Nigerian Oil and Gas Update

Quarterly Newsletter

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Introduction

The Nigerian Oil and Gas Update provides information on current developments on regulatory, accounting and tax matters affecting the industry. We hope that you find the insights in the publication useful in making your business decisions.

Update on cash call arrears

The Federal Government of Nigeria (FGN), through the Nigerian National Petroleum Corporation (NNPC) owns majority stakes in all of the Joint Venture (JVs) arrangements with the international oil companies (IOCs) operating in the country, owed the IOCs about **USD$6.8billion** in unpaid counterpart funding (cash calls) as at 2016[1]. This had impacted the ability of the IOCs to continue to invest in oil field development in the country. In December 2016, the FGN commenced negotiations with the IOCs and was subsequently able to obtain a discount of **USD$1.7billion** from the outstanding amount.

The NNPC had, through its former Group Managing Director (GMD) in his valedictory speech on 8 July 2019, stated that USD$2.3billion (an estimated 47%{sic})[2] of the re-negotiated debt had been settled as at the end of June 2019 using cash obtained from incremental oil production.

The NNPC also reiterated plans to introduce the Incorporated Joint Venture (IJV) model in conjunction with the IOCs. The IJVs will operate as independent entities with the ability to raise capital through equity or debt to finance cash call obligations. However, the 2020 budget does not seem to contain any details about the restructuring of the existing JVs.

The settlement of outstanding cash calls, which have been a perennial issue in the industry, as well as the setup of a new funding mechanism to address this issue going forward, should restore the confidence of the IOCs, increase investments in oil field developments and improve reserves growth. However, this will be highly dependent on development and implementation of the right fiscal framework to improve and sustain investments in the sector through the passage of the components of the overdue Petroleum Industry Bill (PIB).

Sanction for non-submission of daily output report by oil companies

The Department of Petroleum Resources (DPR) recently launched the National Production Monitoring System (NPMS)[3]. The NPMS, which is developed and managed by the DPR, will facilitate the tracking of oil production from the various oil terminals in the country and movement of oil export and import vessels. The objectives of the NPMS are to ensure timely and accurate reporting of oil production and export data, improve consistency and quality of the database and facilitate seamless transfers of oil and gas data to the National Data Repository (NDR). The NPMS, which replaces the current paper-based reports, will simplify production reporting to the relevant government agencies such as Federal Inland Revenue Service (FIRS) and Nigeria Extractive Industries Transparency Initiative (EITI). The DPR also announced that it would commence imposition of strict sanctions on companies that fail to submit the required daily production and export reports via NPMS platform.

Oil and gas producing companies are required to upload the following information to NPMS:

- Daily crude oil production report.
- Monthly report on producing wells.
- Maximum efficient rate results.
- Well test reports.
- Crude oil lifting reports.
- Daily associated gas and non-associated gas production reports.
- Terminal reports.

DPR has set up a task force to drive, monitor and ensure full compliance with the data submission via NPMS, with compliance linked to some regulatory processes such as issuance of export permits, approval of technical costs and other statutory approvals and permits.

A robust and reliable oil and gas production database will strengthen stakeholders' and investors' confidence and allow investors access to more reliable information on the sector.

[1] https://assets.kpmg/content/dam/kpmg/ng/pdf/tax/Nigerian-Oil-and-Gas-Update.pdf
[2] https://punchng.com/nnpc-repays-2-3bn-jv-cash-call-arrears/
[3] NPMS is a web-based oil and gas production accounting and monitoring platform designed and managed by the DPR

Impact of African Continental Free Trade Area Agreement (AfCFTA) on the Nigerian Oil and Gas Sector

The AfCFTA, which was introduced in March 2018[4] and became effective 30 May 2019, is the largest free trade agreement in the world after the World Trade Organization. The objectives of the agreement are to create a tariff-free continent that can grow local businesses, boost intra African trade, improve industrialization and create jobs among partner States. Currently, intra-African trade stands at 15%, which is paltry when compared to Asia's 58% and Europe's 67%. High tariffs and colonial-era infrastructure make it easier for African countries to export to Europe or the United States than to one another. Furthermore, the overlapping membership in Africa's eight Regional Economic Communities (RECs) hinders trade standardization and enforcement. AfCFTA, which seeks to establish a single continental market for goods and services, is expected to increase intra-African trade by 52.3% by 2022, through the application of at least a 90% cut in tariffs and by harmonizing trading rules at regional and continental level[5].

More than 75% of Africa's external exports are extractive, mainly oil and minerals. Nigeria became a signatory to the AfCFTA in July 2019. The main consideration for Nigeria's oil and gas sector under the AfCFTA is the applicable tariff on energy resources since participating countries are expected to reduce tariffs by 90%. The other challenge will be to address the issue of rules of origin and cross-border infrastructure. The African Development Bank (ADB) has created a regional integration strategy for periods up to 2025[6] to address the infrastructural challenge. The ADB plans to provide funds for the construction of 9000km cross-border transmission lines, the construction or rehabilitation of about 16,400km of cross-border roads, the support of rail lines and transport corridors construction, the increase of transport links wherever possible and use investments in infrastructure as a way of creating market linkages.

The above investment, though relevant, may not be enough especially for Nigeria given the current state of our internal infrastructures. Therefore, the FGN will need, as matter of urgency, to begin to make investments in the development of internal infrastructure and systems to ensure that the country is ready to compete when the AfCFTA becomes fully operational.

Lease renewal update

The FGN, through the DPR, launched the accelerated lease renewal program (ALRP) in January 2019. As at 31 January 2019, the DPR noted that 22 out of the 25 licence renewal applications made under the ALRP had been approved by the President. This is in addition to the 16 new field development plans[7] approved by the FGN in 2018 and which are expected to increase the nation's oil and gas production capacity by about 560,463 barrels per day when fully commissioned. However, the Group Managing Director (GMD) of the NNPC, Mr. Mele Kyari, in a recent meeting with the IOCs, noted that the FGN had no immediate plan to renew the licences of some of the IOCs, which have been operating with expired licences[8]. The GMD attributed the reason to FGN's interest in having the exploration and production arm of the NNPC operate those licences.

The non-renewal of the expired IOCs licences will have immense impact on both the FG and the companies with the attendant revenue and investment losses.

Applicability of Cabotage to drilling services

The Court of Appeal (CoA), on 24 June 2019, issued judgment in the case between **Transocean Support Services Nigeria Limited& 3 Ors3. and NIMASA & Minister of Transport (CA/L/503/2016)[9]**. The Court ruled that drilling rigs are not vessels and that drilling activities do not constitute coastal trade. The Court also stated that drilling rigs are not used for marine navigation and do not engage in the transportation of goods or passengers from one point in Nigeria to another. They therefore cannot be considered as vessels used for coastal trade under Section 2 of the Cabotage Act. Rigs are also not expressly listed in Section 22(5) of the Cabotage Act and cannot be deemed to be a vessel eligible for registration under Section 22(1) of the Cabotage Act. The CoA further emphasized that the Minister, when issuing a guideline, cannot deviate from the provisions of the principal legislation and expand or curtail the provisions of the substantive statute. Thus, the inclusion of rigs as "foreign vessels" in the Guidelines is improper.

The judgement of the CoA has resolved, for now, the perennial controversy regarding the applicability of cabotage levy on drilling rigs. It has also settled the legal tussles between rig operators and NIMASA on the issue. Based on the above, rig operators in the Nigerian oil and gas industry can focus on the performance of their contracted obligations without any worry of interference from marine regulators. However, the National Assembly is proposing an amendment to the Cabotage Act with respect to the definition of vessels, amongst other things. It is hoped that the proposed amendments would be consistent with the spirit and intent of the Cabotage Act.

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[4] Spotlight On The African Continental Free Trade Agreement: www.mondaq.com/Nigeria/x/813804/international+trade+investment/SpotlightOn+The+African+Continental+Free+Trade+Agreement

[5] https://www.cfr.org/blog/african-continental-free-trade-area-new-horizon-trade-africa

[6] Africa's continental free trade area comes into effect: https://africanbusinessmagazine.com/in-the-news/africas-free-trade-agreement-comes-into-effect-what-happens-now/

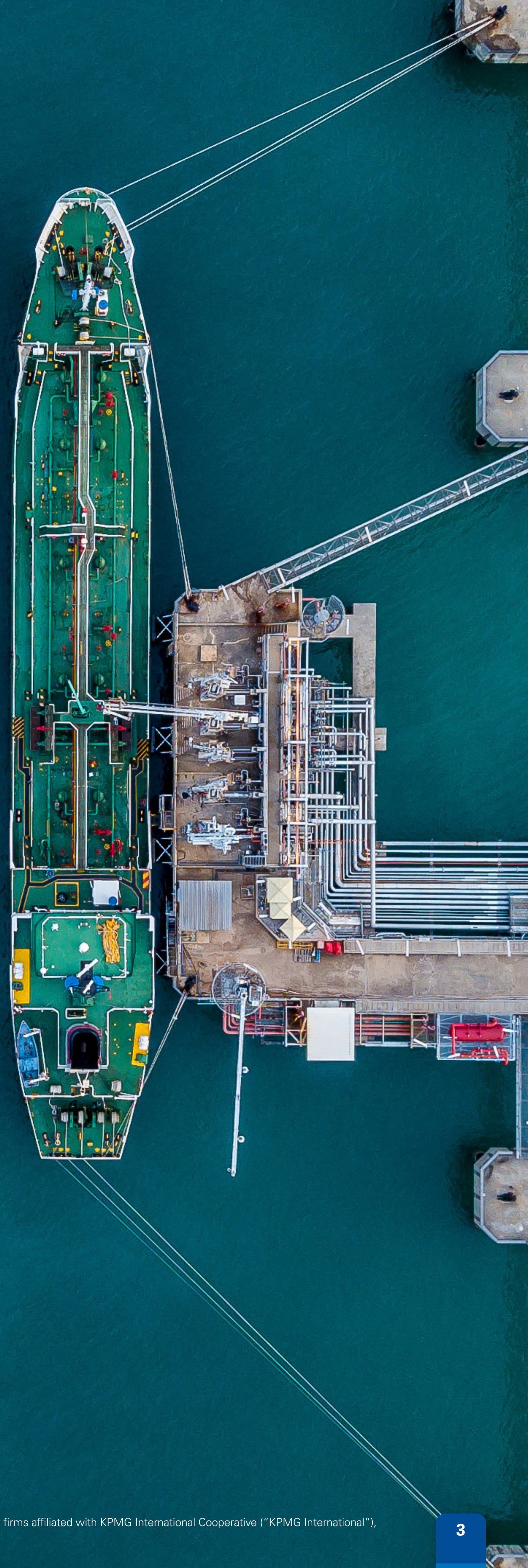
[7] https://allafrica.com/stories/201807270338.html#targetText=Data%20made%20available%20to%20Daily,per%20day%20when%20fully%20commissioned.

[8] https://allafrica.com/stories/201807270338.html#targetText=Data%20made%20available%20to%20Daily,per%20day%20when%20fully%20commissioned.

[9] Follow link to the full text of our newsletter on the case: https://assets.kpmg/content/dam/kpmg/ng/pdf/tax/Cabotage-levy-drilling-rigs-and-drilling-operations-through-the-cases.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:



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