NDDC v Nigerian LNG: Echoes and Lessons

'Taxspectives' by **Afolabi Elebiju** | Originally published in *ThisDay Lawyer, 20th March 2012, p.7*

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Introduction

In tandem with "revival" efforts to enact the Petroleum Industry Bill (PIB), the PIB Task Force's deliverable will foreshadow an Executive Bill to be (re)submitted to the National Assembly. Given the divergence in previous versions, tax fiscal provisions of the new PIB will be of particular interest. The recent trial and appellate decisions in ***NDDC v NLNG*** *(2009) 1 TLRN 25; (2011) 4TLRN 1* comes to mind, against PIB's expressed intent to overhaul petroleum fiscal landscape, *vis a vis* potential implications on subsisting industry contracts.

The PIB's "resource nationalism" objective should not surprise anyone: Nigeria owes herself a duty to extract optimal value from her natural endowments, although how well that is deployed for national benefit is another matter. The Economist of 11/2/2012 stated: *"resource nationalism is nothing new… Nor is the practice confined to developing countries that feel they came off second-best when negotiating resource deals in years gone by. Australia is set to raise some $8 billion a year through a controversial new tax on miners…" "Resource nationalism has jumped to the top of the list of things that worry the 30 biggest miners. This was prompted by 25 countries worldwide announcing plans to boost their take of profits…"*

NDDC v NLNG: The Facts

NDDC, a Federal Government (FG) agency established under the *Niger Delta Development Commission (Establishment) Act 2000* (now *Cap. N86, LFN 2004)*, sought to collect 'NDDC Levy' under *section 14(2)(b) NDDC Act* from NLNG. The Levy is *"3 per cent of the total annual budget of any oil producing company operating onshore and offshore in the Niger Delta area; including gas processing companies."* NLNG resisted, arguing that the *NLNG (Fiscal Insurances and Assurances) Act 1990*, exempted them from such contributions. NDDC then sought declaratory and mandatory orders that NLNG is a gas processing company subject to the *NDDC Act*, and should pay the Levy for outstanding years (2000-2004) and subsequently.

Nwodo, J. held that the NLNG Act exempts NLNG from paying the Levy. Although NDDC Act was later in time, it cannot repeal the NLNG Act by implication. Since both legislations are special Acts, any repeal must be done expressly. Being a Federal Government agency, NDDC is bound by the provisions of the NLNG Act, which exempts NLNG from Nigerian taxes not generally applicable to all companies operating in Nigeria.

Nwodo, J. held (p. 54): *"there is no doubt that the Act was founded on agreement between the Defendant and the Federal Government as evidenced in the preamble to the Second Schedule to the Nigeria LNG Act… However, the fact … does not make the Act any less."* The Court held that *"… that the Assurances are contained under the Schedule does not make it any less important. It forms part of the Act and enjoys the legal status of legislation."* The Court recognised that *"it is a special Act with legal force."* Variously at pp.56-57, the Court held: *"… the provision in this case should be regarded as words of contract to which the legislature has given its sanction than as the words of the legislature itself." "… the provisions in LNG Assurances Act should be regarded as founded on contract… It remains an Act of the National Assembly notwithstanding that it is founded on contract."*

Dissatisfied, NDDC appealed to the Court of Appeal, whilst NLNG also cross-appealed against the trial court's finding that it has "annual budget" as statutorily defined. Both appeals were resolved in favour of NLNG. NDDC contended that the trial court's *obiter dictum* that *NLNG Act* was unconstitutional should have resulted in declaration of its nullity to the extent of inconsistency, whether or not such relief was sought. *Owoade, JCA* (delivering the majority decision), held (at p.24): *"… all the observations, findings of the learned trial judge in relation to the constitutionality of… Paragraph 3 of the Second Schedule to the Nigerian LNG… Act are indeed obiter dicta which are not appealable."Agube, JCA* dissented on the main appeal but agreed with the majority on the cross-appeal.

Stabilisation Provisions in Nigerian Petroleum Contracts

It has now been generally accepted that "freezing" stabilisation clauses (which purports that no law will change the economic equation of the contract) are invalid, being impermissible interference with the host state's sovereign rights.

Although the NLNG Act followed the "freezing" model, the decisions in the *NDDC case* exemplified giving effect to incentive legislation, a result helped by NNDC's omission to request a specific declaration that the *NLNG Act* was unconstitutional. Meanwhile, a repeal of the *NLNG Act* will also have implications - whilst some provisions (e.g. 10-year tax holiday) may be considered as spent, other "exemption" provisions (such as safe harbour from the NDDC Levy), are arguably not and could therefore be the basis of contractual relief. The wholesale repeal of all industry legislation by the PIB (*NLNG Act* is not listed amongst legislation to be affected), is indicative that a new, universally applicable regime is intended. Additionally, Dr. Bayo Adarelegbe's scholarly review of the NDDC trial decision: *Stabilizing Fiscal Regimes in Long Term Contracts: Recent Developments in Nigeria (2008)* provides interesting perspectives.

The more acceptable stabilisation clause is the "contract equilibrium" model, which requires parties to renegotiate in order to achieve the same economic effect operative before the change. Many Nigerian oil and gas contracts, (especially with the IOCs), have stabilisation provisions. The purport is to restore parties to "contract equilibrium" – if any change in law, regulation, policy or the like (specific wording and scope varies) adversely and materially affects the economic rights of a/the party(ies). Ready examples are Nigerian PSCs - their fiscal terms are also codified in the *Deep Offshore & Inland Basins PSC Act* and *section 22 PPTA*, but which would be repealed by the PIB - potentially triggering stabilisation rights of the Contractors.

Tax Fiscal Provisions of PIB: Stabilisation Issues

Under the current regime, royalty rate is largely a function of water depth (some recent PSCs have a (daily) production volume element), such that petroleum operations under a 1993 PSC in over 1,000 metres water depth has zero royalty liability; PPT rate for deepwater PSCs is 50% flat (as opposed to 85% or 65.75% in *section 21 PPTA*); there is also 50% Investment Tax Credit or Allowance (ITC/ITA) for pre-1998 and post-1998 PSCs respectively; signature bonuses are not cost recoverable but can be capitalized as part of pre-production capital expenditure, etc. However, the PIB contemplates a stricter fiscal regime whereby upstream operators will be liable to increased royalties, significantly higher lease rentals and tax. At one time it was alleged that (pursuant to a particular version of PIB) that Government take would be as high as 98%, rendering many ongoing (and of course proposed) projects, uneconomic.

At this stage, I admit lacking a crystal ball to predict the exact provisions of the revised *PIB* to be re-submitted to the National Assembly, and can only look forward to detailed analysis at an appropriate time. However, previous versions had prescribed *inter alia*: (a) royalty being a function of production volume, water depths and value (price of crude); (b) removal of ITC/ITA (replacement with less beneficial production allowance); (c) applicability of CIT (at 30%) and Nigerian Hydrocarbon Tax (NHT), which depending on the version is fixed or variable, depending on water depth and NHT not being deductible from CIT; (d) removal of incentives such as current ability to charge gas development expenses against oil income; (e) non-capitalization of signature bonuses; (f) contribution of 10% net profit to Petroleum Host Communities Fund; etc.

The cumulative effect is that if parties are unable, post PIB enactment, to agree amendments towards restoring contractual equilibrium as initially contemplated, stabilisation claims may result. One challenge though is the problem of circularity that will result from provisions (such as *PIB (HB 54)'s sections 435(5)* and *434* which enjoins the NOC not to *"include any provisions in the contract that would lower the rents, royalties or taxes established under this Act"*; and that NOC can only enter into contracts which have the tax fiscal provisions in the PIB as minimum provisions, respectively. These would effectively render stabilisation relief nugatory, but there are approaches to dealing with such challenge, including invocation of treaty obligations.

Interestingly, varied provisions on preferential treatment of "indigenous companies" in the PIB may also be the source of *Bilateral Investment Treaty (BIT)* claims, being a breach of obligation to grant MFN status to investors from treaty countries or not to discriminate against them. Clearly, investors will pick and choose what battles to fight given their overall business interests.

Conclusion

Clearly, enactment of the PIB must not prejudice Nigeria's continued efforts to market itself as a competitive investment destination where sanctity of contracts and rule of law in the determination of investment disputes are critical pillars of the "pro-investment" architecture. It is noteworthy that Government has undertaken to submit to institutional dispute resolution pursuant to BIT provisions and the *NIPC Act*.

The most important lesson is that petroleum agreements must be properly negotiated, drafted and reviewed before execution to ensure a win-win for all parties, particularly the host State. Efforts to walk away from the contract or to seek to increase Government take in breach thereof, inevitably lead to disputes. There is no certainty of which part would win or the quantum of damages, as this would usually be a function of the facts and circumstances of the case. The best approach may well be negotiated settlement, albeit the willingness of the parties towards such end is not always a given.

I concur with the wise counsel of *The Economist: "African governments must not wring so much out of their resources today that the mining companies fail to invest for the future."*