

CASE REVIEW: ESSO PETROLEUM AND PRODUCTION NIGERIA LIMITED & SNEPCO V. FIRS & NNPC

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INTRODUCTION

The Nigerian Court of Appeal in *Esso Petroleum and Production Nigeria Limited & Shell Nigeria Exploration and Production Company Limited v. Federal Inland Revenue Service & Nigerian National Petroleum Corporation* [Esso v. FIRS] deviates from its previous position that disputes arising out of Production Sharing Contracts having tax implications, are tax disputes which are not subject to arbitration.

On 10th March 2017, the Court of Appeal took a different view from its previous position in *Esso Exploration and Production Nig. Ltd & Anor v. NNPC*, [Esso v. NNPC] and in *Shell Nigeria Exploration and Production & Ors. v. FIRS & Anor.*, [SNEPCO v. FIRS] in holding that disputes arising out of the rights and obligation of parties to prepare Petroleum Profit Tax returns and determined the volume of Tax Oil to be allocated in accordance with a Production Sharing Contract, was essentially a contractual dispute and not a tax dispute, therefore the arbitral tribunal has jurisdiction to determine the dispute.

The Court had in the earlier cases cited above, interpreted such disputes to be tax disputes and declared that they are incapable of being arbitrated upon, thus nullifying arbitral awards determining the claims.

Facts

Esso Exploration and Production Limited, Shell Exploration and Production Limited (“the Contractors”) and Nigeria National Petroleum Corporation (“the Corporation”) entered into a Production Sharing Contract (PSC) aimed at the exploration of oil from the OML 133 contract area.

The PSC contained provisions on how oil produced from the contract area was to be allocated between the parties. By virtue of the PSC, Cost Oil was to be lifted by the Contractors, Royalty oil and Tax oil to be lifted by the Corporation, and Profit Oil was to be lifted by both the Contractors and the Corporation in accordance with the lifting allocation prepared by the Contractors. Under the PSC, the Contractor has

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the right to prepare the Petroleum Profit Tax (PPT) returns and deliver it to the Corporation, whose responsibility is to submit the returns as prepared by the Contractor to the Federal Inland Revenue Service (FIRS).

The Contractors initiated arbitration against the Corporation on the basis that the Corporation was lifting more tranches of oil (including Tax oil) than it was entitled to lift under the lifting allocation prepared by the Contractors, and that the Corporation had unilaterally prepared and submitted PPT returns to the FIRS in breach of the PSC. It therefore sought declaratory orders to the effect that the Corporation was in breach of the PSC by wrongfully over lifting crude oil, that the Corporation ceases further wrongful over-lifting and only lift cargoes of oil in accordance with the **Contractor's lifting allocation, that the Corporation** refunds the over lifted crude oil and that the Corporation ceases further submission to the FIRS, tax returns which are inconsistent with those prepared by the Contractors.

The FIRS filed an action at the Federal High Court, challenging the jurisdiction of the arbitral tribunal to hear and determine the subject matter of the dispute on the basis that the matters were direct tax matters or matters relating to tax, which were within the exclusive jurisdiction of the Federal High court.³ It sought declarations that a determination of the award by the tribunal would impinge on its obligation to access and collect tax and an order excluding the taxation related matters from the ambit of the arbitration agreement, amongst others.

The Contractors filed a Notice of Preliminary objection on the basis that the court lacked jurisdiction to entertain the suit by virtue of Section 34 of the Arbitration and Conciliation Act CAP A18 LFN 2004, and that the FIRS had no locus standi, as it was neither a party to the PSC nor a party to the arbitration agreement.

The Federal High Court, on 9th March 2012 delivered its ruling in favour of FIRS, holding that the subject matter of the arbitration was related to tax and therefore was not subject to the jurisdiction of the arbitrator. The Contractors appealed to the Court of Appeal.

Contractors' Submission

The Contractors contended that the claim before the arbitral tribunal was not a tax matter but purely a contractual matter, which is, how oil produced from the contract area was to be shared between the Contractors and the Corporation, as agreed under the PSC. The counsel representing the Contractors further submitted that the contractual dispute stems from **the Corporation's breach** of the PSC, by lifting more cargoes of oil than it was entitled to lift under the lifting allocation prepared by the Contractors which was as a result of **the Corporation's** unilateral filing of PPT returns inconsistent with those prepared by the Contractors.

FIRS Submission

³ The FIRS application is pursuant to section 251 of the Constitution of the Federal Republic of Nigeria, 1999

The FIRS, as the 1st Respondent, submitted that the main grouse of the Contractors was their tax liability which was wrongly assessed by the FIRS due to the **Corporation's** unilateral computation of tax returns and its lifting of oil required for that purpose. It further contended that the filing of PPT returns is a tax matter and that such matters were not arbitrable by virtue of section 3(g) of the Petroleum Profit Tax Act (PPTA).⁴

Corporation's Submission

The contention of the Corporation was that the matters referred by the parties to arbitration are direct tax matters or matters relating to taxation, particularly the filing of PPT returns. It submitted that the **Contractors'** claim before the arbitral tribunal was basically that they had been over taxed with regards to Tax oil and Royalty oil, which necessarily fall under section 3(g) of the PPTA, and as such, this dispute was not arbitrable. It further contended that granting the **Contractors'** reliefs would amount to hampering **the Corporation's** contractual and statutory duty to file accurate PPT returns.

The Court of Appeal's Decision

The Court, in reaching a decision, examined the Notice of Arbitration and the Statement of Claim before the arbitral tribunal. It came to the conclusion that the dispute amongst parties was as regards who had what rights and obligations under the contract (i.e. the PSC) and as such, the dispute was clearly a contractual dispute. The court noted that the substance of the complaint is that the Corporation violated the contractual provisions for the preparation of the PPT returns. It noted that the preparation of PPT returns and the determination of Tax oil that should be allocated would be with regards to the PPTA, the Deep Offshore and Inland Basin Production Sharing Contracts Act and other relevant tax legislations. The fact that the parties guide themselves by the provisions of the said tax legislations in determining the lifting allocation of Tax oil or in making PPT returns does not render the basic contractual dispute on the obligation not to lift beyond the prescribed allocation of any tranche of crude oil (including Tax oil) and the right to prepare PPT returns, a tax dispute.

The court refused to be bound by its earlier decisions in *Esso v. NNPC* and in *SNEPCO v. FIRS*, where it held on the basis of claims similar in substance to the present case, that the disputes were “**centrally and effectively tax matters**”, stating that the earlier decisions on the arbitrability of the issues from the PSCs were reached *per incuriam*. The court had also held in *Esso v. NNPC* that the dispute that was submitted to the arbitral tribunal was in essence a tax dispute in the garb of a commercial dispute.

⁴ Section 3(g) of the PPTA provides that “*subject to the provision of [the PPTA], every claim, objection, appeal, representation or the like made by any person under any provision of [the PPTA] or subsidiary legislation made under the PPTA shall be made in accordance with such Act and legislation.*”

The court however held that although the primary dispute was contractual, some of the reliefs sought by the Contractors before the tribunal were birthed from issues which were in substance, tax disputes and therefore out of the jurisdiction of the arbitral tribunal. It stated that the relief seeking an order of the tribunal that the Corporation ceases from making tax returns inconsistent with the PPT returns prepared by the Contractor, takes away the discretionary power of the FIRS to **accept returns filed with it and assess a tax payer's tax liability vested in it** by sections 35, 36, 37 and 43(1) of the PPT Act. It also defeats the operation of sections 52 and 53 of the PPT Act which makes the filing of inaccurate PPT returns an offence. It also noted that the award of damages and interest to cover the value of the crude oil over-lift amounted to ordering the Corporation to refund the Contractors part of the over-lifted Tax oil that was used to pay PPT to the FIRS on their behalf and such an award disregards the provision of section 23 (1) and (2) of the Federal Inland Revenue Service (Establishment) Act No. 57 of 2007 which vests the authority to decide on who is eligible for a tax refund, the extent of tax refund that can be made and the basis for it, on the FIRS.

The court agreed with the decision of the courts in *Esso v. NNPC* and *SNEPCO v. FIRS*, that some of the reliefs claimed for (which were exactly similar to the three reliefs singled out in the present case) raised tax issues and as such, were not arbitrable. It declared the awards on the three issues a nullity. The court however set aside the decision of the trial court to the extent that it nullified the entire agreement, but it upheld the decision nullifying the award on the claims which the court had identified as tax matters.

Our Thoughts

In an earlier review of *Esso v. NNPC*, **we noted that** “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”.⁵ The **Court of Appeal's** decision in the present case now offers a glimmer of hope for arbitration clauses in Nigerian PSCs which typically have tax implications due to provisions on the allocation of various tranches of oil, including Tax oil.

Unlike the decisions in *Esso v. NNPC* and *SNEPCO v. FIRS*, where the awards were nullified on the ground that the disputes submitted for determination were tax disputes which were within the exclusive jurisdiction of the Federal High Court, the court took a different view in holding that despite the fact that the dispute before the arbitral tribunal touched on the tax obligations of parties (i.e. who is to file PPT returns and what allocation of Tax oil a party is entitled to), the primary grouse before the tribunal was the breach of the rights and obligations arising out

⁵[http://www.aelix.com/media/Esso/Esso/Esso%20Petroleum%20and%20Production%20Nigeria%20Limited%20%20SNEPCO%20v%20%20NNPC%20-%20Case%20Review\(1\).pdf](http://www.aelix.com/media/Esso/Esso/Esso%20Petroleum%20and%20Production%20Nigeria%20Limited%20%20SNEPCO%20v%20%20NNPC%20-%20Case%20Review(1).pdf);
<https://www.lexology.com/library/detail.aspx?g=737969b0-58f9-4b7c-ad37-e4fbad77acdc>

of contract and therefore the dispute was not entirely a tax dispute but a contractual dispute.

The implication of this decision is that an arbitral tribunal will have jurisdiction to hear and determine disputes arising out of PSCs regardless of the fact that such dispute may relate to the tax obligations of parties. However, any relief claimed before the tribunal arising out of matters which would necessarily impinge on statutory duties or jurisdiction, must be excluded from the submission to arbitration, as the court will not hesitate to pronounce such issues as tax disputes and as such, not arbitrable.