by the Attorney-Generals of Rivers, Bayelsa and Akwa Ibom States against the Attorney-General of the Federation, where the issue for determination was the interpretation of the provisions of Section 16 of the Act.[4] Several stakeholders have agitated that the DOIBPSCA should have been amended to increase total Government take under PSC arrangements immediately the global price of crude oil exceeded $20 in real terms.

However, the procedures and responsibility for instituting a review of the Act were not clearly defined, and this might have been responsible for the non-implementation of this Section.

(iii) Introduction of new Section 16(A)

This Section mandates the Minister of Petroleum Resources to cause the Nigerian National Petroleum Corporation (NNPC) to call for a review of the PSCs every eight (8) years.

[1] $ refers to United States dollar
[2] Government take is defined as royalty oil+tax oil+share of profit oil
[3] Contractor take is defined as cost oil+share of profit oil
[4] Suit no: SC964/2016

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The DOIBPSCA defines the PSC as *"any agreement or arrangements made between the Corporation or the holder and any other petroleum exploration and production company or companies for the purpose of exploration and production of oil in the Deep Offshore and Inland Basin"*. This means that there could be PSCs executed solely between oil companies without the NNPC's involvement. The mandatory review every 8 years should, therefore, not apply to such PSCs; though it is more likely that government will exercise its back-in right in such mining leases in the event of a significant commercial discovery.

(iv) Introduction of offence and penalty for non-compliance (Section 16(B))

The Amendment Act introduces a fine of at least ₦500 million for non-compliance with any obligation imposed by the provision of the Act, or imprisonment for a period not less than five years, or both, upon conviction by a competent court of law. While these penalties will apply to the Act in general, they seem to have been introduced to compel the Minister of Petroleum Resources and the NNPC to initiate a review of the PSC every 8 years, as stipulated in Section 16(A) of the Amendment Act.

Conclusion

The general perception is that the key objective of the Amendment Act is to maximise government take from PSCs in the face of changing prices of oil and gas. In the 2019 budget, the Federal Government had estimated ₦320 billion as revenue from the revision of the terms of the PSCs. However, industry analysts are of the opinion that investment in the deep offshore may be adversely affected based on the current decline in the flow of investment into the country and the oil industry in particular. In fact, as at October 2019, there were only 26 active rigs in Nigeria. Out of these rigs, only 1 deep water rig is currently carrying on workover activities. There are 3 other rigs that are in between locations or in pre-drill mode.

Therefore, a holistic review of the fiscal provisions for the oil and gas industry is desirable. This will reduce, if not eliminate, the uncertainty surrounding the delayed passage of the Petroleum Industry Bill (PIB). The delay has negatively affected the flow of investment in the oil and gas industry as many projects are being put on hold. Interestingly, the PIB, which has been outstanding for so many years, also contains the provision for the computation of royalty based on price; though based on a different threshold.

However, due to various factors, the PIB has not been enacted into law and this delay has caused the government to lose significant revenue that would have accrued if the provisions of Section 16 had been triggered during the era of high oil prices. This was the genesis of the consent judgement delivered by the Supreme Court. However, it is yet to be seen how the consent judgement will be enforced against the oil companies that were not a party to the suit. The Supreme Court judgement mandated the FGN to increase its share of revenue and recover all lost revenue under the PSCs. The way and manner that the FGN implements this judgement will determine, to a very large extent, its ability to achieve its vision of 40 billion barrels of crude oil reserves.

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