NEW COMPENSATION SYSTEMS AND MECHANISMS IN THE OIL AND GAS INDUSTRY IN NIGERIA

RESEARCH REPORT
SUMMARY

JULY, 2014
RESEARCH TEAM

The research on ‘New Compensation Rates and Processes in Nigeria’ was initiated and facilitated by the Stakeholder Democracy Network (SDN) with funding from the Dutch Ministry. The research team gratefully acknowledges this support and is convinced that focussed action research of this nature is a catalyst to meaningful change and a more sustainable oil and gas industry in Nigeria.

LEAD RESEARCHER

Dr (Mrs) Iyenemi Ibimina Kakulu, ANIVS¹, RSV
(Associate Professor of Land Management and Valuation)
BTech. Estate Management (RSUST); MSc Urban Land Appraisal (Reading); PhD Real Estate and Planning (Reading)

RESEARCH TEAM MEMBERS

Mr Utchay Augustine Okorji, ANIVS, RSV
BTech. Estate Management (RSUST); MSc Real Estate (Reading)

Mr Francis Mumeya, ANIVS, RSV
BTech. Estate Management (RSUST)

Mr Sheriff Eugene Izebe
ND. Estate Management, Auchi Poly, BTech Estate Management (RSUST)

Mr Tamunosiki Nyanabo Wokoma
BTech. Estate Management (RSUST)

¹ ANIVS – Associate Member, Nigerian Institution of Estate Surveyors and Valuers
The current compensation assessment and payment mechanism in the oil and gas industry in Nigeria is largely dominated by civil courts and compensation payments are increasingly being obtained through litigation and negotiation in preference to valuation. Ideally, compensation can be obtained through a systematic professional and technical assessment of the immediate and long-term impacts of pollution on land, property and environmental resources. In terms of the quantum of compensation, there is often a wide disparity in value estimates which can differ significantly from one plot to another in similar locations. This is a reflection of the apparent lack of standardization in this process in Nigeria which is further complicated by interplay of different and often conflicting legislation on the subject of compensation embedded in different enabling laws. In her desire to contribute to the transformation process in the current inefficient and often counterproductive oil spill management and compensation system in Nigeria, the Stakeholder Democracy Network (SDN) with funding from the Dutch Ministry, facilitated a research on ‘New Compensation Rates and Processes in Nigeria’. An expert team of researchers and Valuers undertook the study to identify a fair and comprehensive ‘oil spill rates mechanism’ that captures the immediate and future loss of earnings due to oil spills which are presented in this report.
A case-study and grounded theory research strategy was adopted. The study team undertook a critical review of the existing laws and regulations on damage assessment and compensation operational within different sectors of the oil and gas industry and discovered several gaps and lapses. A comparative analysis was done of existing compensation rates currently in use in Nigeria. The findings of the study reveal that Nigeria lacks a distinct compensation code which specifies the processes and methods that are to be applied in compensation assessment and payment arising under different circumstances. The processes to be followed and methods to be used can be compiled into a single readily accessible document in the form of a compensation code as obtains in some countries such as the United Kingdom, is lacking. What exists in Nigeria, is a plethora of separate and often conflicting enactments regulating the practice in different sectors and which is often subject to multiple interpretation. The findings also reveal that the traditional and rather primitive practice of crop enumeration (numerical counting) and the use of historical predetermined rates as a multiplier to get a compensation value, is not only professionally incorrect but lacks any scientific capacity to deal with the impact of oil pollution on the immediate, medium-term and long-term impact on land and environmental resources. The use of historical or predetermined rates such as the 1997 OPTS Rates, the 1998 DPR Rates, the rates operational at the State level or the most recent 2008 NTDF compiled Rates to value contaminated land or marine resources, is not consistent with the principles of valuation or international valuation standards and should be discontinued and replaced with actual valuation as at the date of loss. The compensation assessment process requires a thorough scientific and technical approach to uncover the full impact of the spill on property and all other media prior to ascribing monetary or other values to the loss through valuation.
RECOMMENDATIONS

The value or worth of landed property assets is not retrospective and should be determined as at the date of loss and projected into the future to determine and capture future losses. Within the context of statutory valuation, the team recommends that a new procedure for compensation should as a minimum be distinct and separate from the provisions in the Land Use Act, an Act designed primarily for use in cases involving compulsory acquisition and not damage assessment due to oil and gas related pollution. The underlying issues in each case present different scenarios and should be separated. A total paradigm shift from the traditional, unscientific and rather primitive practice of crop enumeration (manual counting and multiplication) is required and the fundamental principles of valuation-of-loss strictly adhered to.

A new compensation system, mechanism or process if put in place, should as a minimum address the following issues in a clear, concise and unambiguous manner

1. Once a spill has occurred, the appropriate authorities led by NOSDRA, should establish the source and cause of spill, nature of pollutant and assign liability.

2. The appropriate authorities should assess the magnitude/scale of the spill in terms of its spatial impact and volume, and not only the recorded barrels of crude spilled.

3. The spatial impact should include the physical area which covers the source, pathway and receptor communities, as well as its depth of impact.

4. The process should include an immediate post impact environmental assessment (PIEA) study which will lead to clean-up, compensation and remediation.

5. The new process should incorporate a post impact socio-economic survey (PISS) that will lead to compensation for other artisanal industries that will be affected by the spill ultimately.

6. The process should ensure that the valuation professional is engaged on all matters of valuation of landed property as specified in the Estate Surveyors and Valuers Registration Act, on behalf of both the claimants and the Polluter.

7. The New process should ensure transparency in the identification of genuine claimants and ensure that prompt payment of adequate compensation is made.

8. It should also ensure that both parties have access to courts of law to seek redress or other compensation tribunal as provided for in the Nigerian Constitution and other enactments.

6 National Oil Spill Detection and Response Agency
In the absence of a distinct regulatory compensation code for use in the Nigerian oil industry, there is the need for intensified and harmonized sectorial effort from different stakeholders, Ministries, Departments and Agencies (MDA’s) to ensure that their regulations and activities conform to international best practices in the area of compensation assessment, valuation and payment of compensation. Understandably, this might involve the amendment of existing legislation or enactment of new legislation, regulations or policies for this purpose. In so doing, the gaps and weaknesses of the current system might be addressed. Standardization is urgently required in order to reduce or avoid widely differing financial compensation for similar incidents by different courts (SDN, 2013).
FINDINGS

Compensation by negotiation leaves a wide margin for subjectivity and corruption. It is not systematic and the disparity in values will tend to be much higher using this approach.

Seven economic trees and seven crop types predominant in the Niger Delta region were analysed using the DPR Rates and the recent NTDF rates to assess the continued use of rates as a method for compensation or otherwise. The findings from the analysis reveal the following issues:

1. There is no scientific approach to the determination of rates that can be linked to market realities, cost of labour or material inputs in cultivating farmland.
2. The historic DPR rates which were developed in 1998 and are in some cases significantly higher than the 2008 NTDF rates developed 10 years later.
3. Rates are applied as single figures and are therefore unable to incorporate or reflect the degree of contamination and impact it its blanket application.
4. The rates developed in 2008 are already outdated in 2014 when compared with current market realities.
5. Value is time bound, it is not retrospective and cannot depend on historic rates since the date of assessment and valuation are crucial to the completeness of a valuation report.
6. Valuation of land and buildings cannot be subject to rates as market evidence or replacement cost can be estimated.
7. There is clear indication that the rates are arbitrary in most cases and are therefore not dependable.
8. The use of rates as part of a mass appraisal system is expensive as rates for all known types of crops, trees, ecosystem services, forest resources and other items subject to damage will need to be developed on an annual basis or at least updated if this system is to work.
9. Rates are incomplete in some zones no rates are provided for some crop types.
10. Current rates are completely inadequate to the extent that they do not address the yield or potential yield of farmland.
11. Rates do not reflect the true position of the Use Value of Value -in-use of farmland to peasant farmers which should form the basis of their claims and not otherwise.

12. They do consider the farmers labour input which includes time spent farming, tilling and monitoring the progress of the tree/crop.

13. Rates do not make any provision for return on investment and unexpired term of the agricultural asset in the form of a tree.

14. Annual derivable income is totally disregarded whereas such income or income potential should be adequately captured and utilised to form the total value of loss to the tree owner.
PROPOSED OIL SPILL COMPENSATION RATES MECHANISM

Valuation of contaminated lands is an estimation of the capital value of loss to land owners due to the presence of contaminants in their soil and a valuation report is usually expected to accompany compensation claims against a polluter. Post Impact Environmental Assessment (PIEA) surveys following an oil spill incident should assess the damage to the bio-geophysical environment - Environmental Impact Assessment (EIA); the disruption to socioeconomic activities - Social Impact Assessment (SIA), and the damage to Real and personal property. A new compensation regime should as a minimum ensure that claims are assessed, made and paid for under these three important categories.

Valuation of the worth of agricultural or other landed property assets should be similar if the same principles, Bases and methods are applied. Where the purpose for which a particular valuation is required differs, then whatever adjustments that have been made should be clear and traceable within the final estimate of value. For instance, the difference between valuation for compensation and valuation for sale is the fact that one owner is assumed to be ‘willing to sell’ while the other is ‘under compulsion to sell’. Whatever adjustments there are to either valuation it should as much as possible be in favour of the party who is under compulsion to give up his property due to the spill. This is clearly not the case in Nigeria. In situations where damage is involved, another variable is added to the picture and besides the initial valuation of the worth of an asset be it agricultural or other forms, the addition should be reflected in other considerations such as disturbance or injurious affection without manipulating value estimates to achieve this. The heads-of-claim are important in each instance and should be clear.

The current practice indicates that EIA’s and SIA’s are two parallel and independent studies leading in some cases to the production of two independent reports that do not establish the connection between the impact on the environment and subsequent impact on the property and livelihoods of those who depend on it. In several instances, there is no laid down procedural set of steps from the establishment of a spill to the assessment for clean-up, remediation and compensation. This divided and usually non-existent approach deprives the process of the advantages of a more scientific and technical approach where field data is fed back into the compensation assessment process at an earlier stage and which informs further investigation before final reporting (Kakulu, 2014). The value of ecosystems particularly the rich mangroves of the Niger Delta region cannot be underestimated. Economic valuation of environmental losses should focus on actual losses from the mangrove which is a large industry responsible for providing self-employment opportunities to thousands of riverine community dwellers.
PROPOSED OIL SPILL COMPENSATION RATES MECHANISM

Periwinkle and shell fish harvesting and other mangrove resources are the mainstay of most riverine communities, also are environmental goods lost from passive and non-market use losses. It is usually difficult to ascertain market price for such losses however, the value-in-use approach makes it possible to identify artisanal fishermen, periwinkle pickers and shellfish harvesters whose livelihoods have been impacted. In the absence of market price data, cost or income based valuation methods may not be suitable rather a qualitative and survey based methods can be used as supplementary tools to determine the contingent valuation, conjoint analysis and perceived diminution in value using other parameters. Valuation of contaminated farmlands and mangrove resources requires extensive data inputs of both scientific and qualitative nature which EIA and SIA reports can provide following further discipline specific synthesis of the findings within a framework of contaminated land valuation. This will enable the assessment team ascertain the short-term, medium and long-term consequences of oil pollution to crop production, ecosystem services and personal property in the form of landed property, buildings and trade tools.

The analysis reveals a number of issues which cannot be ignored if a new compensation rates mechanism is to be introduced. References to value must be addressed and the specific bases or type of value being referred to should be specified in any enabling laws. In order to formulate an appropriate method of valuation for damage it is important to establish the relationship between the source of pollution, spatial distribution and pathway; receptor communities or ecosystems; and concentration of the contaminant or pollutant, the environmental impact including stigma associated with it. More importantly, the parameters for ensuring that the process is clear will include unambiguous details under the following categories:

TYPE OF COMPENSATION

It is important to establish what qualifies compensation within the context of oil spill damage assessment for compensation. The fundamental principles of compensation which include adequacy, fairness, completeness, equivalence, equitable are important. The need to achieve promptness in payment should be clearly stated.
PROPOSED OIL SPILL COMPENSATION RATES MECHANISM

BASIS OF VALUE

In Britain, the basis of compensation where no land is taken is the reduction in value of the land as a result of seven specific physical factors which are noise, vibration, smell, fumes, smoke, artificial light and discharge unto the land of any solid or liquid substance. Anything outside this is not to be compensated for. The basis of valuation in any legislation on compensation must be decided upon at the point of formulation. The final value estimate is the product of a number of considerations and combination of methods that are linked to objectives the valuation. One of the difficulties in the use of the rates method in Nigeria is the indecision of statute on a specific interpretation of value and the application of valuation methods which are consistent with the pre-determined value type.

There are several considerations which inform the bases of value and are discussed.

a. The value-in-use or the use-value is most applicable in all circumstances involving farmland judging from how communal farmland is used particularly in Nigeria. Contrary to the assertions of the Land Use Act, there is no land without value. The use-value captures what the land can produce over time or what it can be used for. This reflects the income that can be generated under its use which could include lumbering activities as well. It is usually measured in terms of the productivity of an economic good to its owner or user and since land is part of everyday life to those who live on it, when lying fallow or as pasture it is an investment for future farming seasons particularly in a crop rotation system. An average farmer farming on a single mixed crop farm would expect to generate a certain net income having allowed for outgoings and expenses on labour fertilizer and other things.

b. The Market Value looks at what the investment can be sold for in the market, where the usual forces of demand and supply dictate the final value based on an analysis of recent sales trends such as hard wood or trees.

c. The Commercial Value may be prescribed where economic trees and crops of a commercial nature are involved.

d. The Investment Value of property may be viewed as the price at which an investor would pay for property in the light of his perceived capacity of such an investment to yield positive returns in the future.

In deciding on a new compensation rates mechanism, we assumed different types of value for damage to different forms of property and agricultural investments.
PROPOSED OIL SPILL COMPENSATION RATES MECHANISM

METHODS OF ASSESSMENT.

There are basically three approaches to valuation which are the Cost Approach, the Income Capitalisation approach or the Comparative sales approach. In whatever circumstance, the specified bases-of-value will inform the most appropriate method to use as valuation for compensation.

THE COMPARABLE SALES APPROACH.

The current use of rates is based on the comparable approach but fails in the sense that it is not developed from current market realities but predetermined historical rates. A new mechanism should insist on establishing rates as at when the damage occurs from comparable un-impacted sites and thereafter, apply such rates as a basis for replication where necessary. The truth is that mass appraisal techniques such as the use of rates cannot be discontinued in its entirety but modified to conform to best-practice principles. The comparable properties used should be based on recent valuation, as at the time of damage of similar property values in similar locations.

THE INCOME CAPITALIZATION METHOD.

This is a good method to use for farmland. Farmland produces an income to the farmers in occupation of land, as long as the land remains clean and is not the subject of contamination. The derivable income remains guaranteed subject of course to natural disasters or act-of-God which is beyond the control of the farmer. The Value-in-use can be determined by a combination of the capital valuation of the income (from sales or food consumption) for a period to be determined by the severity of the impact and anywhere from 5 to 30 years or more. Where impacted land has no crops on it at the time of impact, the law provides nothing but the DPR Report provides for an annual payment for a fixed duration. It separates compensation for Agricultural land from the compensation for crops or economic trees on it. Payment for the land is for a period of 5 years possibly in consideration that the process of restoration and natural attenuation will take place during this time. The investment method of valuation is suitable where landed property is involved and will capture the future expectations of income growth to the investor. The Profits method which is a derivative of the income capitalization approach can be applied where buildings are being used for business such and have established goodwill by virtue of location and clientele, compensation valuation should capture the value of the business lost and not just the replacement cost of the structure which may be insignificant compared to the actual loss sustained by the owner.
PROPOSED OIL SPILL COMPENSATION RATES MECHANISM

THE COST-TO-CORRECT APPROACH/REPLACEMENT COST

This is an important component in valuation for damage. It captures the cost of remediating the damaged area and restoring it to an acceptable standard. This forms the basis of compensation including all such other losses as might be sustained. The replacement cost may be sourced for.

HEADS-OF-CLAIM

The heads-of-claim should be clear and unambiguous. They should be clearly spelt out and should as a minimum include the following items:

LAND

There is no land without value and where land has been polluted, it should be compensated for, taking into account the type of contaminant, its immediate and future impact on the land or groundwater resources. In deciding on the value of compensation for land, its existing use-value or impaired potential use-value should be assessed as much as possible. For land with development potential, the prevailing market value from recent sales of comparable properties is a realistic approach while with fallow farmland the loss of farming rights may be assessed on an annual basis and discounted using a term of years as may be required for full recovery of the land for agricultural use.

BUILDINGS

Buildings should be valued using the most appropriate valuation method in the each circumstance and according to the particular use to which the building was put at the time of destruction. A cheaply constructed building may be located in a busy commercial neighbourhood and could attract high patronage and make huge profits on turnover. The loss of income of capitalized might be significantly higher than the replacement cost of the building itself if pollution impedes business activity. The value of loss is not the building but profits and goodwill including the building. The replacement cost method fails to capture the value-in-use of a building while the depreciated replacement cost method assumes that a depreciated house can be built and it excludes the value of comparable alternative land. This defeats the principle of equivalence and might impede full replacement of loss to a claimant. Buildings of a commercial nature should be valued as a going-concern and where the profits based method is considered the best approach, it should be used.
PROPOSED OIL SPILL COMPENSATION RATES MECHANISM

CROPS

The value of crops should incorporate all the costs associated with farm rentals, debushing, burning, clearing, tilling and weeding the farm during the farming season in which the pollution occurred. Secondly, it should also include the projected estimates of the forfeited harvest expected at the end of the farming season, grade of maturity notwithstanding because in the absence of pollution, the crops would have grown to maturity. Thirdly, the cost of securing an alternative farm plot and the disturbance associated with this change of location and proximity to markets should also be provided for. Fourthly, the loss of farming rights for the period between when the pollution occurred through remediation, monitoring and reasonable recovery of the land for farming purposes (anywhere between 5-30 years or more, depending on the intensity of spill) should be compensated for on an annual on a reducing balance based on the monitoring results.

ECONOMIC TREES

The economic or commercial value of a tree should be the basis of valuation. The commercial value of a tree such as hardwood or softwood can and should be assessed with respect to the timber market and other timber resources. Fruit bearing trees should be assessed based on the life span, bearing capacity and yield for mature trees. For immature trees, the valuation should incorporate losses to the fruit bearing potential of the tree and make adjustments where necessary to reflect the stage of maturity at the time the damage occurred.

SURFACE RIGHTS

The valuation of the loss of surface rights should be linked to the period for which the polluted land will remain inaccessible to the community during the clean-up/ remediation; monitoring phases and up to recovery. The period will however need to be determined prior to commencement such that a discounted value may be assessed and paid.

DISTURBANCE

The valuation of disturbance may be necessary in all categories of loss of real property, economic crops or trees or rights to land and aquatic resources. The cost of relocation of farmlands and property can include the loss of goodwill for business premises and this should be valued for compensation. Migration can lead to a decline in socio-economic livelihood.
**PROPOSED OIL SPILL COMPENSATION RATES MECHANISM**

**INJURIOUS AFFECTION**

Injurious affection may be assessed for adjacent properties which might not be within the immediate spill location but along the pathway or receptor communities or properties that have become or will become stigmatized on account of the spill having occurred. The valuation will involve an estimate of loss in business operations and other such activity decline occasioned by the spill. Land which is stigmatized as a result of oil spills to adjacent lands may suffer decline in value which can be estimated. It might be necessary to make provision for losses under injurious affection.

**LOSS IN ECOSYSTEM SERVICES AND OTHER RESOURCES (COMMUNITY AND GOVERNMENT)**

Loss in ecosystem services are important to not just the spill source, pathway or receptor communities but to the general public and compensation should be paid to enable government make amelioration where required. Such compensation should however not be paid to individual claimants.

**LOSS IN FOREST RESOURCES (SNAIL HARVESTING AND MEDICINAL PLANTS)**

Hunters, gatherers, pickers, and other terrestrial or aquatic resources users risk losing their means of livelihood when forest resources or mangrove forests are affected by pollution. Compensation should accommodate this category of people as much as possible and the assessment should be made in terms of resettling them into other trades and means of livelihood.

**SHRINES AND OTHER SACRED PLACES**

Shines and sacred places may be valued on the basis of sentimental attachment of individuals and communities and the basis of compensation should be by negotiation with the claimants.
PROPOSED OIL SPILL COMPENSATION RATES MECHANISM

SOCIO-ECONOMIC LOSSES

Artisanal fishing and shell fishing activities are a predominant occupation in oil producing communities in the Niger Delta Region. Although illegal bunkering and artisanal refining of crude oil had seriously impacted on this industry, the losses from this sector have to be fully reflected in any assessment for compensation. The categories of claimants who suffer losses from this sector are usually very many and may not be resident at the spill source community but might be communities located along the pathway of the spill or those in receptor communities. Fishermen may be forced to move further away from their fishing locations while women and youth actively engaged in shellfish harvesting in nearby creeks may to lose this source of income completely. Fishmongers who depend on steady supply of fish and shell fish will also suffer loss where their suppliers are unable to feed the market demands due to pollution. It is important that a new compensation regime captures the effect of a single spill on the industry and not on individuals alone. The artisanal fishing industry includes the transporters who provide the connection between the fishermen and the consumers of their products and in the event of pollution, they form part of the category of individuals who would lose self-employment and will need to be compensated.
CONCLUSION/RECOMMENDATIONS

In conclusion, the study has simply exposed some of the challenges associated with the existing compensation regime. It has identified the rather unscientific and unprofessional assessment methods in certain areas. Although a full blown study will yield more detailed results, this paints a picture and the need for a compensation code in Nigeria is extremely urgent.

Damage assessment for compensation requires a multidisciplinary approach in order to arrive at a fair, equitable, equivalent, just and adequate compensation value. Professionals from various fields of expertise will need to work with specialist Valuers to develop more robust assessment method theory, research and development. Although the use of rates can be applied to situations where mass appraisal is the recommended approach, such rates should first of all be derived from valuation and not mere guesstimates as the current rates indicate.

A new and fair compensation rates mechanism cannot be based on historic rates as this is not in consonance with valuation principles. Valuation is not retrospective and should as a minimum determine the actual loss sustained as at the date of the incident where possible. A separate and distinct regulatory framework in the form of an ‘Oil Spill Compensation Valuation Code’ is required whose underlying principles and tenets must be rooted firmly ‘damage assessment’ and not in ‘compulsory purchase’ as the Land Use Act provides for. Where such damaged land has investment potentials, the investment value of such land should be considered as the basis of valuation.

A compensation code will be expected to cover all activities from the initial spill through its assessment for clean-up, compensation and remediation. The new code should address the following issues in a clear and concise manner:
PROPOSED OIL SPILL COMPENSATION RATES MECHANISM

1. Once a spill has occurred, establish the source and cause of spill, nature of pollutant and assign liability.

2. Establish the magnitude/scale of the spill in terms of its spatial distribution and volume.

3. The spatial distribution should include the physical area which covers the source, pathway and receptors and depth.

4. Initiate an immediate post impact environmental assessment (PIEA) study which will lead to clean-up, compensation and remediation.

5. Initiate a post impact socio-economic survey (PISS) that will lead to compensation of other artisanal industries that will be affected by the spill ultimately.

6. Ensure that the valuation professional is engaged on all matters of valuation of landed property as specified in the Estate Surveyors and Valuers Registration Act.

7. Ensure transparent identification of genuine claimants and prompt payment of adequate compensation is achieved.

8. Ensure that both parties have access to courts of law to seek redress or other compensation tribunal as provided for in the Nigerian Constitution and other enactments.