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### **The Continuous Advocacy for Modular Refineries in Nigeria: Time for all hands to be on deck - Frederick Adefarati and Portia Chigbu**

#### **Introduction**

In the face of the present economic challenges in Nigeria and the apparent global stance on oil production,<sup>2</sup> there is an urgent need to overhaul the Nigerian oil and gas sector even as it remains a major source of revenue generation for the nation. To this end, there have been various initiatives at diversifying the sources of income to redress the current economic downturn without neglecting the sector that produces the largest volume of income. In overhauling the Nigerian oil and gas sector, it is necessary to revisit the processes by which crude oil is refined and more particularly by addressing the issue of modular refineries.

#### **What is a Modular Refinery?**

Crude oil in its natural state has little practical use, but when it is refined we can end up with petrol, diesel, jet fuel, liquid petroleum gas (LPG), gas oil, heating oil and residues such as bitumen. Through refining, by-products for lubricants most importantly for petrochemicals can be obtained<sup>3</sup>, and considering the high demand for refined products, the increased agitation for more efficient modalities for refining crude oil is justified.

A modular refinery is a processing plant that has been constructed entirely on skid mounted structures. Each structure contains a portion of the entire process plant, and through interstitial piping the

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<sup>2</sup> Oil and gas remains the engine of the world economy, and the consensus view is that the demand for oil is on the rise despite negative statistical data. See: Jude Clemente, "The Steady Drumbeat of More Global Oil Demand" <https://www.forbes.com/sites/judeclemente/2017/05/29/the-steady-drumbeat-of-more-global-oil-demand/#c3dc9275e2d7> (accessed on 7<sup>th</sup> September 2017)

<sup>3</sup> <https://asokoinsight.com/news/modular-refineries-are-economic-wastes-nigeria> (accessed on 25 August 2017).

components link together to form an easily manageable process.<sup>4</sup> It is manufactured in controlled conditions, fully assembled and tested prior to overseas shipment, and installed at a client's site in much less time than a traditional refinery.<sup>5</sup> Constructing a modular refinery in Nigeria requires a design capacity not exceeding thirty thousand barrels per day (30,000BPD). If the plant capacity exceeds 30,000BPD, the plant must be upgraded to a full conventional refinery.<sup>6</sup>

Despite the reasons advanced in support of the establishment of modular refineries in Nigeria, it must be emphasized that it cannot take the place of traditional refineries. Modular refineries can only supplement the conventional refineries and in Nigeria with its peculiarities of low maintenance culture, relative insecurity and the dearth of funds, it will do the country great good to focus its attention in this direction whilst sorting out the never-ending challenges of managing regular refineries.

### **The Legal and Regulatory Framework for Establishing Modular Refineries in Nigeria**

The process for establishing a petroleum refinery in Nigeria is regulated by the Department of Petroleum Resources (DPR)<sup>7</sup> through Policies and Regulations made by the Ministry of Petroleum Resources.<sup>8</sup> The regulatory procedure is laid out in compliance with Regulations (2) and (3) of the Petroleum Refining Regulations<sup>9</sup> made under Section 9 of the Petroleum Act.<sup>10</sup>

An application for licence to construct or operate a refinery is made to the Minister of Petroleum Resources. The Applicant is required to accompany the application with not less than three copies of a detailed study of the project and the prescribed fees under the regulation which is non-refundable.<sup>11</sup> The Minister in the exercise of his discretion may grant the application if the Applicant has complied with the prescribed terms and conditions listed in the regulations.<sup>12</sup> An applicant who intends to modify or enlarge an existing refinery with a view to increasing the capacity of the refinery must submit an application to the Minister. The application will be considered after the non-refundable prescribed fee is paid. The approval of the Minister must be in writing.<sup>13</sup> For example, if the Applicant intends to enlarge the plant capacity beyond 30,000BPD, the plant shall be upgraded from a modular refinery to a full conventional refinery; otherwise the Minister may refuse the application.<sup>14</sup>

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<sup>4</sup> Ikenna Ifedobi "Benefits of Modular Refining in Emerging Economies;" available at [www.guardian.ng/opinions](http://www.guardian.ng/opinions), accessed on 29<sup>th</sup> July 2017.

<sup>5</sup> Sonny Atumah; October 17, 2017; [www.vanguardngr.com](http://www.vanguardngr.com) (accessed on 4<sup>th</sup> August 2017).

<sup>6</sup> See "General requirements and guidance information for the establishment of modular refineries in Nigeria" as published on May 2017 by the Federal Ministry of Petroleum Resources, available at: <http://www.publicnow.com/view/7FAD7CDDCB3411F3EDBD0487266D3A116BD6C096?2017-07-03-16:30:25+01:00-xxx2146>, accessed 7<sup>th</sup> September 2017.

<sup>7</sup> Guidelines for the Establishment of Hydrocarbon Processing Plants (Petroleum Refinery & Petrochemicals) in Nigeria, 2007 published by the Department of Petroleum Resources. available at: <https://dpr.gov.ng/index/wp-content/uploads/2013/09/GUIDELINES-REFINERY-AND-HYDROCARBON-PROCESSING-PLANTS.pdf>, accessed 7, September 2017.

<sup>8</sup> Pursuant to Section 47 of the Petroleum Refining Regulations, Laws of the Federation of Nigeria, No. 45 of 1974, the Director of Petroleum Resources, Ministry of Petroleum Resources is empowered to give directions as to the manner of compliance with any matter provided under the Regulation.

<sup>9</sup> Petroleum Refining Regulations Laws of Nigeria 45 of 1974 Cap P10 LFN 2004.

<sup>10</sup> Petroleum Act of 1969 Cap P10 LFN 2004.

<sup>11</sup> Section 1 of the Petroleum Refining Regulations.

<sup>12</sup> Section 2 of the Petroleum Refining Regulations.

<sup>13</sup> Section 3 of the Petroleum Refining Regulations.

<sup>14</sup> See "General requirements and guidance information for the establishment of modular refineries in Nigeria" as published on May 2017 by the Federal Ministry of Petroleum Resources.

In May 2017, the Federal Ministry of Petroleum Resources released the general requirements and guidelines for the establishment of modular refineries in Nigeria. The objectives of the guideline are:

1. To promote availability of petroleum products in the country.
2. To conserve foreign exchange utilization for the importation of Petroleum Products.
3. To promote socio-economic development in order to stop restiveness, criminal and illegal refinery activities, thereby sustaining peaceful coexistence in the Niger Delta Region.
4. To mitigate and eliminate environmental degradation associated with illegal refinery activities, crude oil theft and pipelines vandalism in the country.

These objectives are laudable and achievable with sincerity of purpose and special attention from the government. The general criteria for a company to operate a modular refinery are provided for under Article 9 as follows:

- (a) Institutional Framework – Company and Organizational Structure: For Nigerian companies/entities, there must be evidence of registration with the Corporate Affairs Commission.<sup>15</sup> In the case of foreign companies, it must be referenced by Home Country’s supervisory agency. For consortium partnerships, foreign and local companies, they must meet standard criteria and present legal documents evidencing the partnership, certified true copies of Memorandum and Articles of Association, evidence of joint venture/partnership agreement, company profile and other relevant documents.
- (b) Financial Status: The Company must show an Audited Account for a three year period, financial report and Tax Certificates for Nigerian companies and similar documentation for foreign companies, paid up share capital, investment type, detailed financial plan with proof and source of funding, sworn affidavit and letter of authority allowing verification of all claims.
- (c) Community Affairs, Safety, Health, Environment and Security (CASHES): It is further required that the company shows its Health, Safety and Environment (HSE) Plans, quality management systems, security plans, management of Change Procedure, community affairs and corporate social responsibility plans.
- (d) Nigerian Content: The Applicant Company is required to maximize the utilization of local human and material resources in line with local content requirements.

There is a mandatory three phase licensing process which the Applicant for a license to operate a modular refinery is expected to comply with, namely:

- i. License to Establish (LTE);
- ii. Authority to Construct (ATC); and
- iii. License to Operate (LTO)<sup>16</sup>

A License to Operate (LTO) a petroleum refinery, petrochemicals or gas processing plant, is valid for a period of two (2) years. We consider this period insufficient to make good returns on investment. This is discouraging to both local and international investors who would require longer time to recoup on investments. It is therefore advocated that a longer term would be more productive for business, in

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<sup>15</sup> The CAC is saddled with the statutory responsibility for the incorporation and regulation of companies in Nigeria, pursuant to the Companies and Allied Matters Act Cap C20 LFN 2004.

<sup>16</sup> Article 8 of the general requirements for the establishment of modular refinery.

addition to providing an investment-friendly structure and an enabling environment to support investments in modular refineries. This would go a long way in encouraging banks and other institutions to provide needed funding for such projects.

Under Article 7 of the general requirements for the establishment of modular refineries, the prospective categories of investors are expected from the private sector, public-private partnership with credible participation from relevant stakeholders like foreign technical partners, State Governments, cooperative societies, community equity contributions amongst others and regional refinery stakeholders involved in artisanal activities.

### **Tax Incentives**

As part of the requirements of the law, establishment of modular refineries (being midstream oil and gas processing facilities) are entitled to certain incentives. These are as enumerated under Section 39 of the Companies Income Tax Act (CITA)<sup>17</sup> and adopted under Article 13 of the general requirements for the establishment of modular refineries. Both provisions exempt newly set up companies from paying certain taxes especially during their early years of formation to ensure their profitability. The relevant provisions of the CITA provides as follows:

*(i) A company engaged in gas utilization (downstream operations) shall be granted the following incentives:*

*(a) an initial tax free period of three years which may, subject to the satisfactory performance of the business, be renewed for an additional period of two years;*

*(b) as an alternative to the initial tax free period granted under paragraph (a) of this subsection, an additional investment allowance of 35 per cent which shall not reduce the value of the asset, so however that a company which claims the incentive provided under this paragraph shall not also claim the incentive provided under paragraph (b) (ii) of this subsection;*

*(c) accelerated capital allowances after the tax free period, as follows, this is-*

*(i) an annual allowance of 90 per cent with 10 per cent retention, for investment in plant and machinery,*

*(ii) an additional investment allowance of 15 per cent which shall not reduce the value of the asset;*

*(d) tax free dividend during the tax free period, where-*

*(i) the investment for the business was in foreign currency, or*

*(ii) the introduction of imported plant and machinery during the period was not less than 30 per cent of the equity share capital of the company;*

*(e) interest payable on any loan obtained with the prior approval of Minister for a gas project, shall be deductible.*

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<sup>17</sup> Companies Income Tax Act Cap. 21 LFN 2004.

*(2) The tax free period of a company shall start on the day the company commences production as certified by the Ministry of Petroleum Resources*

Although the incentives provided are indeed commendable and should inspire investors, nevertheless, the Federal Government is encouraged to do more in view of the sensitive nature of this sector which requires peculiar attention.

### **Government Intervention**

The DPR has also recently announced that the Federal Government of Nigeria has decided to issue twenty-three (23) licenses for investors seeking to establish modular refineries in Nigeria in order to increase local refining capacity, viable deliveries and decrease the importation of petroleum products into the country. There is therefore the need to ensure that the appropriate conditions as enumerated above are in place to ensure the viability of these projects.

Currently, 56 Companies have been approved by the Federal Government of Nigeria for the setting up of modular refineries in the Niger Delta area, designed to end illegal refining activities and youths agitation in the region.<sup>18</sup> It is recommended that while approving these licenses, more consideration should be given to youths from the restive zones if they have satisfied the requirements for obtaining the license. This may help prevent or at least ameliorate incidences of sabotage in the region.

In a bid to take part in the federal government modular refinery initiative, the United States has introduced plans for the construction of modular refineries. The United States Trade and Development Agency (USTDA) has approved a grant of 1 Million (USD) for the detailed engineering design of a 20,000 barrel per day (bpd) modular refinery in Lagos.<sup>19</sup> We expect that this step taken by the US government would encourage more investors to key into investment opportunities in the modular refineries project in different locations of the country.

Further, the Federal Government on 25<sup>th</sup> August, 2017 has announced its initiation of plans to achieve 100 per cent local fabrication of modular refineries by entering into discussions with select Original Equipment Manufacturers (OEM). A deadline for the local fabrication of oil vessels and Floating, Production, Storage and Offloading vessels (FPSO) is to be set. On the other hand, the Bank of Industry (BoI) has stated that the newly earmarked \$200 million intervention fund could be used for the financing of the contract and loan refinancing for oil companies. The BoI added that it would, through the fund, take over the loans of the oil companies in commercial banks and reduce interest rates on such loans.

### **Conclusion**

In conclusion, the steps taken by the federal government towards establishing modular refineries in Nigeria is a great one as this would lead to an increase in the local refining capacity, initiate viable deliveries and decrease importation of petroleum products into the country.

Both local and international investors should see this as a potential area to invest in. If the government continues to give practical attention to its resolve to utilise modular refineries as one of the ways of

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<sup>18</sup> Rosemary Nwisi: "Modular refinery: FG approves 56 licenses to operators" Published in The Nation Newspaper of 22nd May 2017.

<sup>19</sup> Guardian Newspaper 13<sup>th</sup> August 2017 [www.guardian.ng/business-services/](http://www.guardian.ng/business-services/).

improving the production of refining crude oil in Nigeria, it will boost the confidence of investors and potential creditors in the oil and gas sector. Financial institutions would be more willing to approve funds if there is a viable business plan indicating how the money would be recovered. In the absence of this, there would be skepticism from financial institutions, making it ultimately impossible for those with operating licenses to build modular refineries to take off on these projects.<sup>20</sup>

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<sup>20</sup> Experts under the umbrella of Association of Energy Correspondents of Nigeria (NAEC) have likewise urged the Federal Government to engage banks in financing modular refineries. The major reasons why most investors in modular refineries have abandoned it has been attributed to lack of finance. See <https://www.vanguardngr.com/2017/08/experts-urge-fg-engage-banks-financing-modular-refineries/> (accessed 7<sup>th</sup> September 2017).