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***CURRENT LEGAL ISSUES FOR GAS  
PRODUCTION AND UTILISATION IN  
NIGERIA***

***BY***

***CHIEF RICHARD AKINJIDE,  
SAN, FCI Arb. (UK)***

***MRS. JUMOKE AKINJIDE-BALOGUN  
LL.B (Lond) LL.M (Harvard) ACI Arb***

***&***

***MR. ABAYOMI AKINJIDE, M.A., LL.M (Cantab)***



**London Chambers: 10 King's Bench Walk,  
Temple, London EC4Y 7EB  
TEL: 0171 353 2501 FAX: 0171 353 0658**

## **Introduction**

The greatest challenge that faces the petroleum industry in Nigeria today is this - how do we harness the enormous gas resources and potential of the nation for the common good i.e government, investors (both foreign and local), neighbouring states and most importantly the Nigerian citizenry? Further, in doing so what are the legal issues and challenges to be faced?

This paper is intended to cover the relevant areas, with the intention of identifying issues and/or offering solutions. In order to paint the background to the legal issues, it is necessary to examine, very briefly, the current state of gas production and utilisation in Nigeria, where we want the gas industry to be and the possible routes to get there.

## **Current State of the Nigerian Gas Industry**

Gas production in Nigeria is mostly linked to the production of oil. This “associated gas” is separated from oil at flow stations and more than 70 percent of it is simply flared. Current estimates show that Nigeria produces an average of 34 billion cubic metres (bcm) of gas yearly out of which 75 per cent is flared.

On the distribution side, the Nigerian Gas Company Limited (NGC), a wholly owned subsidiary of NNPC, was established in 1988 and has a monopoly on the transmission via pipeline of domestic natural gas needs.

As ready mentioned, Nigeria flares a staggering volume of gas daily. We have the dubious distinction of being the world's greatest gas flaring country. The gas flared daily is said to be sufficient to meet the energy requirements of a small industrialised nation! The reasons identified by industry experts for this unfortunate state of affairs are many. They include:

- Limited commercial demand. The local market is only able to absorb a relatively small percentage of daily production of associated gas.
- Unrealistically low gas pricing. It was generally said to be uneconomic to embark on admittedly costly gas utilisation facilities.
- On the export front, Nigeria is far from the major international gas markets, the sub-regional market is not attractive, hence exports are limited to liquefied gas transported by sea, which is an expensive process.
- Associated gas is more expensive to harness than non-associated gas. This again means that prevailing economic factors militate against the development of facilities to use associated gas.
- Absence of necessary policies and fiscal incentives to encourage the development of the industry, especially in the downstream sector.
- Low liquid hydrocarbon fuel prices which make industrial and commercial enterprises, reluctant to invest funds necessary to convert their energy source to gas.

In addition, there are major investment disincentives leading to the flight of foreign investment from Nigeria. These negative factors are well known and include:

- Lack of infrastructure and the deterioration of existing infrastructure.

- Political instability.
- Insecurity and the break down in the rule of law,
- Slow pace of development and economic activity in the country.
- Unwieldy, inefficient and ineffective Administration of Justice system.
- Corruption
- Inadequate government funding necessary to attain planned growth and development of the industry.

The resulting effect of the current state of the gas industry is loss of revenue; waste of valuable nonrenewable national resource; environmental pollution and degradation (acid rain and suspended particulates); the production of carbon dioxide, a 'greenhouse gas' believed to contribute to global warming and side effects deleterious to health.

### **Where do we want to be?**

Clearly as a nation our aim must be to stop gas flaring as rapidly as possible and to promote the production and utilisation of our abundant gas reserves and to improve the business and political environment of the country in order to attract, and keep, both local investment and foreign direct investment.

The attendant benefits of a vibrant and stable economy which fully exploits our gas reserves are obvious:

- Increased revenue generation by the government;
- Elimination of environmental pollution and attendant health risk;
- Promotion of local industrial development;
- Technology transfer;
- Conservation of local forests; and
- Substitution of gas a cleaner, more efficient energy source for more traditional sources such as coal and hydrocarbon fuel.

## **The way forward**

As is usually the case there are many ways of achieving the desired objective. These are policy issues, which will gradually be resolved through much debate and consultation by government, technical experts and the stakeholders in the industry.

Indeed the government has already gone some way towards resolving these problems. The recent measures announced by government are in the right direction, e.g,

1. All exploration and producing companies are henceforth to obtain approved gas utilisation plans from the federal government before pursuing new crude oil projects. This is obviously addressed at harnessing production of associated gas.
2. Government has set a "flares out" target date of the year 2010.
3. Government has promised to formulate a comprehensive National Energy Policy, and
4. Government in the 1997 and 1998 annual budgets, undertook a review of fiscal incentives in order to encourage the development of gas development and utilisation projects.

## **Fiscal incentives**

In the 1997 budget statement, encouragement was given to companies to exploit natural gas resources and utilise the gas for commercial purposes.

Additional incentives were given in the 1998 budget. At present the following incentives are available in the gas sector: -

### **1. Gas development or exploitation (Upstream Operations)**

- (a) All gas development projects are to be taxed under the provisions of the Companies Income Tax Act ("CITA") and not the Petroleum Profit Tax Act ("PPTA"). For companies involved in both oil and gas projects, the oil operation, which is taxable under the PPTA, is to be separated from the gas operation. All expenditure pertaining to the integrated oil and gas project will be chargeable under the PPTA.

Before 1998, gas development projects were subject to the provisions of the PPTA and profits arising therefrom were therefore taxed at the rate of 85 per cent.

- (b) The fiscal incentives approved in 1992 under the Associated Gas Fiscal Arrangement were reviewed as follows:-

- (i) All investment necessary to separate oil and gas from the reservoir into usable products is considered part of oil field development;
- (ii) Capital investment facilities to deliver associated gas in usable form at utilisation or designated custody transfer points, will be treated for fiscal purposes as part of the capital investment for oil development.

In the 1997 budget the following fiscal incentives were introduced:-

## **2. Gas Utilisation (Downstream Operations)**

- (a) Profits are to be taxed under the provisions of CITA;
- (b) An initial tax holiday for 3 years, renewable for an additional 2 years;
- (c) Accelerated capital allowances after a tax holiday are available as follows:-
  - (i) Plant and machinery, 90% annual allowances with 1% retention.
  - (ii) Additional Investment Allowance of 15% which will not reduce the value of the asset.
- (d) Tax free dividends during the period of the tax holiday

The 1998 budget retained these incentives subject to the following changes:

- All fiscal incentives under the gas utilisation downstream operations granted in 1997 are extended to industrial projects that use gas, i.e power plant, gas to liquid plant, fertiliser plant, gas distribution and transmission pipeline.
  - The initial tax holiday period is extended from 3 years to 5 years and a renewable period of two years
  - Interest on loan for gas projects is to be deductible where the prior approval of the Federal Ministry of Finance was obtained before taking the loan.
- (c) Machinery, plant and equipment imported by industrial establishments using gas in the manufacturing process are subject to a 0% import duty rate.
  - (d) The penalty for gas flaring which had remained at 50 kobo per 1,000 cubic ft since 1992 was increased to ₦10 per 1,000 cubic feet with effect from 1st January 1998. In reality as the Nigerian Natural Petroleum Corporation, a joint venture partner in most oil production ventures, is exempted from paying this penalty, the foreign venture partners will pay the penalty in proportion to their equity interest in each of the joint ventures.

In the past, the government approved gas pricing structure and incentives introduced in 1990 together with the grant of additional fiscal incentives to national gas producers under the Associated Gas Framework Agreement (AGFA) 1992 have largely encouraged investment in the export market e.g. Chevron's Escravos Gas Project, Mobil's Natural Gas Liquid Project and of course the Nigerian LNG Project. The new 1997/98 gas incentives should attract significant investments.

It is widely accepted in the gas industry that in order to stimulate the required level of investment the following must be done:

- Local markets must be created for gas utilisation.
- Gas prices must be set at commercial levels to stimulate development of gas facilities.
- The fiscal incentives contained in the Associated Gas Framework Agreement (AGFA) of 1992 should be extended to downstream gas projects.
- Investor confidence must be restored in order to attract investment through business friendly policies, improved services, efficient administration of government agencies, improvements in the administration of justice system and the eradication of corruption.

What is less certain however is the manner in which the gas industry is to be structured as far as the local gas distribution is concerned. This is an area in which opinions differ and where several alternatives are available.

1. One way is to retain the monopoly of the Nigerian Gas Company for local gas transmission, but to contract out services performed by the NGC i.e leasing of business rights in respect of public facilities. The state still funds the service and owns the pipelines but invites the private sector to bid for the right to provide the service under contract.
2. Another route is deregulation. This entails the provision by the private sector of a service that is currently monopolised by the state. The ability of the new service provider to serve the public efficiently will determine its success or failure. Deregulation should lead to a wider choice of service providers, which, in turn, should result in more effective competition. However the nature of gas distribution is such that competition is difficult to achieve. This is because of the huge investments required and the long pay-off term which serve as disincentives to others to compete with an established concessionaire.
3. The traditional privatisation approach by way of sale of assets is another option. The Nigerian Gas Company can be removed from state ownership and its assets transferred to the private sector. Privatisation should bring greater efficiency

but the lack of competition remains a worry. If this privatisation model is adopted then the role of government may be simply to set the framework in which the private sector can pursue the development of Nigeria gas resources and to ensure, through the tax system, that a fair share of the benefit is secured for the nation.

The corollary of the above is that a government regulatory agency is established as the watchdog, for standards setting, pricing and for dispute resolution.

### **Some legal issues**

#### **I. The Gas Regulator and a Gas Code**

As part of the development of the supply of gas for local commercial and domestic use, it is desirable that a Gas Ombudsman is appointed and an Office of Gas Supply is established. The role of the Regulator (supported by the gas agency) will include responsibility to ensure that there is no abuse of the monopoly position held by owners of facilities, the power to set tariffs and the arbitration of disputes by statute. A statutory gas code setting out in detail the duties and rights of the consumer and the gas supplier is also recommended.

#### **2. Conservation and Habitat Protection**

The Oil Pipeline Act, cap 338, Laws of the Federation 1990, regulates the grant of licences for establishment of oil pipelines - defined to include gas and gas derivatives pipelines. With the development of the local gas market there will inevitably be a growth of an increasingly complex and extensive gas pipeline transportation system. In addition to ensuring that a coherent, safe and efficient system is developed, the statutory protection currently bestowed on burial grounds and other venerated land by the Oil Pipelines Act, should be extended to empower the Minister to declare certain areas as Special Protection Areas and Special Areas of Conservation. These areas will be granted such status in order to protect the ecology, listed plant and animal species and to promote the maintenance of bio-diversity. Accordingly such protected areas will be ruled out for use for pipelines.

#### **3. Business Climate**

Admittedly government has taken great strides forward in liberalising the economy through the promulgation of the Nigerian Investment Promotion Commission Decree 1995 ("NIPC") and the Foreign Exchange (Monitoring and Miscellaneous Provisions) Decree 1995, but more needs to be done.



Happily the Investment Promotion Commission was recently established after a time lag of more than two years. It is hoped that the Commission will now set about dismantling all cumbersome and obsolete regulatory processes and provide a one-stop forum for the foreign investor who is setting up business in Nigeria.

Because the gas business is less flexible than the oil business, gas contracts are mostly long term and huge financial investments are required. Thus the need for legal certainty, consistency and transparency cannot be overemphasised.

Of vital importance also is the need to undertake far reaching reform of the Courts system in order to guarantee that litigation proceedings are speedy and fair. There must be consistency and certainty both in the promulgation and application of laws in order to promote investor confidence.

#### **4. Arbitration**

Increased local gas utilisation will inevitably throw up disputes between the gas supplier and the customer. Regulations should be made for the reference of disputes to an arbitrator for determination. The provision of an impartial expert and quick dispute resolution procedures should attract customers who presently suffer the arbitrary "take it or leave it" attitude of competing energy suppliers and encourage them to choose gas as an alternative energy source. Our arbitration law needs urgent revision and updating.

#### **5. Extension of AGFA**

II, as is suggested by some people in the industry, the Association Gas Framework Agreement ("AGFA") is to be extended to downstream gas utilisation projects, it would then be administratively more sensible to codify the AGFA. Statutory codification of the incentives addressed to a wider downstream audience, will promote certainty and encourage greater downstream gas utilisation.

#### **6. National Energy Policy**

The promised National Energy Policy although not strictly law has legal underpinnings, being the declared policy of the executive arm of government. Again the policy statement should be released as soon as possible as this will result in greater transparency. If acted upon, the Energy Policy can form the basis of a legal claim by the gas sector investor based on the doctrines of estoppel and legitimate expectation.

#### **7. Environment Impact Assessment**

Before an application to the Minister for a licence under the Oil Pipelines Act for development consent can be approved, an environmental impact assessment must be undertaken and the project authorised by the Federal Environmental Protection Agency. Construction of gas facilities is listed in the Schedule of Mandatory Study Activities - see Environmental Impact Assessment Decree No.86 of 1992. This is a welcome and environmentally friendly development in the law.

## **8. Compensation**

Section 5 of the Oil Pipeline Act imposes an obligation on the licence holder to pay compensation to persons whose interests in land are adversely affected and to persons who have suffered damage through negligence of the licence holder or pipe leakage. Compensation must be fair and reasonable. The courts are the final statutory adjudicating authorities for compensation disputes.

The common law causes of action such as negligence, nuisance, the doctrine of *Rylands v Fletcher* and trespass are also available to an injured party.

Once more, I must emphasise the need to strengthen our administration of justice system to provide speedy resolution of disputes.

## **9. The West African Gas Pipeline**

The West African Gas Pipeline project is designed to supply natural gas to countries in the West

African sub-region i.e Benin, Togo and Ghana via the extension of the Escravos-Lagos Pipeline. It is currently proposed that the project vehicle should be a company whose members will be the project participants from the respective countries. The legal crafting of the project agreements will need to be carefully done in this cross border gas supply scheme in order to protect the various competing interests.

Another arrangement that might be considered is for each country to incorporate a local company to own and manage the section of the pipeline located in its territory. Each country will therefore grant throughput rights to each of the states at each end of the transmission line.

This is the more conventional approach and is likely to be politically more acceptable to the participating states than the establishment of a singly corporate entity registered under the laws of one of the participating states or under the laws of a neutral third party state.

## **10. Third Party Access**

Owners and operators of gas pipelines may be viewed as owners/operators of a "dominant undertaking" who own, control and use essential facilities. It is important that laws are promulgated to allow competitors access to such gas facilities on terms no less favourable than given to the owner/operator's own services. These issues of third party access may arise in relation to:

- (a) Nigeria - Benin - Togo - Ghana gas pipeline
- (b) Nigeria - Sao Tome - Equatorial Guinea - Cameroon gas pipeline

## **11. The Gas Contract**

In drafting the gas contract, the lawyer has to avert his mind to the use of both the long-term-life-of-the-field gas sale contracts and the newer, shorter gas contracts.

Depending of the circumstances it may be that the long 20-25 year gas supply contract or the shorter one that will suit the marketer. Whether short-term or long-term, in drafting a gas contract there are inherent dangers in assuming fixed commercial positions. The legal adviser must build safety valves into the contract. Without such safety nets, the gas contract may become a burning house without any exit door! As such, provision must be made for the following possible situations in a commercial gas contract:-

- (a) Force majeure
- (b) Undue economic hardship
- (c) Price-re-opener clauses
- (d) Significant price fluctuation clause
- (e) Top-stops and bottom-stops on the base price to protect the parties.

### **Conclusion**

From this brief exposition of the state of the Nigerian gas industry it is clear that both government and the private sector must collaborate in partnership to develop the enormous potential for gas production and utilisation in Nigeria.

The government in its capacity as the largest stakeholder, the regulatory authority, the legislative authority and the guardian of the nation's wealth should assume the role of senior partner in the industry by laying down the indispensable structures and framework without which the private sector cannot realistically be encouraged to play its own role.

## THE AUTHORS

### *Chief Richard Akinjide, SAN, FCI Arb. (UK)*

Member, English Bar (1956), Nigeria Bar (1956), The Gambian Bar (1987).

President, Nigeria Bar 1970-73.

Life Bencher Nigerian Law School since 1972 and its former Chairman.

Took Silk and was called to the Inner Bar 1978 as Senior Advocate of Nigeria (1978).

Member of the Committee that drafted the 1979 Nigeria Constitution.

Attorney-General and Minister of Justice in Nigeria 1979-83.

Member: International Law Commission of the United Nations 1981-86.

Editor of Nigerian Monthly Law Report for about ten years.

Author 2nd Edition: "Africa and The Development of International Law" (Publishers: Martinus Nijhoff-Netherlands, 1986).

Practices extensively in civil and criminal matters in Nigeria. Also practices at the English and The Gambian Bars.

Co-Agent and a Counsel for Nigeria at I. C. J in the action, Cameroon v Nigeria, and International Boundary Dispute at The Hague.

Fellow of the Chartered Institute of Arbitrators UK.

Principal Partner of Akinjide & Co. Barristers~ Solicitors & Trade Mark Agents, Lagos, Nigeria.

***MRS JUMOKE AKINJIDE-BALOGUN LL.B (Lond), LL.M (Harvard), ACI Arb***

The Managing Partner of Akinjide & Co., she obtained the LL.B Hons degree in 1980 from King's College London (University of London) and a Masters degree, from Harvard Law School in 1981.

She was called to the Nigeria Bar in 1982.

She has extensive legal experience, having worked in the civil litigation department of the Federal Ministry of Justice in Nigeria, before joining Akinjide & Co. in 1983.

From 1992 to 1994, she worked in both the company department and commercial litigation department of Simmons & Simmons, one of the top 10 law firms in the City of London. During this period she sat for the Solicitors Final Examination achieving First Class Honours. She was thereafter admitted to the Roll as a Solicitor of England and Wales.

She now heads the company law and energy & natural resources law departments of Akinjide & Co and is an Associate of Chartered Institute of Arbitrators of the UK.

Other articles by Mrs. Akinjide-Balogun on Energy are “*Investment Opportunities for Oil Service Companies in Nigeria*” (1996) presented at the African Oil ‘96 conference, Cape Town, South Africa and “*Legal Aspects of International Environmental Protection*” (1996) presented at the 8th Biennial International Seminar on the Petroleum Industry and the Nigerian Environment, Port Harcourt, Nigeria.

Mrs. Akinjide-Balogun recently pioneered the provision of Seminars and Courses for continuing professional development purposes in the Nigerian legal profession.

***ABAYOMI AKINJIDE, MA., LL.M (CANTAB).***

***BARRISTER AND SOLICITOR OF THE SUPREME COURT OF NIGERIA.  
SOLICITOR OF ENGLAND AND WALES.***

After Marlborough College where he was a prefect, he went to Cambridge University where he obtained BA Law Tripos (Second Class Upper) and LLM (Second Class Upper) during which he was appointed Warden of his college, Sidney Sussex. After Cambridge, he joined Generale Bank in the City of London as an investment banker for two years during which he worked in every department of the bank. Generale Bank is the largest Belgian Bank.

He represented his Colleges in athletics and rugby.

He joined Ashurst Morris Crisp in 1990, one of the top law firms in the City of London. Some of the notable transactions in which he has been involved in:

- (a) acting for Chauvco Resources Limited;
- (b) a member of the Ashurst Morris Crisp energy team featured by Petroleum Economist on main legal energy teams of 1996;
- (c) the successful defence of Henleys Plc from a hostile take-over bid by T Cowie Plc;
- (d) merger of MAI Plc and United Newspapers;
- (e) acting in GNPC (Ghana National Petroleum Corporation) led transactions;
- (f) advising on the flotation of Brunner Mond Plc;
- (g) the private placing of shares of On-Track Innovations Inc. (an Israeli Company);
- (h) negotiating the development of a gas power project in Ghana;
- (i) advising Amrescap on the English and non-American aspects of the acquisition of the asset management division of the Liechtenstein Global Trust for approximately US\$1.3 billion (£790 m);
- (j) advising Hemingway Properties PLC in its recommended bid for Olives Property PLC; and
- (k) advising MCIT Plc (Investment Trust) on, inter alia, its capital reorganisation and equity issue.

He is the author of “Recent Developments in the Law of Mareva Injunctions” published in most of the major Nigerian Newspapers in December/January 1996/7, and by Akinjide & Co.

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**BARRISTERS, SOLICITORS  
& TRADE MARK AGENTS**

NCR BUILDING (4TH FLOOR)  
6 BROAD STREET  
LAGOS  
NIGERIA.

TEL: +234 (0)1-263 2342, 263 7407, 263 5315

FAX: +234 (0)1-263 2342 or 264 5525

E-Mail: [akinjideco@compuserve.com](mailto:akinjideco@compuserve.com)