

Corruption and Reform in Nigeria's Oil Sector

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The Politics of Development and Security in Africa's Oil States
SAIS, Washington DC; April 2-3, 2009

OVERVIEW

- Background on Nigeria's Oil Sector
- Mapping Corruption Risks in Nigeria's Oil Sector

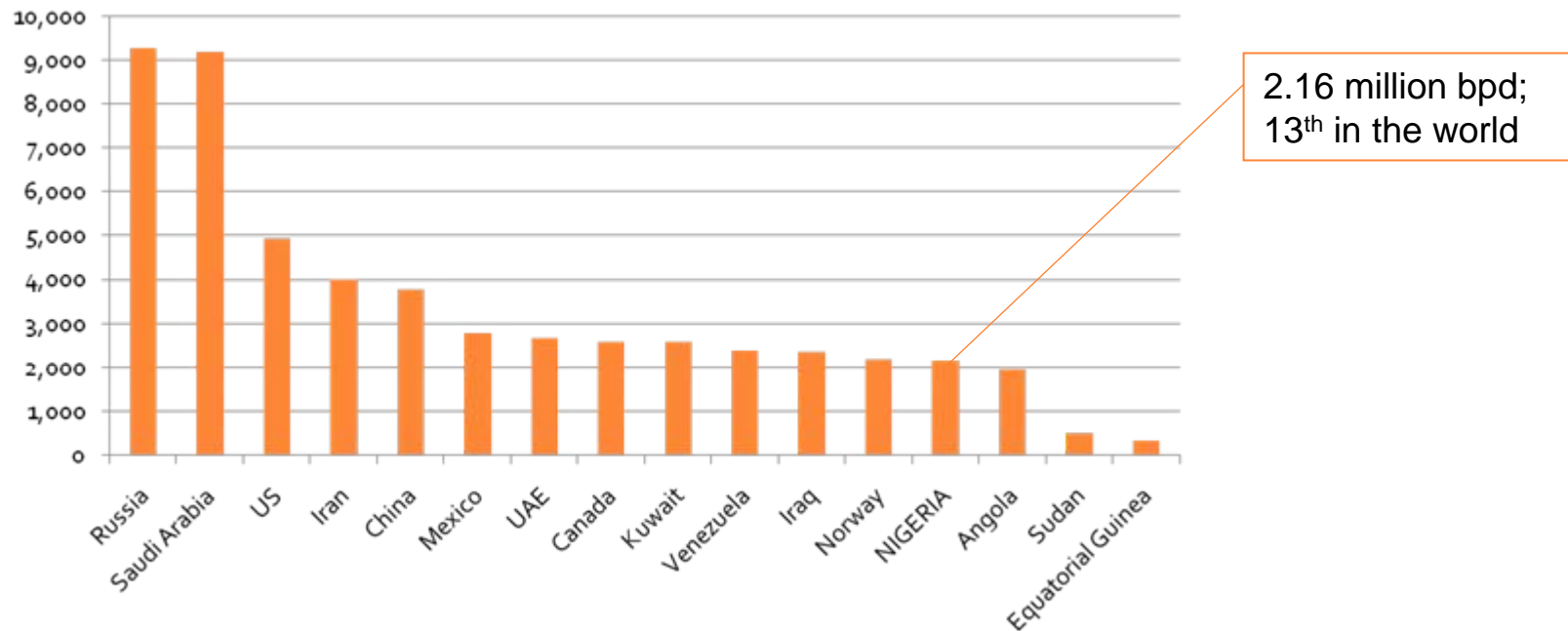
Def: corruption is "the manipulation of conditions to attain exclusive benefits to individuals or groups at the cost of social benefits (U4, 2008)".

- Efforts at Sector Reform and Reducing Corruption



Nigeria in the Global Context

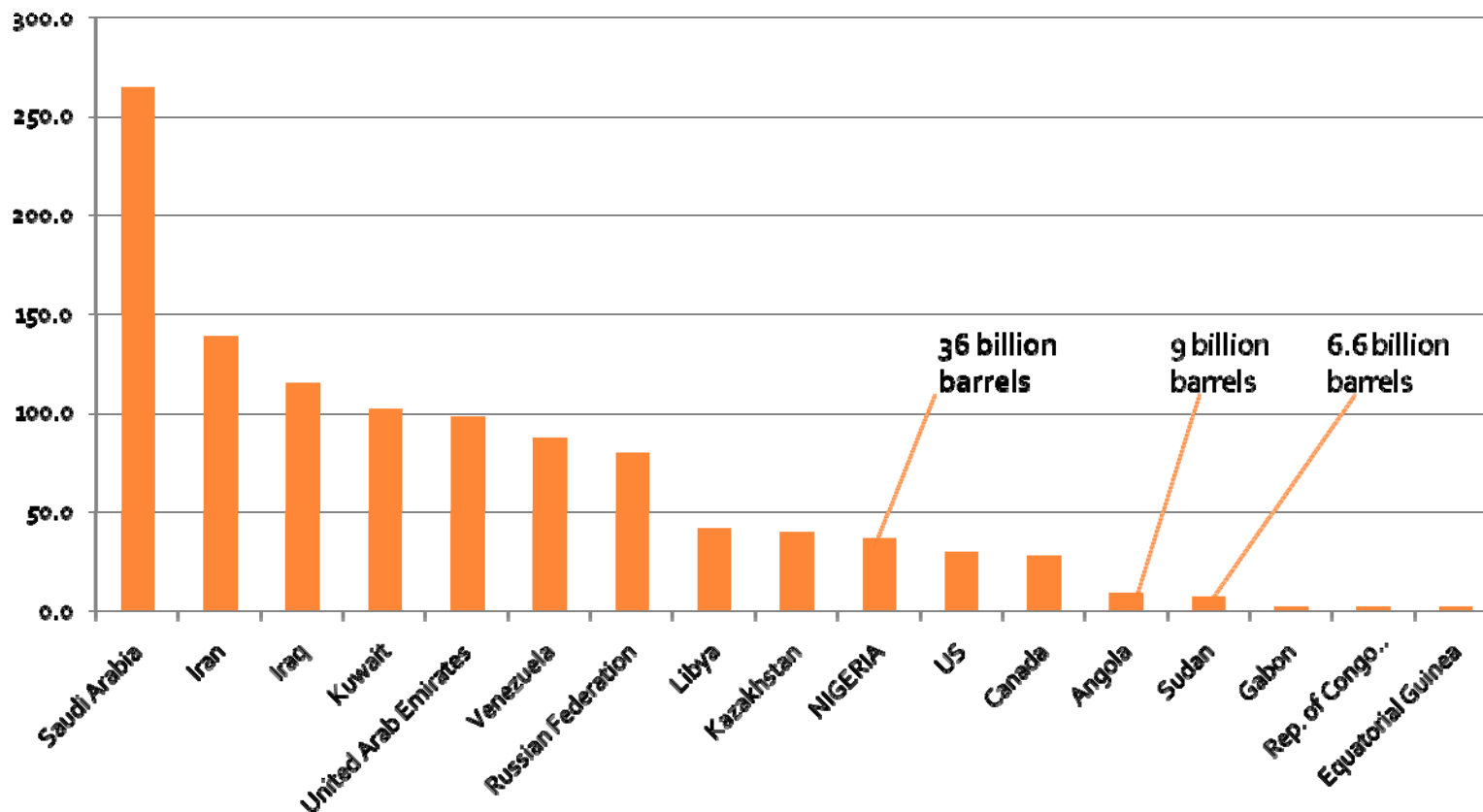
- **2008 Production** (crude production plus lease condensates, thousand barrels per day, Energy Information Administration)



- Light, sweet crude; easily transported to US and Europe; key to US diversification away from Middle East (5th largest importer).

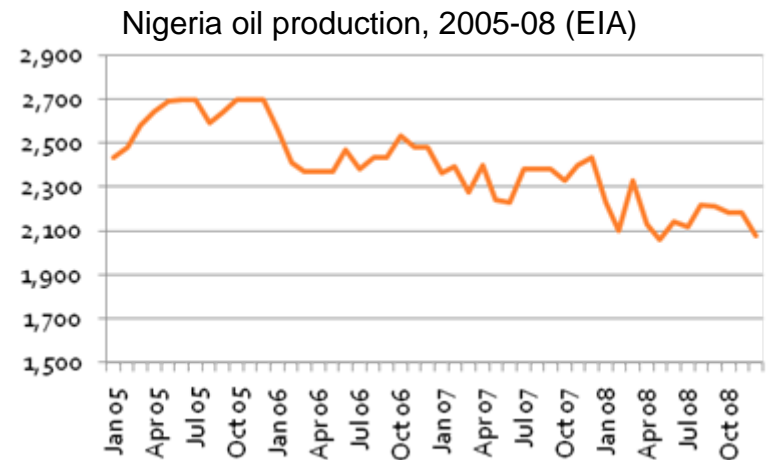
Nigeria in the Global Context

10th in Proven Reserves at end of 2007 (BP 2008 Statistical Review)



Oil in the Nigerian Context

- In 2007, oil provided 85% of government revenues and 99% of export earnings.
- Production declining due to bunkering and insecurity in the Niger Delta, and under-investment by NNPC
- Hundreds of billions earned over time, but some data indicate declines in standards of living for massive population.
- Classic resource curse symptoms with regard to politics, economics, and the prevalence of conflict



Structure of Upstream Industry

- **Joint Ventures** between NNPC and IOCs still dominate production
 - NNPC is majority stakeholder with 55-60%
 - IOC is operator
 - NNPC & IOC split operating costs; NNPC regularly unable to make these “cash calls”
 - IOC sells its share of crude production, and pays royalties and taxes to government
 - Nigeria sells its share of crude production
 - Niger Delta militancy and bunkering largely affect JV production
- **Production Sharing Contract (PSC)** production growing, especially offshore
 - Rights to explore and produce awarded to company
 - Company bears all exploration and production costs
 - Oil produced is divided into “cost oil”, which is retained by the company, and “profit oil” which is (in some cases) split between the company and the government
 - Companies then pay taxes and royalties
 - A more diverse range of companies entering into PSCs

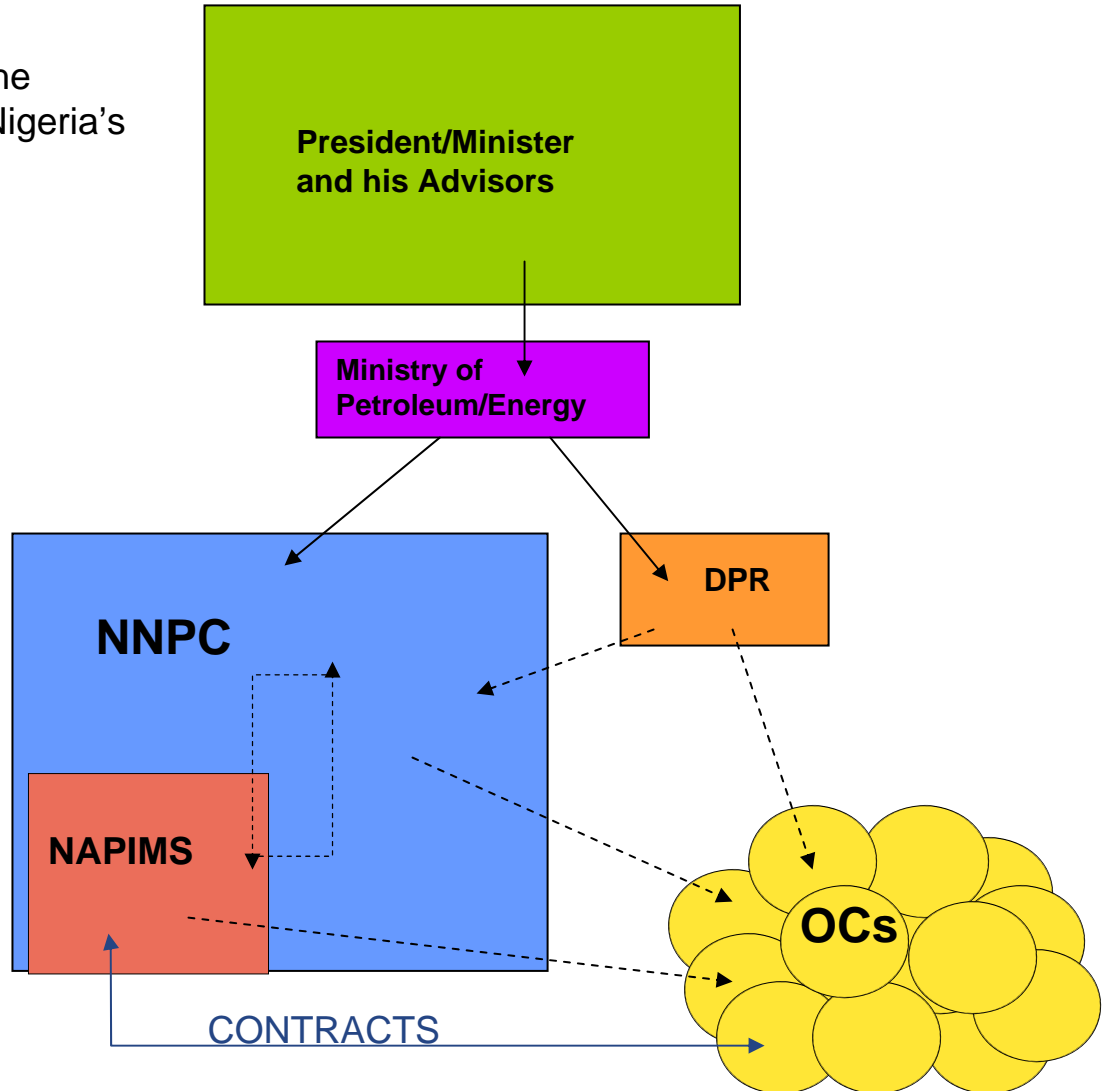
Governing Nigeria's Oil

Key players in the governance of Nigeria's oil sector

Size of box approximates actual level of influence in the sector

Official Lines of Authority →

Regulatory Relationship - - - - - →



Governing Nigeria's Oil

Criticisms of this structure

“The Ministry of Petroleum remains essentially a civil service outfit that is ill-equipped to conceive and formulate the required policies for such a complex and sophisticated industry. The regulatory body, the Department of Petroleum Resources (DPR) is, by and large, similarly constrained being a body tucked away within the Ministry. The most problematic, however, remains the National Oil Company, the NNPC. It is simply a typical Nigerian state institution that operates as a huge amorphous cost centre with little or no sensitivity to the bottom line .”

-- The Oil and Gas Implementation Committee Final Report, 2008.

An independent study notes a “bewildering overlap across NNPC subsidiaries and units, partly a function of unrestrained covetousness and expansion of incongruent responsibilities”

--Ugo Nwokeji, 2007.

Locating Corruption Risks

1. Awarding Upstream Licenses

- Petr. Act of 1969: Licenses awarded at the Minister's discretion
- Long history of secrecy, favoritism, neglect of national interest
- Obasanjo's effort to improve the system in 2005-2007 rounds- establish rules, improve transparency and increase competition
- Problems remain, take more subtle form, especially before & after the round itself.
 - Before: pre-qualification process, 'local content vehicles', invited participation esp. 'first rights of refusal'.
 - After: 'forced marriages', uneven enforcement of SB payment deadlines, term renegotiation, no enforcement of downstream commitments.
 - Discretion of Pres and his advisors trumps due process throughout.
 - Courts cases, probes, revocation of blocks, suspension of officials have ensued

Locating Corruption Risks

2. Awarding Contracts

- Majority of costs associated with E&P activities are contracted out to OSCs (overlooked by transparency movement)
- NNPC closely involved in these contracting processes; low approval thresholds
- FCPA cases leave no doubt of corruption in these processes
 - KBR pays \$180 million in bribes to secure \$6 billion in Bonny Island NLNG contracts
 - Wilbros pays \$6 million in bribes for pipeline construction business
 - No action taken against bribe recipients.....yet!
- Corruption can take several forms- bribery, favor companies in which they have a stake, give preference to companies of their allies (multiple avenues of pol and econ interactions)

Locating Corruption Risks

3. Bottlenecks and Inefficiencies

- Delays = rent-seeking opportunities, exist throughout the sector
 - Approvals and visa for each expatriate worker
 - Customs. US investigating 12 OSCs for bribing custom officials through a 3rd party
 - Contract approval process: 18-24 months, NAPIMS->NNPC Board->Federal ExCo.
- Gatekeepers profiting at each bottleneck

Locating Corruption Risks

4. Bunkering

- 200,000 bpd? from theft and process manipulation
- Complicity of government and company officials
- Lowers the amount of revenues, dissuades onshore investment, increases costs for repairs, security, etc.
- Huge levels of illicit funds for godfathers, bribery, arms, militants

Locating Corruption Risks

5. **Exporting crude and importing refined products**
 - NNPC issues: “lifting” licenses to export NNPC crude, and import refined products (gasoline, kerosene, diesel)
 - No transparency on award processes
 - Opaque, unclear relationships between NNPC and the marketing companies, messy revenue flows with no oversight
 - Reports of off-the-book payments straight to gov’t officials by license recipients
 - Subsidy on gasoline creates further opportunities for corruption via imports/export deals, black market sales, delays on paying reimbursements
 - Beginning to be addressed?

Sector Governance Reforms

1. Sector “Restructuring”

- New legal framework
- New institutions, clear roles, less conflicts of interest
 - A cost-efficient NNPC
 - Strong and independent regulatory institutions
 - Less political interference, more oversight

Status: draft Petr. Industry Bill before Nat’l Assembly, reformers in top positions, area of most active leadership by President.

Sector Governance Reforms

2. Award of Blocks, Contracts & Licenses

- E & P licenses
- Services contracts
- 'Lifting' licenses to export crude
- Licenses to import petroleum products

Best Practice Principles

Transparency Fair, open competition

Oversight Merit- and rule- based

Long-term national interests

Status: some halting progress (bid rounds, procurement reform, NIPLEX, downstream investigations)

Sector Governance Reforms

3. NEITI and beyond

- Excellent 1999-2004 NEITI audit report released in 2006; significant loss of pace since then; 2005 audit release pending...
- Broad scope of audit reports, under-utilized, need better dissemination and advocacy
- Increase transparency in other areas
 - Who operates which blocks
 - Contracts
 - PTDF, NDDC
 - OC community development payments/programs

Sector Governance Reforms

4. Investigation & Prosecution

- Domestic: EFCC & ICPC, various probes
 - Challenges: politicization, weak follow-through
- International:
 - Good progress with FCPA
 - Need similar progress in other OECD countries
 - Reach bribe recipients: money laundering, asset repatriation, tax havens, Proclamation 7750
- Some meaningful deterrence gains

Conclusions

- Limitations, but importance, of “upstream” reforms
- Obstacles to reform
 - Leadership
 - Collective action constraints
 - Vested interests in status quo
 - 2011 and the political utility of corruption
 - Implementation
- But opportunities from hardship?
 - \$40 /barrel oil, 1.6 million bpd production & the plummeting naira

Supply and Production in World Energy Markets: Trends and Prospects

Politics of Development and Security in Africa's Oil States Conference
by Monica Enfield

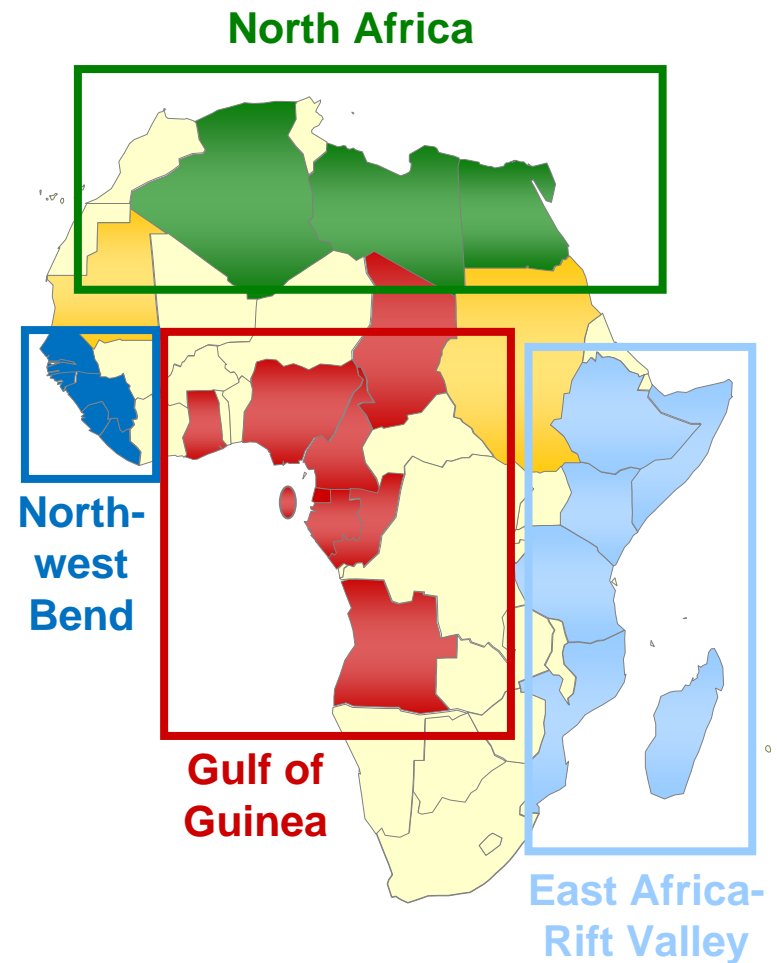
2 April 2009



Sub-Saharan Africa and Global Energy Markets

- Global Supplier to Key Markets
- New Source Production
- Investment Center for Western IOCs and Asian NOCs
- Frontier Exploration Outlook
- Upstream Challenges in Africa

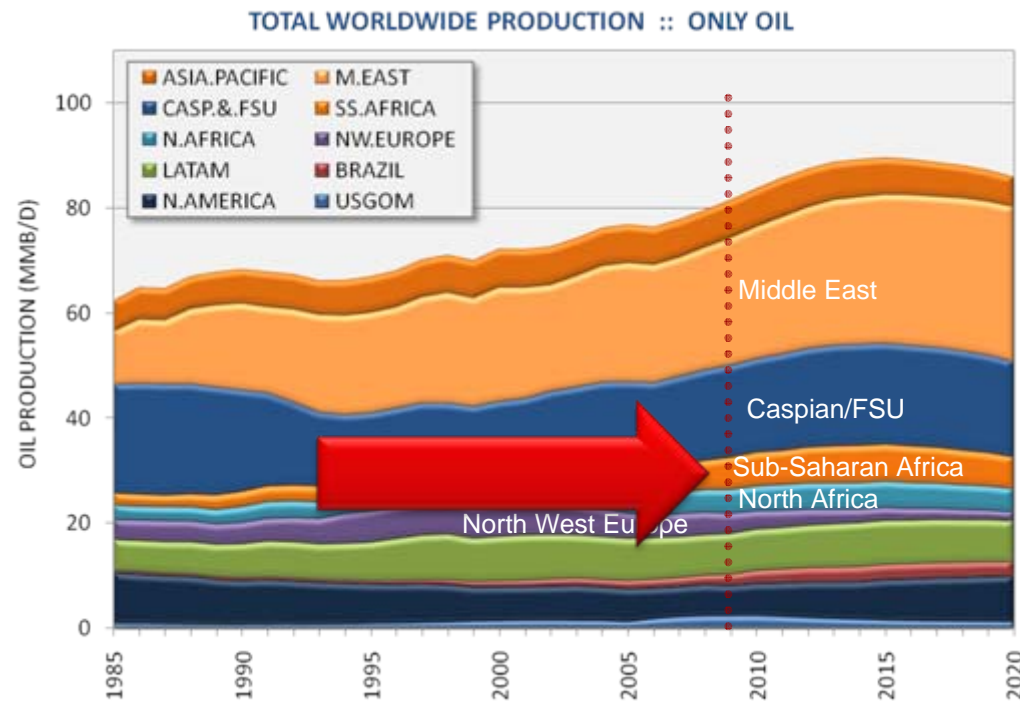
African Oil/Gas Producers



Africa in the Context of Global Energy

- Africa is a **strategic component** of the global oil market.
- Although smaller than the Middle East with regard to proven oil reserves and crude oil production, Sub-Saharan Africa is important because:
 - It **supplies key markets** (North America, Europe, Asia) with high quality crude oil
 - Its production helps **offset declines** in mature oil provinces (such as the North Sea)
 - It represents the **last “land grab”** for oil company investment and reserve replacement

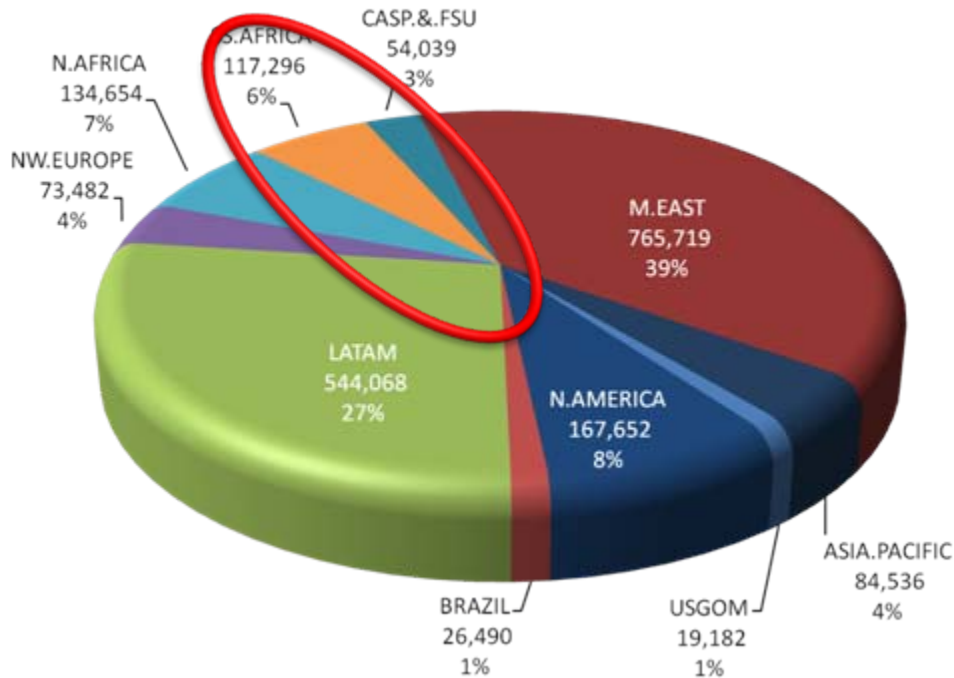
PFC Energy P50 Liquids Supply Forecast



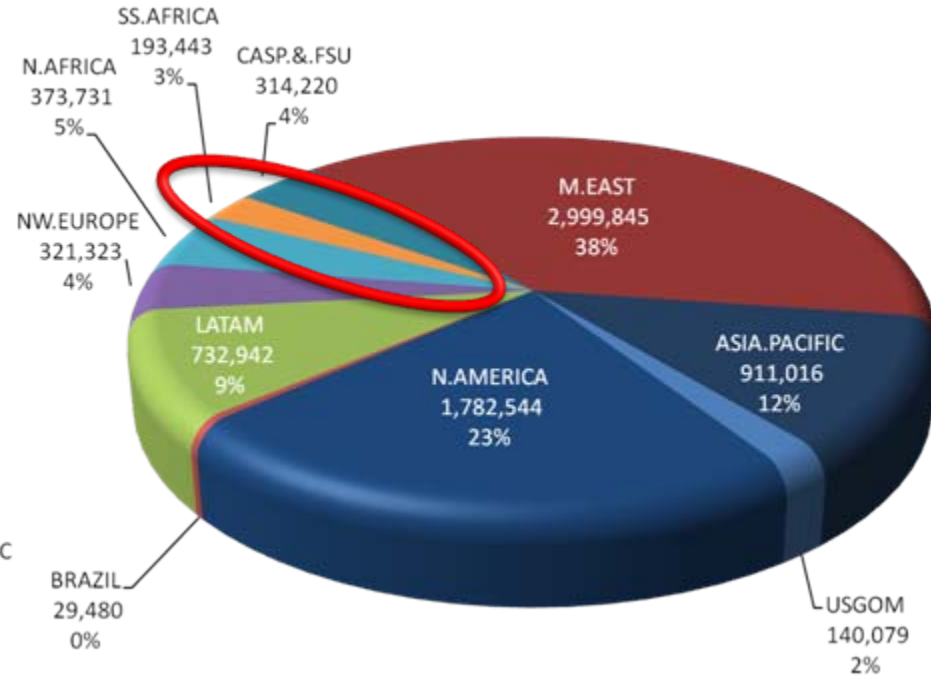
Africa in the Context of Global Energy

- According to PFC Energy's P50 Liquids Supply model, Sub-Saharan Africa holds 6% of total oil reserves, and 3% of total gas reserves.

TOTAL RESERVES (PROD+REM+EXPL) :: OIL.MMB



TOTAL RESERVES (PROD+REM+EXPL) :: GAS.BCF

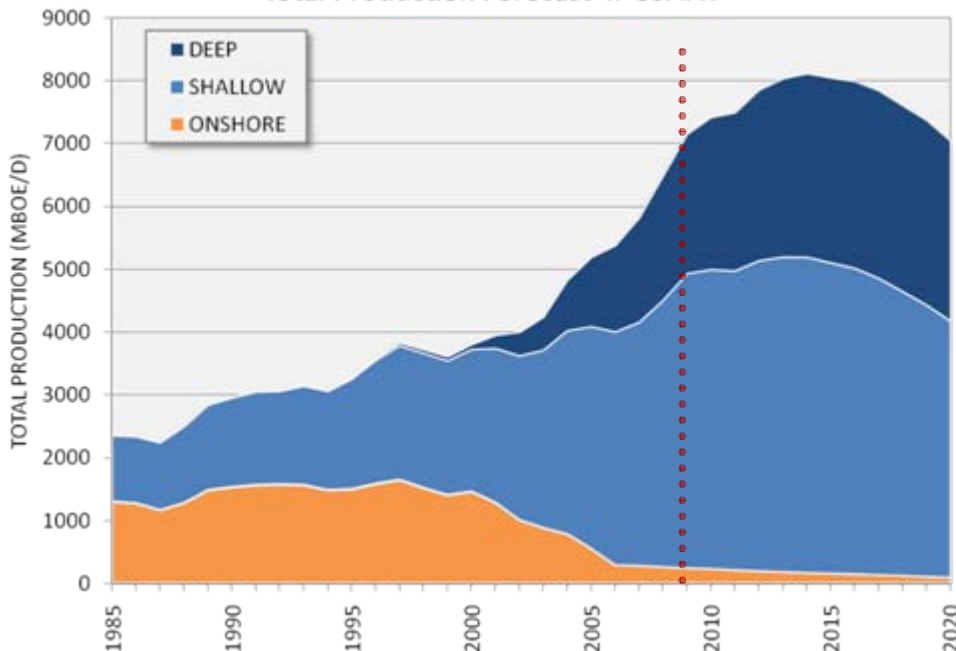


Sub-Saharan Africa Production Forecast

- Sub-Saharan Africa will increase production, from current 5.8 million to 7.1 million boe/d by 2015.
- Future growth in the Sub-Saharan African region will come from offshore activity, comprising more than 95% of regional production.
- Nigeria and Angola will comprise almost 85% of total offshore production, with significant contribution of other countries as Equatorial Guinea, Gabon, and Congo Brazzaville.

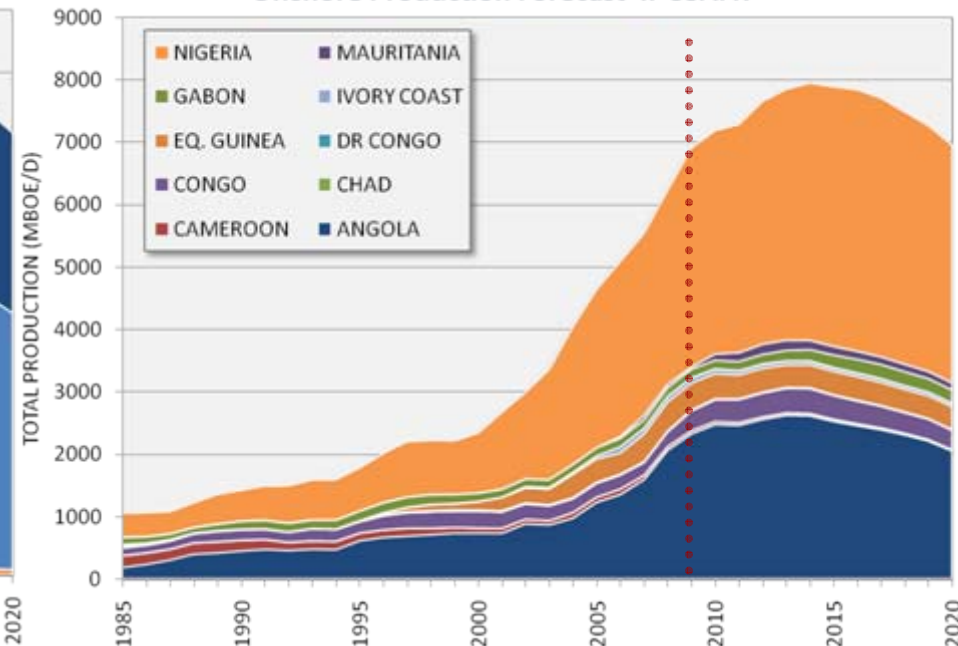
PFC Energy P50 Liquids Supply Forecast

Total Production Forecast :: SSAFR

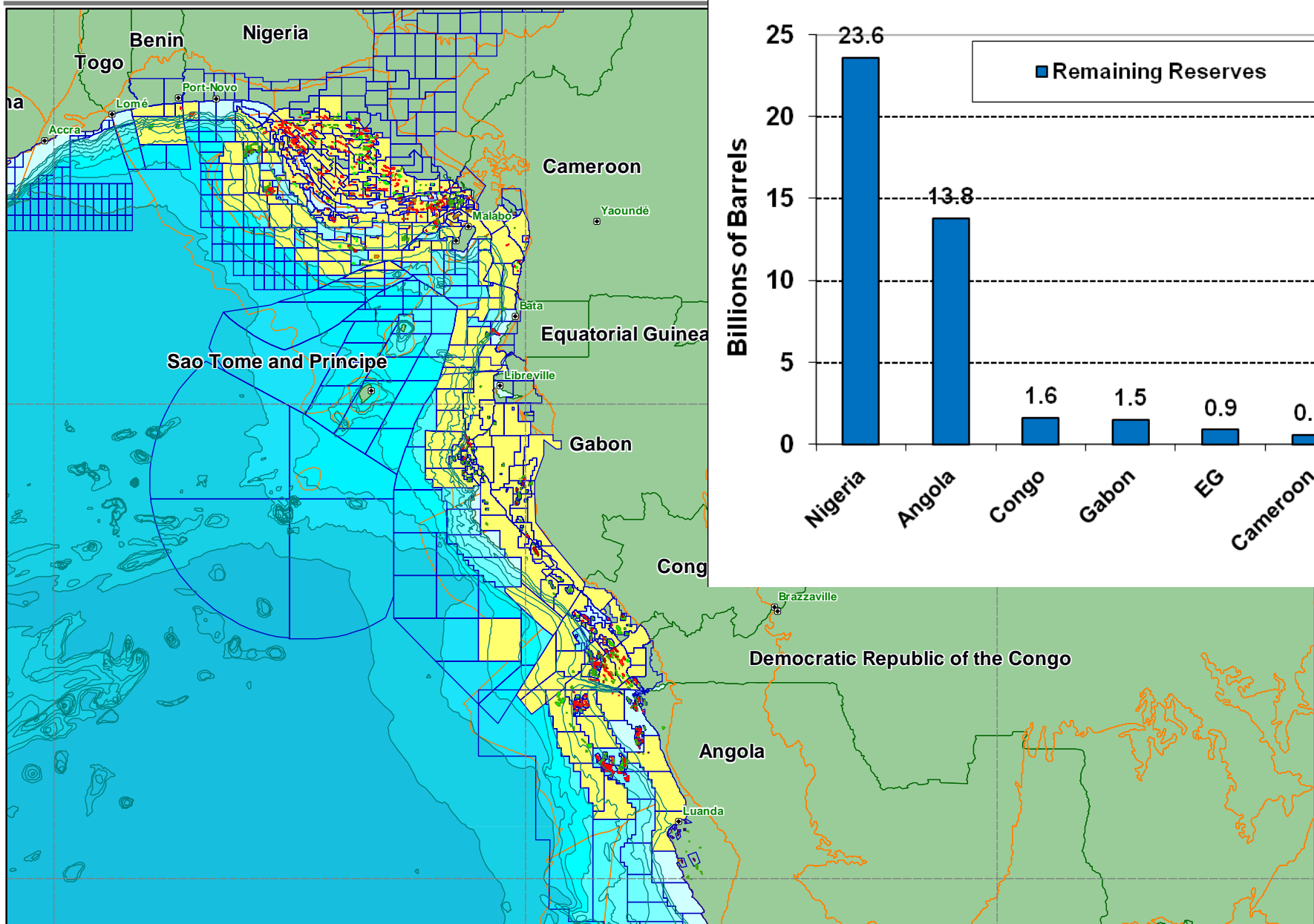


PFC Energy P50 Liquids Supply Forecast

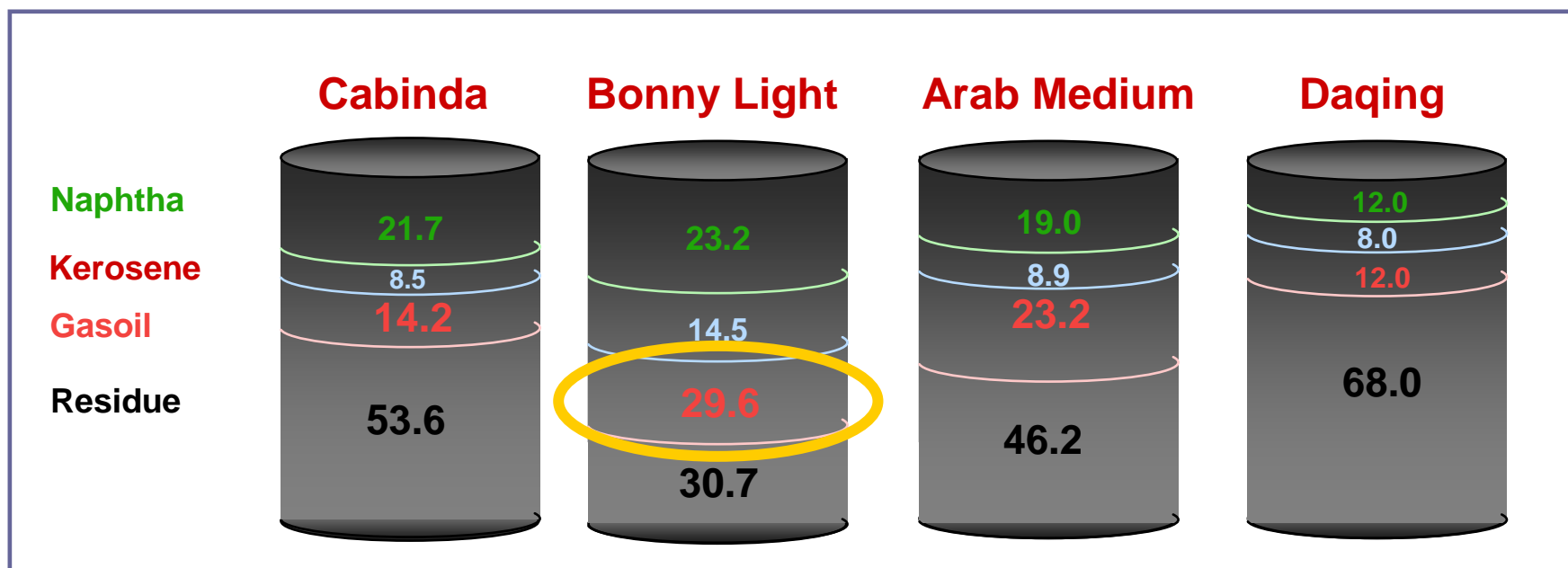
Offshore Production Forecast :: SSAFR



Remaining Reserves are Dominated by Nigeria and Angola



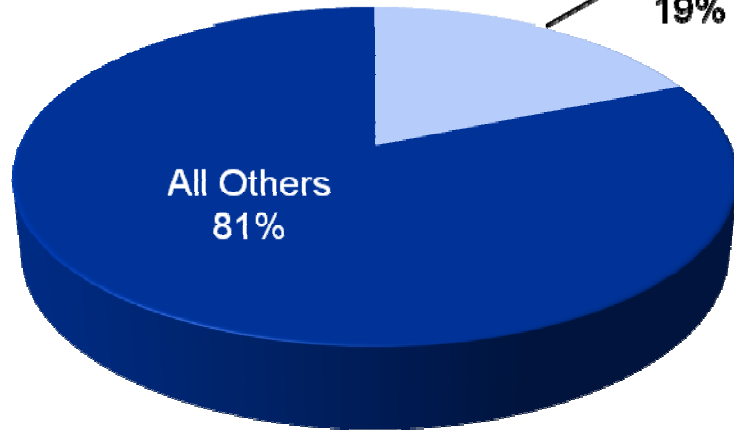
African Crude Favored By Refiners



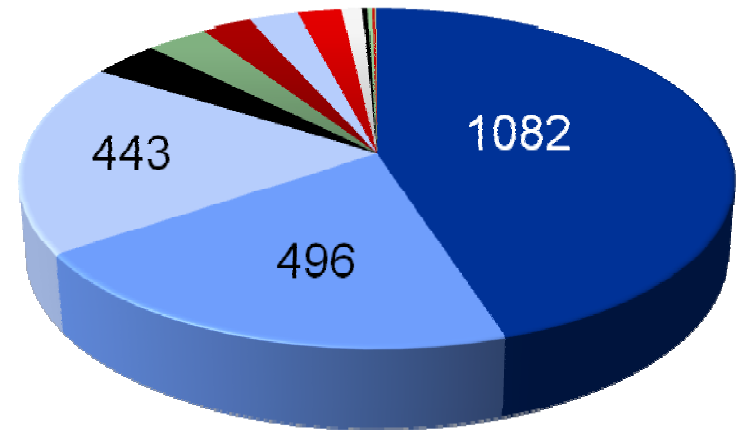
- West African crude contains sizeable amounts of gasoil – half of recent global demand growth has been for distillates (diesel, kerosene, heating oil).
- Compared to domestic grades such as Daqing, Nigerian and Angolan barrels offer far less residue when processed. The same is true for most West African producers.
- Bonny Light plays an important part as an emergency crude in the United States; Hurricane Katrina import spikes.

African Oil Imports to the United States

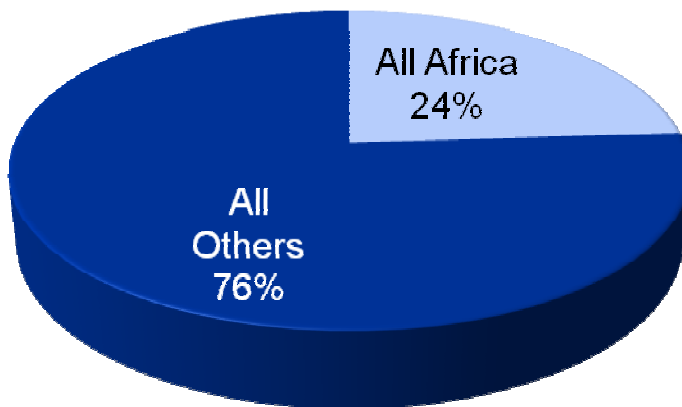
US Oil Imports, 2007
Sub-Saharan Africa 19%



US Imports from Africa, 2007 (mb/d)



US Oil Imports, 2007

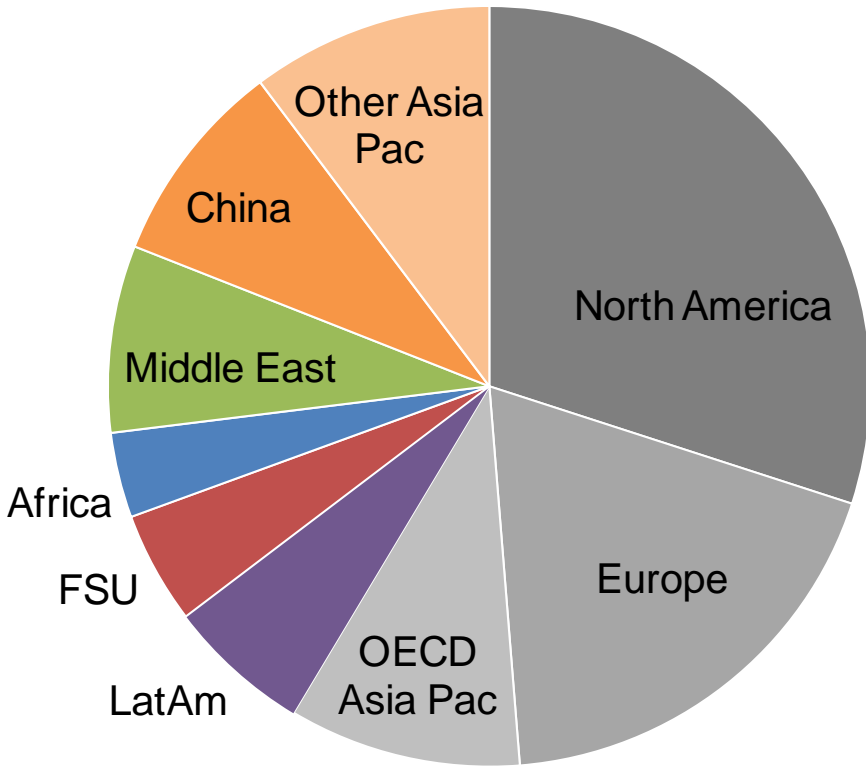


- | | | |
|-----------------------|---------------------|--------------|
| ■ Nigeria | ■ Angola | ■ Algeria |
| ■ Libya | ■ Chad | ■ Gabon |
| ■ Congo (Brazzaville) | ■ Equatorial Guinea | ■ Cameroon |
| ■ South Africa | ■ Tunisia | ■ Mauritania |

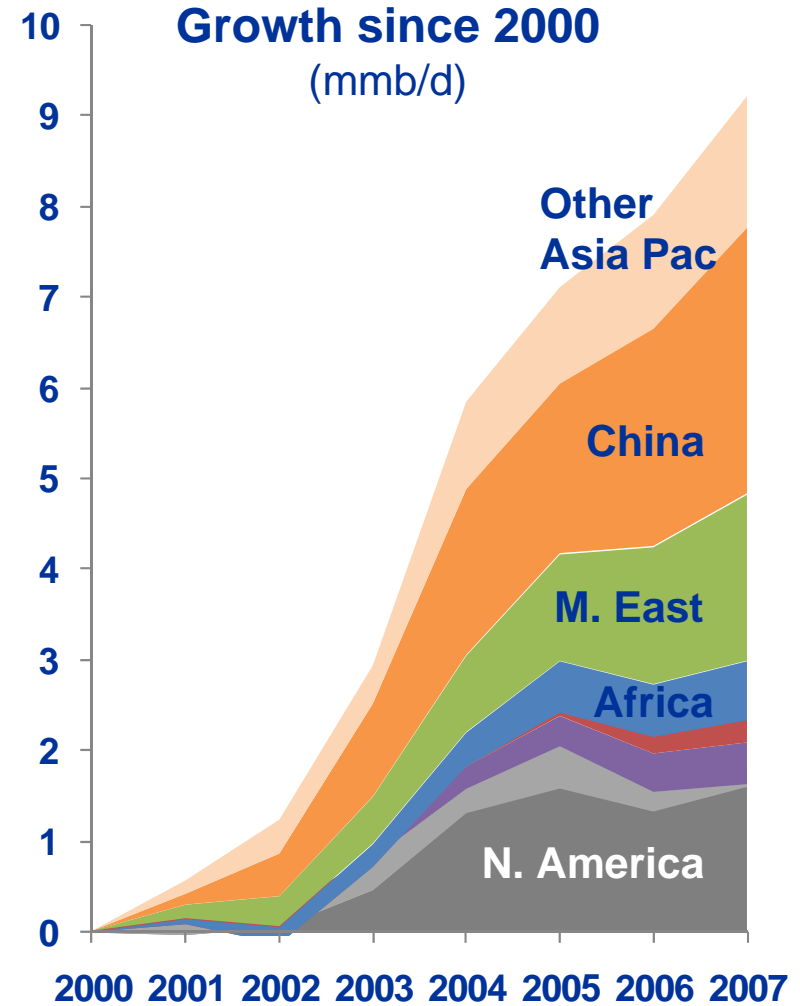
- The United States imports 19% of its oil from Sub-Saharan Africa
- Nigeria, followed by Angola, are the largest exporters from Sub-Saharan Africa

African Crude Supplies Key Demand Centers

World Product Consumption 2007

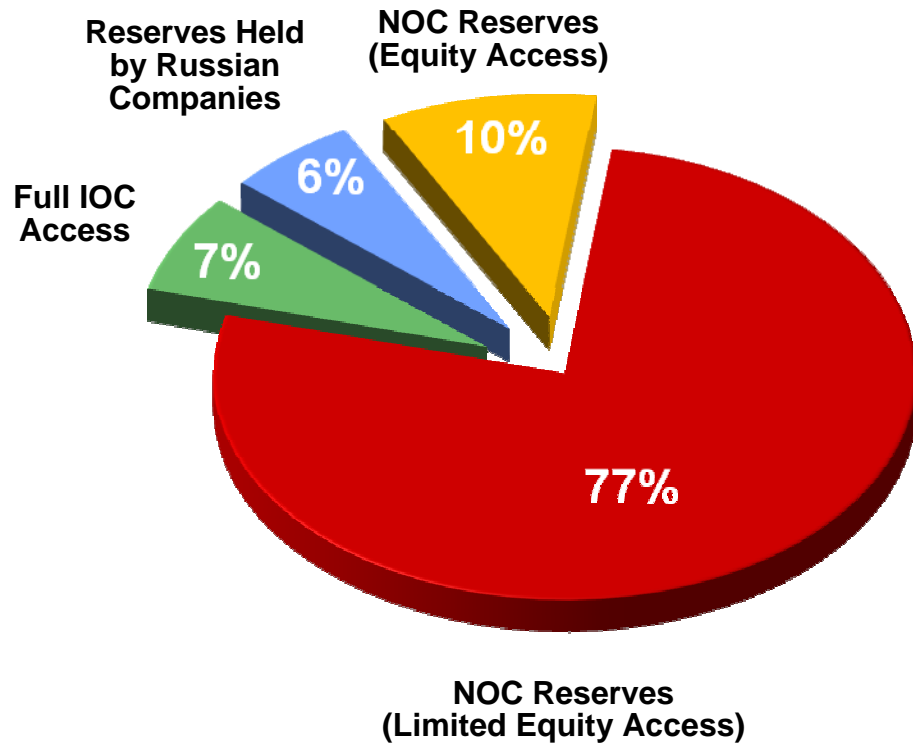


Source: PFC Energy Market Intelligence Service



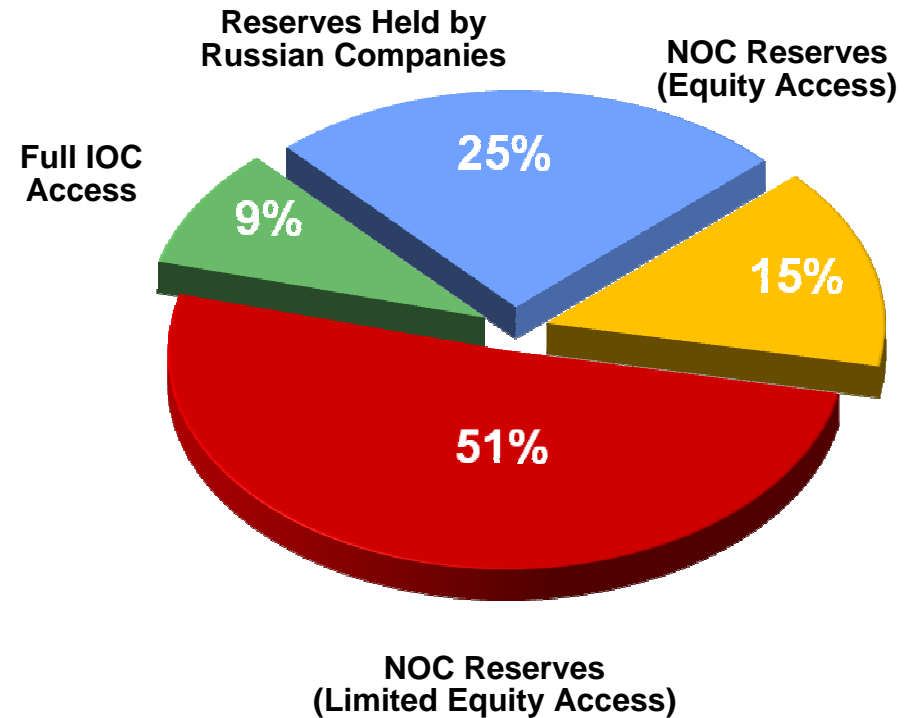
IOC Investment in an NOC-Constrained World

Oil, 2009



Total: 1,238 bnboe

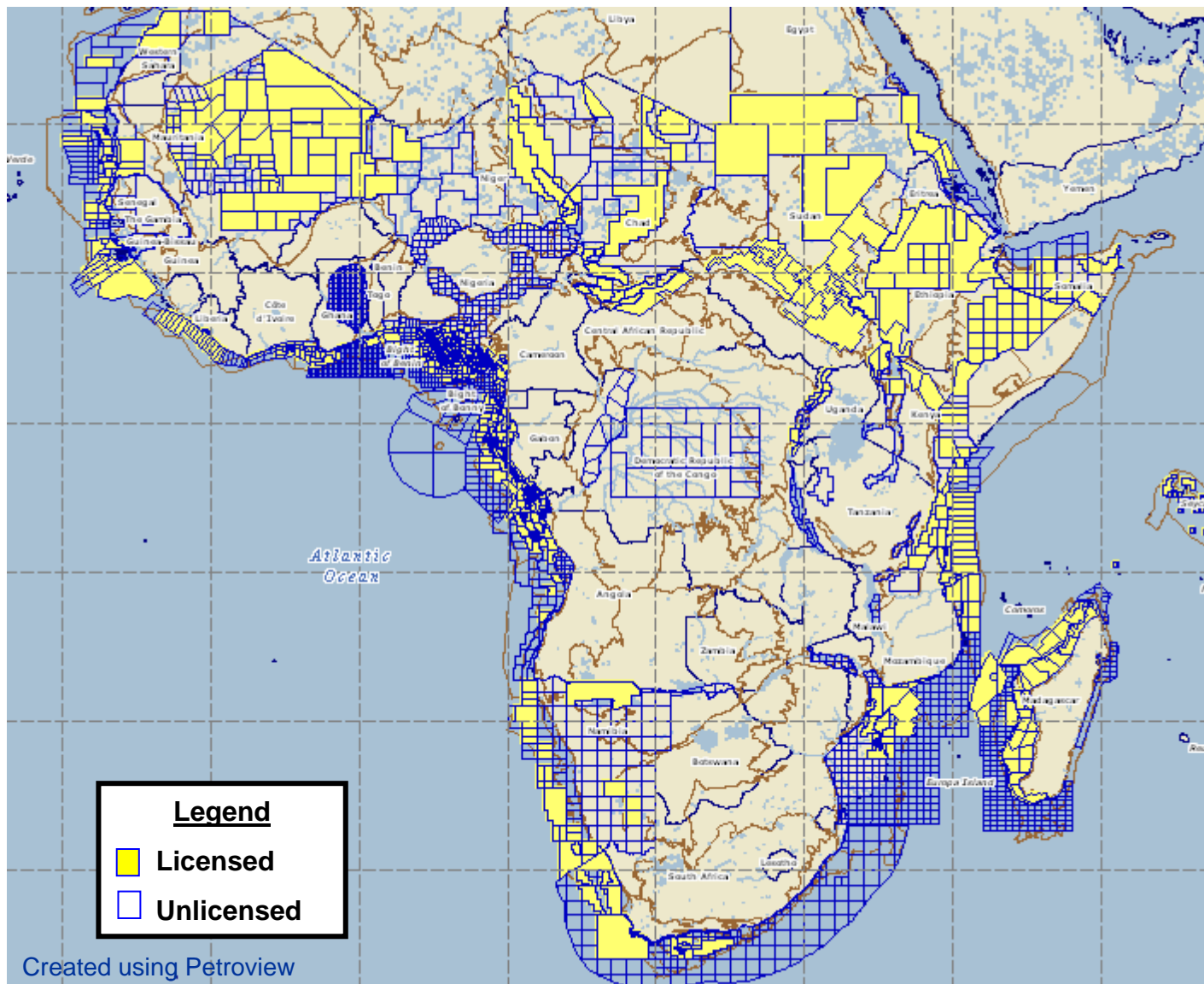
Gas, 2009



Total: 1,041 bnboe

Africa Open for Business...

- Since the 1990's, African countries have been largely open to foreign investment, particularly with regard to the deepwater offshore region.
- Almost every country with a coast has parceled off acreage for licensing.
- For several IOCs, Sub-Saharan Africa constitutes a critical portion of the global portfolio.



Company Positions in Sub-Saharan Africa

Company	% of Global Portfolio
ExxonMobil	18%
TOTAL	24%
Shell	12%
ENI	21%
Chevron	13%
BP	3%
StatoilHydro	8%
Marathon	19%
Hess	11%



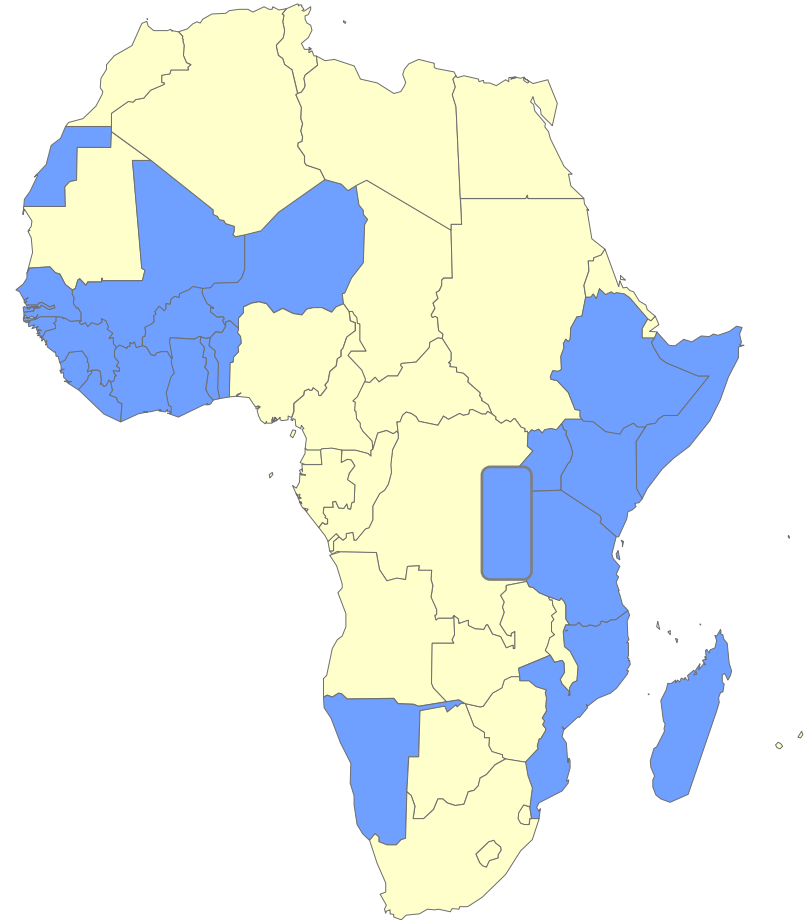
Bonga FPSO



Kizomba A TLP

- Frontier E&P is taking place along the Northwest Bend and East Africa Rift Valley.
- Companies include supermajors, such as ExxonMobil, to minnows such as Kosmos. Asian and Russian NOCs are also prominent investors.
- Likely production increases from Ghana, Mozambique and Tanzania.

Active Frontier E&P in Africa



- **Asian governments can address energy security through:**
 - 1. Increasing domestic energy production**
 - 2. Reducing consumption**
 - 3. Increasing imports from the global energy market**
 - 4. Increasing equity barrels through international investment**

Africa Plays a Role in Both Providing Exports and Equity Barrels

National Oil Company	Key Producing Assets	Africa as % of Production
CNPC (China)	Sudan, Algeria	7% total; 40% int'l
Sinopec (China)	Sudan, Algeria	3% total; 23% int'l
CNOOC (China)	Nigeria	10% total; 50% int'l
PETRONAS (Malaysia)	Sudan, Mauritania, Chad	24% total; 76% int'l
ONGC (India)	Sudan	7% total; 54% int'l

Sub-Saharan Africa will continue to be a strategic component of global energy security, but there will be challenges ahead:

- **Global Financial Crisis and Credit Crunch for Operators**
 - The current global financial crisis is impacting Sub-Saharan Africa due to lower export commodity prices and lower levels of investment globally. For the hydrocarbon sector, this is likely to result in project delays as operators and contractors face potential capital constraints.
- **Is Deepwater in a Cycle or Near a Peak?**
 - As new discovery sizes fall and companies develop their portfolio faster than they find new large fields, there is a predictable peak to the current investment and production growth cycle in the period 2010-2014; will exploration success continue?
- **Can Asia Deliver African Equity Barrels**
 - Flow of foreign investment into Africa could reverse if home governments see too few results from their NOCs. This reversal could have a large impact on the political stability of many African regimes.
- **Political Instability is Impacting Decisions**
 - Violence in the Niger Delta is now the greatest challenge to future oil and gas investments and the most likely area where supply disruptions will occur. Instability in frontier countries could impact future investment and project development plans, as well.



Strategic Advisors in Global Energy

PFC Energy consultants are present in the following locations:

- ▶ **Bahrain**
- ▶ Beijing
- ▶ Brussels
- ▶ Buenos Aires
- ▶ Calgary
- ▶ **Houston**
- ▶ **Kuala Lumpur**
- ▶ **Lausanne**
- ▶ London
- ▶ Mumbai
- ▶ New York
- ▶ **Paris**
- ▶ San Francisco
- ▶ **Washington, D.C.**

Main regional offices are shown in blue.

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New Producers and the Challenges of Transparency: The Case of Ghana

Ghana's big test: Oil's challenge to democratic development

Johns Hopkins – SAIS
African Studies Program
April 2, 2009

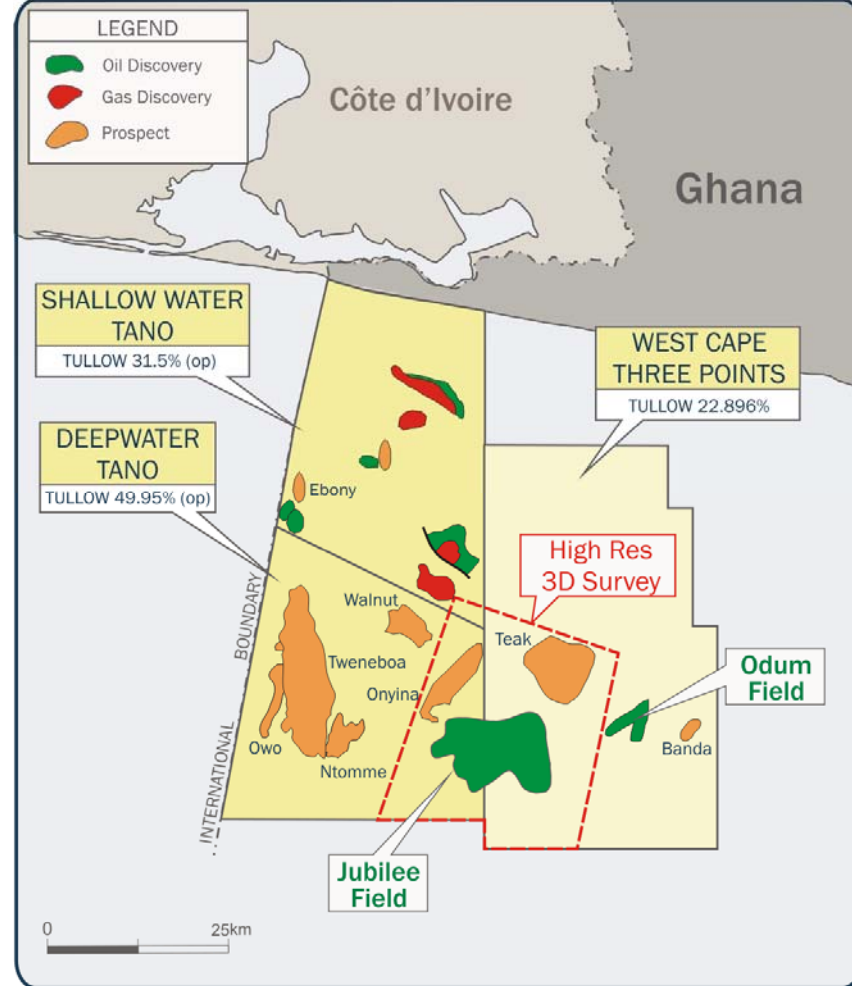


“Black Gold” – Promise and Peril

- Ghana and Uganda most important emerging producers
- Ghana widely perceived by donors as a “model country,” on track to exceed 2015 MDG target of halving poverty
- Oil could boost or undermine that progress depending on how the oil boom is managed
- Declining fiscal environment – temptations to forward sell, etc.
- With “Jubilee” find, 120,000 bpd predicted by 2011
- IMF predicts government revenues from oil and gas could reach US\$20 billion over the production period of 2012–30 for the Jubilee field alone

Jubilee Discovery

- 63 kilometers (39 miles) from the coast and 132 kilometers (83 miles) southwest of Takoradi
- Discovery estimated at between 600 million and 1.8 billion barrels
- Additional 800 billion cubic feet of gas in the field
- Recent positive results of Hyedua 2 well (possible 1 billion barrels)



Detail of Jubilee field off the coast of western Ghana.

Map: Tullow Oil

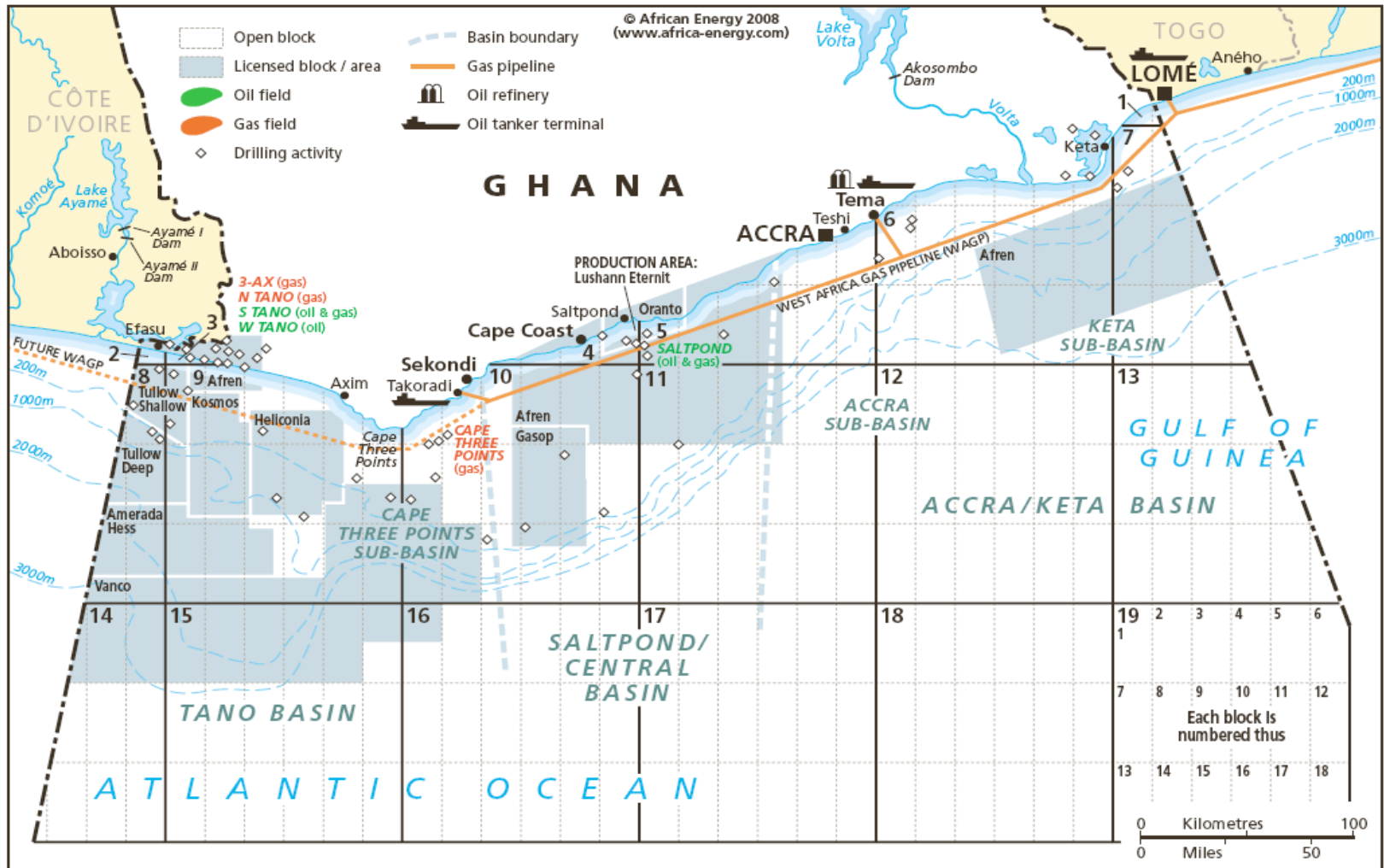
West Cape Three Points:

Kosmos 30.875 % (operator);
Anadarko 30.875%; Tullow
22.896%; GNPC 10% (carried);
E.O. Group 3.5%; Sabre Oil and
Gas Ltd. 1.854%

Deep Water Tano: Tullow

49.95% (operator);
Kosmos 18%; Anadarko
18%; GNPC 10%
(carried); Sabre 4.05%

Ghana: Hydrocarbons exploration



Map courtesy African Energy

Ghana's Preparation for Oil

- National Forum on Oil & Gas Development (Feb. 2008)
- Six technical committees established in 2008
 - Legal framework
 - Fiscal regime and fund types
 - Natural gas utilization and infrastructure development
 - Environmental management and community issues
 - Local content
 - Security issues
- Work unfinished and no draft master plan for the sector
- Limited opportunities for public input
- Draft national oil and gas policy paper (June 2008) contains important, common-sense policy principles, but little detail
- Draft petroleum regulatory authority bill (October 2008)

Petroleum Regulatory Authority Bill

- **New draft with Cabinet**
- Create an “independent” regulatory authority—the Ghana Petroleum Regulatory Authority (GPRA)
- Define GNPC as a strictly commercial entity, although the GNPC would still hold equity on behalf of the state
- Establish regulations for the upstream and midstream sectors
- Partially define the fiscal regime
- Establish disclosure and confidentiality rules for the sector



Photo: Kosmos Energy

Challenges to Managing the Money



- Weaknesses in government revenue collection identified through experiences in mining sector
 - WB 2008 – gov't lacks capacity to collect revenues and audit payments from gold mining companies
- Need for improved budget transparency (49% score in 2008 Open Budget Index)
- Absorptive capacity issues and low quality public spending, e.g. in health, education
- Need to strengthen procurement and competitive bidding, as well as auditing and oversight mechanisms
- Ghana may need oil fund, and no fund yet established – discussion of stabilization and “heritage” fund

EI Transparency

- Ghana produced EITI mining report in 2007 for mining payments from 2004, became EITI candidate country September 2007
- Civil society frustrated with EITI process
- Government reluctance to include petroleum sector in EITI process (though 2009 work plan includes oil)
- Ghana yet to approve freedom of information bill
- IFC requires payment disclosure by Kosmos/Tullow
- Feb 2009 Pres. Mills pledge to disclose all petroleum contracts



Summary Recommendations for Ghana

- Moratorium on new licenses
- Develop policy principles, master plan, and regulations in sequence and as a package
- Incorporate robust public, civil society, and parliamentary participation
- Transparency of key information – payments, licenses, contracts, audits, etc.



Conclusion – Key Messages

- Challenges posed by Ghana's oil boom are broad, deep and complex and should not be underestimated
- Oil could undermine gains made in Ghana on democratic governance and development
- Speed is important, but “haste makes waste” –
 - Ghana must control the pace of petroleum sector development so that it does not outstrip capacity of government and society to build institutions, regulations and safeguards
 - Pacing can lead to better negotiated deals over time
 - Stabilization clauses in new contracts can lock in weak regulatory regime
- Sequencing, transparency and public participation are key to developing petroleum policy, master plan, laws and regulations
- Ghana can learn from the experience in its gold mining sector as well as global good practice on managing oil booms

Conclusion – Key Messages

- Test for Obama administration – new forms of engagement with resource-rich states needed, especially frontier producers such as Ghana and Uganda
- Importance of global disclosure regulations – set the framework for new producers – not one off experiments (Chad)



Photo: Marloes Kraan