

Nigerian Oil and Gas Industry Content Development Act, 2010

TAX, REGULATORY & PEOPLE SERVICES

Introduction

Recently, the President of the Federal Republic of Nigeria signed the Nigerian Oil and Gas Industry Content Development Bill into law. The Nigerian Oil and Gas Industry Content Development Act ("the Act") is designed to enhance the level of participation of Nigerians and Nigerian companies in the country's oil and gas industry. With the promulgation of the Act, the Government has clearly established its intention to increase indigenous participation in the industry in terms of human, material and economic resources. The implementation of the Act is expected to significantly change the current business and operating structure in the Nigerian oil and gas industry, particularly for the international oil service companies.

Key provisions of the Act

We highlight below, some of the major provisions of the Act.

- Definition of "Nigerian Content" as:
 - "the quantum of composite value added to or created in the Nigerian economy by a systematic development of capacity and capabilities through deliberate utilisation of Nigerian human, material resources and services in the Nigerian oil and gas industry"
- A "Nigerian Company" is defined as:
 - "a company formed and registered in Nigeria in accordance with the provisions of Companies and Allied Matters Act with not less than 51% equity shares by Nigerians".
- Establishment of the Nigerian Content Development and Monitoring Board (the Board) to monitor, coordinate and implement the provisions of the Act; and the Nigerian Content Consultative Forum to provide the platform for information sharing.
- Submission of Nigerian Content Plan ("the Plan") to form an essential component of bidding for any license, permit or interest in the oil and gas industry. It shall contain provisions to ensure that 'first consideration' is given to Nigerian independent operators, goods and services and also to Nigerians in employment and training.
- The award of contracts shall not be based solely on the principle of lowest bidder (provided that the Nigerian company's bid does not exceed the lowest bid price by 10% percent). Where bids are within 1 % of each other at the commercial stage, the bid containing the highest level of Nigerian content shall be selected, provided the Nigerian content in the selected bid is at least 5% higher than its closest competitor.
- Where there is inadequate Nigerian capacity, the Minister may authorize the continued importation of the relevant items up to 3 years from the commencement of the Act.
- Requirement to pay 1% of total contract sum awarded in the upstream sector into the Nigerian Content Development Fund (NCDF) - deductible at source.
- All fabrication and welding activities must be performed in-country.
- Grant of tax incentives by the Minister to companies which establish facilities, factories, production units or other operations within Nigeria for the purposes of manufacturing goods or providing services which were previously imported.
- Subsidiaries of multinational companies to own at least 50% of the equipment used for execution of work in the country.
- All operators, contractors and sub-contractors shall maintain bank account(s) in Nigeria in which it shall retain a minimum of 10 percent of its total revenue accruing from its Nigerian operations.
- Only Nigerians shall be employed in the junior and intermediate cadres or corresponding grades by operators and companies in the industry.
- Only a maximum of 5% of management positions may be retained by operators or project promoters for expatriates (as may be approved by the Board). Operators shall submit a succession plan to the Board for positions not held by Nigerians. Nigerians shall understudy the expatriates for a maximum of 4 years, after which the position shall become "Nigerianised".
- Submission of, and receipt of approval from, the Board prior to making application for expatriate quota to the Ministry of Interior, going forward.
- Submission of a programme of planned initiatives aimed at promoting the effective transfer of technologies from the operator and alliance partners to Nigerian individuals and companies.
- Operators, contractors and subcontractors requiring financial and legal services shall retain the services of only Nigerian financial institutions (where practicable) and Nigerian legal practitioners whose offices are located in Nigeria.
- Only insurance brokers registered in Nigeria are permitted, while no insurance risks can be placed with foreign insurance companies without the written Approval of the National Insurance Commission.
- Establishment of a Joint Qualification System (JQS) as an industry databank of available capabilities in the oil and gas industry.

- Companies operating in the oil and gas industry are required to submit the following returns and plans to the Board on a periodic basis:
 - Nigerian Content Performance Report to be submitted within 60 days of the commencement of each year.
 - The following reports, every 6 months:
 - Research and Development Plan
 - Legal Services Plan
 - Financial Services Plan
 - Insurance Report
- Any operator or company that fails to comply with the provisions of the Act commits an offence and is liable upon conviction to a fine of 5% of the project sum, or cancellation of project.

Potential challenges

The promulgation of the Act is a welcome development. Indeed, this is the trend in several of the major oil producing countries of the world.

It is heart-warming to note that the Act gives the Minister of Petroleum Resources the powers to initiate discussions with the relevant arms of government on the appropriate fiscal framework and tax incentives for foreign and indigenous companies which establish facilities, factories and production units for the purposes of carrying out production or provision of services which were previously imported into the country. With such collaboration and agreement on the incentives, it should encourage inflow of investment into the country and expand the country's productive base.

However, there are potential issues that may arise from the implementation of the Act in its current form that deserve attention. Some of them are as follows:

- The requirement to submit, for every contract, a Nigerian Content Plan as a pre-condition before such contract is awarded may sound plausible. However, the Board will need to manage this process expediently, to prevent it from becoming another administrative bottleneck in the contract award process.
- The 3-year timeframe from 2010, given to the Minister to authorise the continued importation of items where there is

inadequate local capacity, appears unrealistic. In our view, the infrastructural base (such as regular electricity supply), necessary for the development of the manufacturing and fabrication industry are still largely undeveloped. It is unlikely that the country would be ready in three years, for all items required for use in the oil and gas industry to be produced locally.

- It is also unclear how the requirement to pay 1% of total contract sum awarded in the sector into the Nigerian Content Development Fund (NCDF) would be implemented. Will this payment cascade to all levels of contract award, or only apply at the stage of award by the oil exploration and production (E&P) companies? Further, this additional 'levy' of 1% of contract value (together with the requirement for contract to be awarded to a Nigerian company, even if 10% higher than the lowest bidder) would significantly increase the cost of contracting in the Nigerian oil and gas industry. Ultimately, this might become a factor in the investment inflows into the country, relative to other countries with lower costs of production.
- The requirement that subsidiaries of multinational companies (MCs) should own at least 50% of the equipment used for execution of work in the country may be onerous to achieve. The oil and gas industry is very capital intensive and most equipment (such as drilling rigs) are leased from the owners and used for operations around the world. Requirement for Nigerian companies to own such high value equipment might therefore not be feasible. But outside the high-value equipment which are traditionally rented, the requirement for the assets to be owned by the Nigerian companies would ensure that the Nigerian companies do have the internal capacity to execute the contracts from the E&P companies.
- The provision of the Act which mandates operators, contractors and subcontractors to maintain bank account in Nigeria in which they shall retain a minimum of 10% of their total revenue accruing from their Nigerian operations is not clear. In our view, the practical implication of this provision for the service companies is that not more than 90% of the contract value can be received into a foreign bank account, with the balance of 10% paid into a Nigerian bank

account and used to fund activities in Nigeria. For the operators however, this provision would effectively require them to repatriate at least 10% of the revenue into Nigeria. Payments hitherto made to contractors from offshore bank accounts may now have to be paid from the Nigerian bank accounts (which we believe, could be maintained in foreign currency). The domiciliation of the 10% of revenue in Nigerian banks is expected to provide a pool of funds that can be loaned by the banks to local operators in the oil and gas sector, as well as in other sectors of the economy.

With the enactment of the Act, international oil service companies, especially those operating through subsidiaries, may have to review their business arrangements. Ultimately, they may have to divest significant portions of their equity holdings, to enable their subsidiaries qualify as "Nigerian Companies". Without this, the potential of the subsidiaries to successfully conduct operations and secure contracts in the country will appear uncertain.

If properly implemented, the Act has the potential to facilitate the participation of Nigerians in the oil and gas sector, and stimulate the development of other sectors of the economy, especially the manufacturing sector. However, a transitional arrangement would need to be developed, such that foreigners, who have over the years, been encouraged to invest in the Nigerian economy, do not lose such investment.

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