

Case Review:

Esso Petroleum and Production Nigeria Limited & SNEPCO v. NNPC¹

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The Nigerian Court of Appeal confirms that an Arbitral Tribunal has no Jurisdiction to determine contractual disputes, the resolution of which has tax implications for any of the parties.

Introduction

On 22 July 2016, the Nigerian Court of Appeal confirmed in part the decision of the Federal High Court Abuja delivered on 22 May 2012 in Suit No. FHC/ABJ/CS/923/2011. The lower court had set aside an arbitral award made in favour of the appellants on the ground that by issuing an award in a dispute that was “a tax matter” the arbitrators had misconducted themselves and acted without jurisdiction as the dispute was not arbitrable.

The appellate court specifically held that in essence, the appellants' complaints at the arbitral tribunal was that the respondent acted contrary to the terms of a Production Sharing Contract [PSC] between them when it over lifted available crude oil in respect of royalty oil and tax oil to the tune of US\$1,584,500,000:00. The over lifting was based on unauthorized Petroleum Profit Tax [PPT] returns which the Respondent had filed with the Federal Inland Revenue Service [FIRS], again contrary to the terms of the PSC.

The appellate court held that a contractual dispute under a Production Sharing Contract which resulted in the over lifting of available crude oil to satisfy royalty and tax obligations under the Petroleum Profit Tax Act [PPTA] was in essence a tax dispute and was therefore not arbitrable.

It found however that disputes as to the contractual right to prepare petroleum profits tax returns and to determine the allocation of oil lifting between the national oil company and the Contractor in the Production Sharing Contract were contractual claims and upheld the arbitration award in that respect.

Background Facts

ESSO Exploration and Production Nigeria Limited and SNEPCO (the Contractors) and the Nigerian National Petroleum Corporation (the Corporation) are partners to a Production Sharing Contract [PSC] aimed at conducting petroleum operations in the contract area.

Under the PSC, the Contractors bear the full cost of operations, prepare the petroleum profits tax returns on behalf of the PSC parties and determine the lifting allocation of available crude oil between the parties. The Corporation is required to file the petroleum profits tax (PPT) returns prepared by the Contractors with the Federal Inland Revenue Service (FIRS), and lift the amount of available crude oil in accordance with the lifting allocation prepared by the Contractors.

The Corporation however unilaterally lifted more cargoes of crude oil than it was entitled to lift under the lifting allocation prepared by the Contractors; and allegedly altered the PPT returns prepared by the Contractors, or unilaterally prepared its own PPT returns and submitted them to the FIRS on behalf of the contract area.

¹ Appeal No. CA/A/507/2012

Aggrieved by the Corporation's alleged breach of the contractual agreement between them, the Contractors commenced arbitration against the Corporation in accordance with the arbitration agreement set out in the PSC. The Contractors sought declarations for breach of contract and in particular, that the volume of crude oil lifted by the Corporation is in excess of what it was entitled to and so wrongful; and an order that the Corporation lifts future Crude Oil only in accordance with the Contractors' Lifting Allocation schedules. The Contractors also required the arbitral tribunal to declare that the Corporation cannot under the PSC submit its own unilateral PPT returns or alter tax returns prepared by the Contractors. The Contractors additionally sought orders refunding to them the value of the over lifted crude oil and restraining the Corporation from making or purporting to make tax payments that are inconsistent with tax returns prepared by the Contractors.

The arbitral tribunal delivered its award on 24 October 2010 in favour of the Contractors. The Corporation then applied to the High Court to set aside the arbitral award on the ground that the arbitral tribunal acted without jurisdiction. The basis of the Corporation's application was that the dispute referred to arbitration was a tax dispute which is not arbitrable under Nigeria's Arbitration and Conciliation Act.

The High Court agreed with the Corporation and in 2012 set aside the arbitral award, whereupon the Contractors appealed the decision of the High Court to the Court of Appeal.

Contractors' Submission

On the issue of arbitrability, the Contractors as Appellants argued that the arbitral tribunal had jurisdiction to entertain the dispute because it was a contractual dispute and not a tax dispute. They emphasized that the dispute arose out of the Contractors' right to determine Crude Oil lifting allocation and entitlement under the PSC; the preparation of PPT returns; and the stabilization claim, which are all contractual issues; and which the Corporation was alleged to have breached, by lifting more cargoes of available crude oil than it was entitled to under the allocation prepared by the Contractors, and presenting to the FIRS PPT returns different from the ones prepared by the Contractors.

Corporation's Submission

The Corporation submitted that the dispute the Contractors referred to arbitration was a tax dispute which is not arbitrable by virtue of section 35 of Nigeria's Arbitration and Conciliation Act. The Corporation's position was that resolving the dispute entailed the computation and quantum of tax obligations of the parties under Nigeria's Petroleum Profits Tax Act [the PPTA]; that the alleged alteration of the Petroleum Profit Tax returns will affect the obligations and liability of the Contractors under the tax laws and which will eventually determine the allocation of profit oil and cost oil to them.

The Court of Appeal's Decision

The Court of Appeal observed that all the parties conceded that tax matters are not arbitrable in view of section 35 of Nigeria's Arbitration and Conciliation Act, Cap A18, Laws of the Federation of Nigeria 2004 which provides that the Act "...shall not affect any other law by virtue of which certain disputes – (a) may not be submitted to arbitrations; (b) may be submitted to arbitration only in accordance with the provision of that or another law", and that the court may set aside an arbitral award if the court finds that the subject matter of the dispute is not capable of settlement by arbitration under the laws of Nigeria or that the recognition or enforcement of the award is against public policy of Nigeria.

The Court of Appeal also reasoned that by section 251 of the Constitution of the Federal Republic of Nigeria, 1999, it is the Federal High Court that has exclusive jurisdiction over tax disputes, (but after exhaustion of remedies with the Tax Appeal Tribunal). In essence, tax disputes are excluded from arbitration.

In determining whether the dispute presented to the arbitral tribunal was a contractual or a tax dispute, noting that “a tax dispute is a conflict or controversy relating to tax especially one which has given rise to a legal process as set out in the relevant law/s of the land.”, the Court of Appeal reviewed the Contractors’ claim within this prism. It held that the dispute between the parties was a tax dispute, since a communal reading of the claim before the arbitral tribunal disclosed the Contractors’ complaint as the Corporation’s over-lifting of available crude oil in respect of royalty oil and tax oil contrary to the agreement, which was based on the unauthorized PPT returns the Corporation filed with the Federal Internal Revenue Service [FIRS]. On this basis the Contractors’ sought a refund from the Corporation of the sum paid by it to the FIRS on this basis. The court concluded that since the dispute between the parties was as to the eventual amount of PPT payable, the dispute was a tax dispute in the garb of a commercial dispute, which the arbitral tribunal lacked jurisdiction to entertain.

The Court of Appeal however declared that the aspect of the claim before the arbitral tribunal relating to preparation of the PPT returns and calculation of lifting allocations can be severed from tax dispute. It consequently affirmed the decision of the High Court which held that tax disputes are not arbitrable, but ordered a restoration of the final award of the arbitral tribunal in respect of preparation of PPT returns and calculation of lifting allocation, which were initially decided in favour of the Contractors by the arbitral tribunal but set aside by the High Court.

Our Thoughts

While the dispute was between the parties to the PSC, the appellate court found that non-compliance with some of the contractual terms had a consequential effect on tax liability of the parties.

This decision especially highlights the anomalous nature of Production Sharing Contracts in Nigeria, as the contracts often contain fiscal regimes in clauses that either replicate aspects of tax legislation, reference tax legislation, or which directly impact upon tax assessment issues. If the decision is not set aside upon a further appeal, it then means that companies cannot validly submit contractual disputes to arbitration where the eventual outcome will impact upon tax obligations.

In view of its decision dismissing the appeal and upholding the lack of jurisdiction of the arbitral tribunal on the ground that the dispute has tax implications, the scope and effectiveness of an arbitration clause in Nigerian PSCs is currently unclear as a claim before a court may be met with an objection based on the existence of an arbitration clause. Meanwhile, and with all due respect to the Court of Appeal, its restoration of the award with respect to the declarations confirming the Contractors’ contractual right to prepare PPT returns and calculate of lifting allocation is a pyrrhic victory for the Contractor parties, as any breaches which will result in overlifting of crude oil Appeal has been held to be a ‘tax’ dispute and non arbitrable.