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Is the issue of tax arbitrable (*Esso v. NNPC*)?

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Abstract

Taxation disputes sit at a unique intersection of law where the boundaries of arbitration are clearly defined. When a company challenges a tax assessment, the law unequivocally places the authority to resolve such disputes in the hands of the court. That court serves as the guardian of government revenue and corporate taxation, recognizing the critical importance of these issues to the state's functioning. Unlike other disputes that may be resolved through arbitration—a process prized for its flexibility—taxation is so deeply intertwined with public policy that it cannot be entrusted to private decision-making.

This principle is further reinforced on a global scale, where international conventions allow countries to reject the enforcement of arbitral awards if the subject matter, like taxation, is considered non-arbitrable or if enforcing the award would conflict with public policy. This isn't merely a legal formality; it reflects a societal decision about what issues are too fundamental to be handled outside the official judicial system. Taxation, as a cornerstone of state governance, demands resolution within the strict confines of legal authority, ensuring that it aligns with the core principles that uphold the fabric of society.

Keywords: International Arbitration; Arbitrability of Tax Disputes; Taxation in International Arbitration; Alternative Dispute Resolution (ADR); Arbitration Law and Agreements; *Esso v. NNPC*.

1. Introduction

In a recent judgment between *Esso Exploration and Production Nigeria Ltd v. Nigerian National Petroleum Corporation* [1] (decided on July 8, 2022 and cited as 19-3159 (L) (2d Cir. Jul. 8, 2022)), the United States Court of Appeals for the Second Circuit ("appellate court") unanimously affirmed the judgment of the United States District Court for the Southern District of New York *per* Pauley J. (district court") which declined to enforce a \$1 Billion arbitral award against the Nigerian National Petroleum Corporation ("NNPC") in favor of *Esso Exploration and Production Nigeria Ltd* ("Esso").

In urging the appellate court to discountenance the judgments of the Nigerian courts setting aside part of the Award, *Esso* attempted to demonstrate to the appellate court that the judgment of the Nigerian courts were offensive to basic notions of justice and decency in the United States, making the enforcement of those judgments contrary to public policy. However, after comparing the circumstances presented in the case of *Corporación Mexicana de Mantenimiento Integral, S. de R.L. de C.V. v. Pemex-Exploración y Producción* [2] (832 F.3d 92 (2d Cir. 2016)) ("*Pemex*") with the case under review, the appellate court concluded that unlike the grounds of the judgment setting aside the contested award in *Pemex*, the judgments of the Nigerian courts are owed comity in the United States. On that ground, the appellate court affirmed the district court's decision in declining to enforce the Award.

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Finally, in affirming the judgment of the district court in part and vacating it in part, the appellate court held, however, that the district court erred in failing to enforce the portions of the award that the Nigerian Court of Appeal reinstated. The appellate court then remanded the case for further proceedings consistent with the appellate court's opinion.

2. Agreement of Parties

In its judgment, the appellate court observed that under the Production Sharing Contract ("PSC") between Esso and NNPC (the "parties"), it was agreed that any oil extracted would be divided, conceptually, into four tranches, as follows:

- Tax oil (to cover the taxes owed by Esso under the Nigerian Petroleum Profit Tax ("PPT") Act);
- Royalty oil (to cover royalty payments owed to the Nigerian Government);
- Cost oil (to cover operating costs, which Esso alone bore); and
- Profit oil (which included all remaining oil, split between Esso and NNPC).

Consistent with the tax oil allocation, Esso was required to calculate its tax liability for the operation and prepare tax returns in accordance with the PPT Act. The PSC further provided that "*any dispute*" concerning the "*interpretation or performance*" of the contract between the parties, was subject to a binding arbitration, and that such arbitration must be conducted in Nigeria under Nigerian law.

3. Issue of taxation

It is a basic understanding of the concept of taxation that a sovereign state has the responsibility of generating revenue by way of taxes, and has the power to promulgate relevant statutes and laws to assist in achieving that goal. The Federal Republic of Nigeria being a sovereign state, has its own tax laws, which when juxtaposed with the provisions of the arbitration agreement between the parties, showed that the arbitration agreement might have been couched to cover tax issues.

By the provisions of the PPT Act [3] (Section 30 of the PPT Act seen at <https://old.firs.gov.ng/wp-content/uploads/2021/01/PPTA.pdf> accessed on August 18, 2024), *every company engaged in petroleum operations in Nigeria is obligated to make an account of its profits and losses arising from such operations for an accounting period and deliver to the Board* (The Federal Board of Inland Revenue ("FBIR")) *for the assessment of tax payable to the Federal Government of Nigeria*. In performing that duty, the Board [4] (section 35 of the PPT Act), is authorized to "*assess every company with the tax payable for any accounting period of the company as soon as may be after the expiration of the time allowed to such company for the delivery of the accounts and particulars provided for in section 30,*" and "*make an assessment accordingly* [5] (section 35, sub section (2) (a) of the PPT Act)."

Where a dispute arises between the paying entity—usually a company—and the assessment made by the Board, the power to intervene and adjudicate over such dispute resides **exclusively** in the Federal High Court (of Nigeria). That court has and exercises jurisdiction, to the exclusion of any other court, in civil causes and matters - (a) relating to **the revenue of the Government of the Federation** in which the said Government or any organ thereof or a person suing or being sued on behalf of the said Government is a party; (b) **connected with or pertaining to the taxation of companies and other bodies established or carrying on business in Nigeria** and all other persons subject to Federal taxation [6] (section 251(1) and (2) of the 1999 Constitution of the Federal Republic of Nigeria).

Considering those clear provisions of the statute, the parties were not at liberty to confer on an individual or a body adjudicatory power over an issue relating to tax and taxation within the territory of the Federal Republic of Nigeria.

Issue of taxation can therefore be arguably said to constitute one of the grounds on which recognition and enforcement of an Award may be refused under section V(2) of the New York Convention [7]. For ease of reference, the section provides that "*recognition and enforcement of an arbitral Award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that (a) **the subject matter of the difference is not capable of settlement by arbitration under the law of that country**; or (b) the recognition or enforcement of the award would be contrary to the public policy of that country.*" (Boldened for emphasis).

Under the current laws of the Federal Republic of Nigeria, taxation is currently a subject matter that may not be settled by arbitration and for which recognition and enforcement of an arbitral Award may be refused by the competent authority in the country where recognition and enforcement is sought, in this instance the United States courts. Based

on this premise, it is clear that under Nigerian law, tax or taxation issue is not arbitrable, even where the parties to the arbitration agreement agree to arbitrate it.

It is common knowledge that parties cannot, by agreement or consent, confer jurisdiction where they have no power to do so. This principle of law is expressed in the Latin maxim--*nemo dat quod non habet*. Unfortunately, the arbitration agreement between the parties seemed to have missed this crucial point, and instead, lumped together both the issues that were arbitrable and the one that was not arbitrable, into one single bunch by the use of the qualifier “any dispute arising” under the agreement.

4. Severability clause in agreements

It is for such an unforeseen situation—as this—that agreements usually contain a severability clause to the effect that “where any part of this agreement is determined to be invalid, unlawful or unenforceable, the other provisions of the Agreement will continue in effect, and the legality, validity and enforceability of the other provisions shall not in any way be affected or impaired.” A subparagraph usually accompanies follows to the effect that “if any invalid, unlawful or unenforceable provision of this Agreement will be lawful or enforceable if a part of it were deleted, that invalid, unlawful or unenforceable part will be deemed to be automatically deleted and the rest of the provision will continue in effect (unless that would contradict the clear intention of the Parties).” This crucial clause would typically save the rest of the agreement from being rendered illegal or null in its entirety.

5. Conclusion

As a final note, this author wishes to state that with the continuous growth and development of the law, we look forward to a time when the borders of arbitration will be widened to allow arbitration agreements encompass issues involving taxes and taxation issues considering the peculiar facts and circumstances of each case. Pending that time, the subtle reminder and gentle advise for practitioners and arbitrators is “*caveat emptor*,” which literally translates into English as “let the buyer beware,” and metaphorically as ‘let contracting parties be careful in entering an agreement.’

Compliance with ethical standards

Disclosure of conflict of interest

No conflict of interest to be disclosed.

References

- [1] Esso Exploration and Production Nigeria Ltd v. Nigerian National Petroleum Corporation, 19-3159 (L) (2d Cir. Jul. 8, 2022).
- [2] Corporación Mexicana de Mantenimiento Integral, S. de R.L. de C.V. v. Pemex-Exploración y Producción, 832 F.3d 92 (2d Cir. 2016).
- [3] Section 30 of the PPT Act seen at <https://old.firs.gov.ng/wp-content/uploads/2021/01/PPTA.pdf> accessed on August 18, 2024.
- [4] Section 35 of the PPT Act seen at <https://old.firs.gov.ng/wp-content/uploads/2021/01/PPTA.pdf> accessed on August 18, 2024.
- [5] Section 35(2)(a) of the PPT Act seen at <https://old.firs.gov.ng/wp-content/uploads/2021/01/PPTA.pdf> accessed on August 18, 2024.
- [6] Section 251(1) and (2) of the 1999 Constitution of the Federal Republic of Nigeria accessed at <https://www.wipo.int/edocs/lexdocs/laws/en/ng/ng014en.pdf>.
- [7] 1958 United Nations Conference on the international Commercial Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards.