Client Update

UNO Reverse? Presidential Order Establishes Cost-Efficiency Incentives Framework for Upstream Petroleum Operations

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Background

The Federal Government has introduced a new fiscal strategy in the form of the Upstream Petroleum (Cost Efficiency Incentives) Order, 2025 (**the "CEI Order"**). This Order creates a performance-based tax credit regime for upstream petroleum operators who achieve cost savings below government-set benchmarks.

In effect, the CEI Order flips the traditional approach to upstream taxation. Rather than companies "maximizing" or inflating their operating costs to avoid or reduce tax liability, the government is now encouraging operators to reduce expenditure to earn a tax credit.

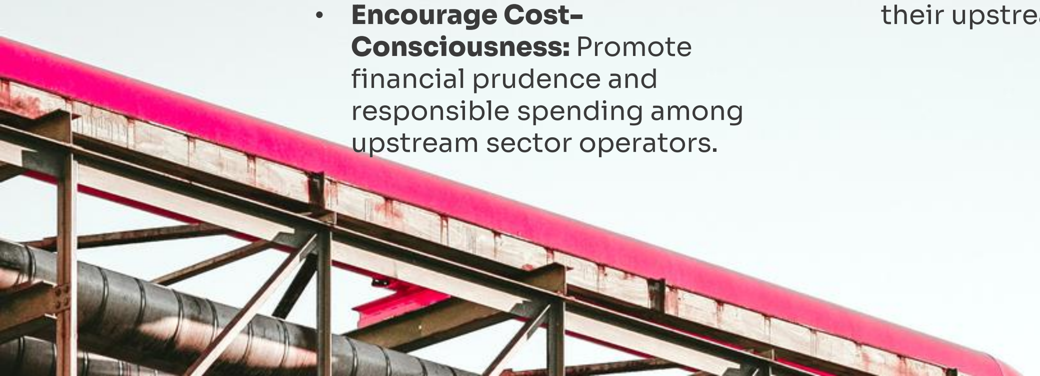
It is a pragmatic uno reversal strategy which rewards cost efficiency.

Issued on 30th April 2025 by President Bola Ahmed Tinubu, the CEI Order aims to align Nigeria's upstream cost structure with global standards by incentivising operators to deliver measurable reductions in their Unit Operating Costs (UOC). The incentive takes the form of a tax credit, calculated based on the value of cost savings achieved relative to the benchmark set by the Nigerian Upstream Petroleum Regulatory Commission (the "Commission").

Objectives

The Order seeks to promote fiscal discipline, enhance competitiveness, and maximize economic returns by implementing targeted measures that encourage cost reduction, improve project execution, and incentivize sustainable practices. Accordingly, the objectives include:

- **Reduce Overall Operating Costs:** Lower the cost of upstream petroleum operations through targeted cost reduction measures, practical strategies, and achievable cost efficiency benchmarks.
- **Encourage Cost-Consciousness:** Promote financial prudence and responsible spending among upstream sector operators.
- **Streamline Project Execution:** Improve operational performance by simplifying and accelerating project execution timelines and contract management cycles.
- **Maximize Economic Value:** Increase the economic benefits derived from Nigeria's petroleum resources by incentivizing cost-effective practices.
- **Provide Tax Credit Incentives:** Offer targeted tax credits to companies demonstrating measurable cost reductions in their upstream operations.



Application

This Order applies to all lessees, licensees, and contractors engaged in upstream petroleum operations under licenses or leases issued by the Commission.

The cost efficiency incentives outlined herein are accessible exclusively to lessees, licensees, and their contractors who meet or exceed cost reduction targets as verified by the Commission.

Key Highlights of the Order

1. Cost Benchmarking and Assessment Process

The Commission is tasked with administering the benchmarking framework for assessing and promoting cost efficiency in upstream petroleum operations. Its obligations include:

- Conducting an annual industry-wide cost benchmarking exercise, which determines the appropriate Unit Operating Costs (UOC) for each terrain, onshore, shallow water, and deep offshore;
- Establishing Target Operating Costs (TOC) based on transparent methodologies that reflect international best practices, while considering terrain-specific challenges and production volumes;
- Publishing the benchmarking methodology and cost matrix prior to implementation, following stakeholder consultation;
- Assigning terrain-specific cost reduction targets annually;
- Performing annual UOC compliance reviews, within the tax return cycle, to determine operator eligibility for CEI claims.

For each reporting cycle, the Commission will reconcile production volumes and lifting figures to avoid distortions resulting from under-lift or over-lift scenarios.[1] The UOC metric is the primary evaluation tool for CEI eligibility, and it means the cost incurred for the day-to-day functioning of upstream petroleum operations expressed on a per unit basis, excluding capital expenditures related to the development of new fields or large infrastructure investments.

2. Calculation of Incentives

Companies that achieve actual operating costs (AOC) below the TOC for the relevant terrain will be eligible for a tax credit calculated as follows:

$$CEI = (TOC - AOC) \times V \times RTR \times 50\%$$

Where:

- TOC = Target Operating Cost per unit, as set by NUPRC;
- AOC = Actual Operating Cost per unit, based on verified operator data;
- V = Volume of fiscalised hydrocarbon sales (i.e., the total volume sold at fiscal measurement points);

1 Under-lift and over-lift scenarios refer to imbalances that occur in joint venture crude oil production arrangements, where one party lifts (i.e., takes delivery of) less than its entitled share of crude (under-lift) or more than its entitled share (over-lift). These discrepancies typically arise due to logistical, commercial, or operational factors and are reconciled over time to ensure each party receives its correct allocation of production volumes.

- RTR = Referenced Tax Rate (i.e., the applicable companies income tax rate, hydrocarbon tax rate or petroleum profits tax rate);
- 50% = Maximum allowable portion of incremental government benefit to be passed on to the operator.

Notably, cost savings (TOC – AOC) must be a positive integer to qualify.[2] If no cost savings are realised, no incentive will be granted. The tax credit applies to the specific asset for which cost savings were achieved, and may be applied toward the operator's tax liability (whether under CITA, PPT, or Hydrocarbon Tax), subject to the following limitations:

- The credit may not exceed 20% of the total tax liability in any fiscal year;
- The credit must be utilised within three (3) years of issuance, after which it becomes invalid;
- Credits are non-transferable between assets or corporate entities.

Let us consider two hypothetical companies operating in the same terrain:

Assuming NUPRC sets the benchmark TOC at $25 per barrel for shallow offshore operations:

- Company A incurs an AOC of $20 per barrel and produces 1,000,000 barrels;
- Company B incurs an AOC of $27 per barrel for the same volume.
- Company A's Cost Savings (CS) = ($25 - $20) × 1,000,000 = $5,000,000 Referenced Tax Rate (RTR) = 30%CEI = $5,000,000 × 30% × 50% = $750,000 tax credit
- Company B incurs no cost savings and is therefore ineligible for the CEI.

3. Governance, Transparency, and Exclusions

The CEI Order imposes safeguards to ensure integrity in the cost savings calculation and to prevent abusive cost-cutting:

- FIRS, in collaboration with NUPRC, shall validate CEI claims by comparing submitted UOC data with that used for adjusted tax profits;
- NUPRC is empowered to exclude from CEI eligibility any cost reductions arising from:
  - i. Harmful cost practices affecting host communities or employees;
  - ii. Unfair or fraudulent contractor arrangements;
  - iii. Any practice deemed prejudicial to safe and sustainable petroleum operations.

The Commission is to issue an Implementation Guideline within 30 days of the Order's effective date and shall contain further details on:

- The benchmark setting process and matrix;
- Annual terrain-specific targets;
- Information and formats required for CEI claims;
- Procedures for public listing of qualified companies;
- Alignment of CEI with tax return timelines.

2 A positive integer means that the CS calculated must be greater than zero. This condition ensures that only companies that actually reduce their operating costs below the benchmark can qualify.

Strategic and Compliance Implications

a. **Operational Adjustments:** Operators will need to critically reassess procurement strategies, contractor engagement models, and project execution timelines. The CEI Order creates a tangible financial incentive to reduce timeframes in project delivery and contracting cycles, which historically have contributed to inflated UOC figures. Although not directly enforceable, the Order exerts indirect pressure on operators to minimise operational drag by tying cost efficiency to a quantifiable fiscal reward.

b. **Internal Cost Monitoring:** Robust internal cost reporting and variance analysis processes will be critical to:

- Demonstrate compliance with NUPRC benchmarks;
- Avoid mismatches between regulatory and tax data;
- Position for CEI qualification during annual reviews.

c. **Tax Planning Considerations:** From a tax structuring perspective, the CEI Order introduces a novel class of performance-based tax relief, which may:

- Offset income or hydrocarbon tax liabilities at the asset level;
- Influence strategic decisions around terrain selection and operational investments;
- Require alignment between operations, finance, and tax functions.

Conclusion

The CEI Order is a strategic attempt to rebalance fiscal outcomes in Nigeria's upstream sector by curbing excessive operational costs and improving national take. While the incentive structure presents opportunities for tax relief, it is ultimately a compliance-driven mechanism requiring demonstrable cost discipline. Operators, lessees, and licensees should proactively evaluate their cost structures and operational models in light of this framework and begin preparing for engagement with the Commission's benchmarking protocols. Failure to do so may not only result in forfeiture of CEI benefits but also expose companies to reputational and regulatory risk in subsequent performance evaluations.

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