

Drafting the new Petroleum Industry Bill

Submissions from industry, civil society organisations, unions, and the media

February 2012 | Adeoye Adefulu, Aaron Sayne, Gbite Adeniji, Patrick Okigbo and Ronke Onadeko

Two roundtables on the Petroleum Industry Bill were held in Lagos on 31 January and 01 February 2012. Senior figures from the organised private sector, civil society, trade unions, and media participated in both sessions.¹ During each session, participants frankly discussed and agreed upon a shortlist of “must-have” issues to be considered during the development of the final draft of the Bill. This report presents the most popular items from that list.²

1. Transparency and accountability

Participants agreed broadly that strong transparency and accountability provisions would improve sector management, engender industry confidence and, most importantly, send the right signals to investors. These include:

▣ **Competitive, open, non-discretionary licensing and tender processes:** Less secrecy and discretion in these areas will encourage fewer controversies, better asset management, and higher returns on investment. Past drafts of the PIB mandated this for the upstream (HB³ 270; SB⁴ 212; IAT⁵ 189), but not for crude oil lifting, midstream or downstream activities.

WISH LIST

1. Transparency & accountability

- Competitive, non-discretionary licensing and tender processes
- Publish all licenses, tenders and contracts online
- Void confidentiality clauses for oil revenue and payment information
- Publish comprehensive production, export and import figures
- Publish NNPC annual reports and audits online

2. Institutional Reforms

- One strong independent regulator
- Scrap NTLC structure; privatize NNPC's downstream assets
- Commercialization and privatization of NNPC
- Eliminate Petroleum Equalisation Fund
- More thought on Petroleum Host Communities Fund

3. Licensing and contracting

- Simple and transparent technical licensing
- Eliminate the downstream allocation process
- End the Minister's role in issuing licenses
- Simplify approval processes

4. Gas

- Reduce government dominance
- Phase out Gas Aggregator and replace with a gas regulatory unit
- Grandfathering of existing contracts
- Tax, fiscal regime issues
- Clear distinction between associated and non-associated gas

¹ Twenty-nine representatives participated in the session with the organized private sector. Thirty-one representatives participated in the session for civil society organizations, unions, and the media. *Chatham House Rule* were invoked; as a result, details of the participants or the institutions they represented cannot be shared. Nextier Advisory was the rapporteurial support at the roundtable discussions.

² All recommendations come directly from roundtable participants

³ Draft Executive Bill (submitted to House in 2008)

⁴ Draft Senate Bill (September 2010)

⁵ Inter Agency Team Memorandum – Final Draft (September 2010)

- ▣ **Publish all licenses, tenders and contracts online:** Documenting licensing and contracting online is a strong incentive to good process. Past language governing the upstream subsector should be retained (HB 270(3); SB 214(7); IAT 189(4), 189(6)). Requiring the Inspectorate to provide copies of all midstream and downstream licenses through an open registry system is also a positive step (HB 301-306, 340-44; SB 301, 302, 306, 333-38; IAT 221-223, 258-260). One draft called for online publication of all licenses and contracts where Nigeria National Petroleum Corporation (NNPC) is a party (IAT 174(6)), but the strongest PIB would extend this to other government bodies as well.
- ▣ **Void contract confidentiality clauses for oil revenue and payment information:** There are sound commercial reasons for these clauses, but keeping financial flows secret is not among them. One past PIB draft cancelled confidentiality clauses for upstream taxes, royalties, fees and bonuses (IAT 173). Stronger language would uphold confidentiality only for business secrets or other narrowly defined proprietary information.
- ▣ **Publish comprehensive production, export and import figures on the Inspectorate website:** Better information about Nigeria's hydrocarbon flows could help ease waste and improve regulation. One past draft provided for this and other positive disclosures (IAT 173(9); IAT 362).
- ▣ **Publish NNPC annual reports and audits online:** Boosting oversight of the Corporation's operations and financials is a key step towards commercialization. Leading national companies like Pemex, KazMunayGas and Statoil have published their annual reports and audits for years, with good results. Past PIB drafts were silent or weak on this issue, however—for instance, by opening annual reports only to the President and National Assembly (SB 139(1)). Two drafts called for audits by “an independent, competent, experienced and qualified auditor,” but stopped short of requiring NNPC to publish the audits (HB 147; IAT 49).

2. Institutional Reform

Participants said the following points were basic to improving sector performance:

- ▣ **Empower the Inspectorate to be a single, independent regulator for upstream, midstream and downstream:** Past drafts of the PIB provided for the creation of multiple agencies to regulate each subsector—in the downstream, for instance, creating overlapping mandates for the Inspectorate, Directorate, and Petroleum Products Regulatory Agency. This would be costly, stretch limited human resources and may weaken regulatory oversight. Recent experience from regulatory reform initiatives in Nigeria (aviation, telecommunications, electricity) suggests that the key to the success of a regulatory agency is the insulation of the regulatory process from short-term political goals through independence of the regulator and its funding, legislative confirmation of appointments and dismissals, and the limitation of ministerial powers to give only “general policy directions”.
- ▣ **Scrap the National Transport Logistics Company structure for the downstream; privatize NNPC's downstream assets:** Downstream products and gas infrastructure development requires significant investment which the Federal Government is unable to provide on a sustainable basis. Recent experience in the downstream (including the privatization of Unipetrol Plc and Eleme Petrochemicals) indicates that privatization boosts efficiency and unlocks private finance for infrastructure development. The Public Enterprises (Privatisation and Commercialisation) Act of 1999 already provides for the privatization of NNPC's downstream assets. This should be implemented in accordance with existing legislation.
- ▣ **Include strong provisions for commercializing and privatizing NNPC:** To ensure the efficiency of the new company, the commercialization of NNPC must be based on international best corporate governance principles. The company must be wholly subject to the Companies and Allied Matters Act

and should not be granted any special privileges that are not available to companies of its kind. For instance, NNPC must be required to compete for acreage. Additionally, any new draft of the PIB would need to provide much more information on the proposed privatization of NNPC. Past drafts announced potentially huge sales of public assets without saying how to conduct them. To avoid leaving NNPC Ltd. captured and unbankable, the final PIB should lay out:

- ***The basic structure of future equity sales:*** Only the original Presidency draft provides that NNPC shares should be sold “on the Nigerian Stock Exchange” (HB 136(5)). Listing simultaneously on an international exchange could make an incorporated NNPC more bankable—consider Statoil and Pemex’s prior listings with the NYSE. By contrast, if NNPC equity will be transferred through private sales, the PIB should state explicitly what law will govern the transactions. The Public Enterprises Act would be the most obvious choice.
- ***Which government entities would hold equity in an incorporated NNPC: The Companies and Allied Matters Act requires limited liability companies to have at least 2 shareholders.*** Past drafts only specify “the Federal Government of Nigeria” (HB 136(4); SB 117(3); IAT 78(4)). Typically Ministry of Finance Inc. holds equity for government, though the Bureau of Public Enterprises could hold portions slated for sale.
- ***Which agency (ies) would oversee sales:*** Past drafts state that only “the government...may decide” to sell its shares in the NNPC (HB 136; IAT78). Elsewhere they list “guiding major plans of action” and “overseeing divestitures” as two powers of the NNPC board, but without granting the board specific decision-making powers for equity sales (HB 146, IAT 88).
- ***When NNPC equity can be sold:*** The original Presidency and IAT drafts allowed the sale of shares after a two-year period (HB 136(5); IAT 78(6)). But the final draft should specify additional triggers and criteria for sales to occur, and the agency responsible for ensuring triggers and criteria are met. The Electric Power Sector Reform Act may provide a useful model.
- ***Which agencies would receive and spend sale proceeds:*** No draft currently specifies the responsible agency. Established federal practice may offer some guidelines—for example, privatization proceeds are paid into a special Central Bank of Nigeria account to be forwarded to the Federation Account.
- ***How the Federation will collect revenues from an incorporated privatized NNPC:*** In a sweeping oversight, no past draft of the PIB explained how NNPC Ltd. would transfer profits to government. If a shareholders’ agreement paying periodic dividends is foreseen, the Bill should state as much, plus make clear which parties would negotiate terms. A draft agreement—or at the very least, a key terms sheet—should also be produced before the Bill becomes law.

▣ **Eliminate Petroleum Equalisation Fund:** The Petroleum Equalisation Fund has been utilized to subsidise the transportation of petroleum products primarily to the non-coastal areas of Nigeria. This has generally proven ineffective, with petroleum products prices in large parts of Nigeria not reflecting the regulated uniform price. In a post-deregulation economy, the market would have to bear its costs. This is already recognized in the electricity sector through the proposed elimination of the National Uniform Tariff. The funds used for equalization, may be utilized to develop or incentivize the development of a viable infrastructure network that would reduce the cost of transporting petroleum products.

▣ **More thought on PHCF:** Some versions of the Bill introduce the concept of Community Equity Participation (“CEP”), which is to fund various Petroleum Host Community Funds. The provisions relating to these funds provide very little detail on how they are to be established, run and held accountable as well as a clear definition of the concept of the “community”, which is not a recognized entity under the Nigerian legal system. There is also a question as to whether the application of these provisions to existing licensees would not amount to expropriation and require the payment of compensation by the Federal Government. If the funds and equity participation are to be retained, more thought would need to be given to how they would work in practice and how they provide a

better solution than the various existing host communities' empowerment mechanisms that are already available.

▣ **Include clear transition provisions:** Critically, no past PIB draft contained the basics of an implementation roadmap. If left unaddressed, this omission could cause commercial and political confusion, and derail the implementation process. Whilst the final Bill cannot address every detail; it should however clarify:

- Which official body (ies) will oversee implementation?
- How will reforms be sequenced, including when different parts of the Bill will come into force? Again, the tiered, multi-triggered structure contained in the Electric Power Sector Reform Act is a useful model.
- Precisely which existing laws and regulations will be repealed, either explicitly or implicitly, along with a process for mapping and filling resulting regulatory gaps?
- Which contracts and leases will be grandfathered? Decisions should be made following cost-benefit analysis and stakeholder consultations. If this process is not possible before the Bill becomes law, the Bill should state which body (ies) would carry it out, and by when.

3. Licensing and contracting

Consensus among participants was widespread that the PIB should:

▣ **Eliminate dual licensing for midstream and downstream activities:** Requiring private sector operators to obtain technical and commercial licenses is inefficient, likely to be politicized, and inconsistent with a deregulation agenda. Participants argued that the final draft should:

- *Provide only for a rigorous technical licensing process that is based on quality and capabilities of applicants and housed within the Inspectorate:* In the downstream sector, for instance, full commercial deregulation appears to be the best solution to the current dysfunction. Again, the technical licensing process should be clear, transparent, and competitive across the sector.
- *Eliminate the downstream allocation process, and disband PPPRA:* Participants concluded that the sector's problems would persist as long as government continued to regulate supply and distribution. Market forces should determine quantities imported and the prices they are sold for, leaving no justifiable role for PPPRA. The Inspectorate would then oversee the quality of imports.

▣ **Eliminate commercial licenses for all midstream and downstream activities:** The licensing regime should be simple. The issuance of two separate licences (technical and commercial) issued by two separate agencies (NPI & PPRA) could lead to regulatory conflicts, potential for bureaucracy, corruption/toll gates and the risk that one of the licences may not be issued – a major bankability issue for investors and lenders.

▣ **End the Minister's role in issuing licenses:** Language in previous drafts of the Bill providing for the discretionary powers of the Minister to award and revoke licenses should be reconsidered. Participants at the sessions were unanimous in their call that the role of the Minister of Petroleum Resources should be restricted to policy making and setting directives for the industry. In addition, government should ensure investment protection and bankability of investment whilst ensuring that investors execute their obligations.

▣ **Simplify approval processes:** Licences should allow holders to undertake specified activities, whilst a regime of permits (usually a matter for implementing Regulators) as currently operates, should regulate the technical aspects – construction, operation of facilities, standards, health, safety and environmental aspects.

4. Gas

Consensus among participants was widespread that the PIB should:

▣ **Reduce dominance of government in the sector:** The continued multiplicity of roles for government (policy maker, regulator, commercial participant) is inconsistent with the desire to foster a progressive regulatory and commercial environment. In the absence of effective regulatory mechanisms to check the overwhelming involvement of government in commercial activity (gas supply, transportation and distribution), the independence of the regulator will be limited and sector development hampered. With a clear policy direction and independent regulation of the sector, a private sector led development of infrastructure will accelerate the growth of the domestic market. The participants also advised that the government should provide incentives for the private sector to induce infrastructure development.

▣ **Phase out Gas Aggregator and replace with a comprehensive gas regulatory unit:** The PIB should recognize the role of the Domestic Gas Aggregator as a temporary construct designed to catalyse the development of the domestic gas sector. However, its role should not conflict with nor limit the powers of the sector regulator nor the regulatory process. Hence, the new regulator should undertake aspects of its current role that are regulatory in nature whilst the transitional provisions of the Bill should provide for the phase out of the *Aggregator* over an appropriate period of time.

▣ **Grandfathering of existing contracts:** There are a number of long term gas contracts in existence that may be impacted by the Bill. The Bill should provide a clear solution to the fate of these contracts including Change of Law Clauses or Stabilization Clauses.

▣ **Tax, fiscal regime issues:** There is need for clarity on tax holiday or similar provisions. For instance, at what point will the tax regime become effective: from the kick-off of business or from the commencement of construction?

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