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FUNDS CREATED UNDER THE PIA (PART 1)



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INTRODUCTION

The PIA introduces several important changes to the administration of the industry, its licensing regime, and its fiscal framework.

Amongst the changes introduced by the PIA is the creation of a few funds which may increase the cost of operations in the industry whilst creating the potential for reserve expansion, community compensation and the promotion of gas utilisation. This article will discuss the various funds, their purpose and how to achieve the goals they are created to serve.

1. FRONTIER EXPLORATION FUND (FEF)

The FEF is created under Section 9(4) of the PIA. Section 9 of the PIA empowers the Nigerian Upstream Regulatory Commission ("Commission") to carry out some functions in relation to frontier basins. The functions include the promotion of the exploration of frontier basins of Nigeria, development of exploration strategies and portfolio management for the exploration of unassigned frontier acreages in Nigeria. The exact description of fields that would constitute frontier basins in Nigeria is still unclear as, according to the PIA, frontier basins are to be defined in a regulation to be issued by the Commission. However, frontier basins are generally defined as basins where previous exploration works have not been carried out or a basin with short-term exploration activities and a significant volume categorised as undiscovered.

Thus, any new field identified for exploitative and developmental activities would be regarded as a frontier field. Such fields are characterised by low total resource volume, no significant prospects, a very low probability of success and a low level of knowledge.

For the Commission to carry out functions related to frontier exploration, the FEF is established. The source of the Fund will be 30% of the profit oil and profit gas which NNPC Limited is entitled to under production sharing, profit sharing and risk service contracts. [1]

[1] NNPC Limited is required to transfer the 30% profit oil and profit gas to the FEF escrow account dedicated to the development of only frontier acreages.

To implement the contribution by NNPC Limited to the FEF, the PIA includes in section 64(c), as part of the objectives of NNPC Limited, the obligation to remit 30% of its profit oil and profit gas into the Frontier Exploration Fund. . We anticipate that when NNPC Limited is being incorporated, one of its stated business objects would be to contribute the specified 30% of its profit oil and profit gas to the FEF. Thus, apart from the contribution to the FEF being a statutory obligation, it would also become part of the core business objectives of NNPC Limited.

There is a question of the constitutionality of the deduction of 30 per cent of the profit oil and profit gas of NNPC Limited. Section 162(1) of the Constitution of the Federal Republic of Nigeria 1999 (as amended) establishes a special account to be known as the "Federation Account," into which all revenues collected by the Government of the Federation (excluding personal income tax of personnel of the Federation's armed forces, the Nigeria Police Force, and the Ministry of Foreign Affairs) will be deposited. Section 162(3) of the Constitution mandates that the funds in this account be split among the Federal, State, and Local Governments in the Federation, who subsequently use their portion to meet their respective commitments.

"Revenue" for the purpose of Section 162(1) is defined as:

Any income or return accruing to or derived by the Government of the Federation from any source and includes:

a.any receipt, however described, arising from the operation of any law;


b.any return, however described, arising from or in respect of any property held by the Government of the Federation;

c.any return by way of interest on loan and dividends in respect of shares or interest held by the Government of the Federation in any company or statutory body.

In A-G of the Federation v. A - G of Abia State and Others (No. 2) ,[2] the Supreme Court declared the deduction of NNPC's cash call obligations as first line charge unconstitutional. It held:

It has transpired also that other deductions are being made from the Federation Account in respect of monies paid to the National Judicial Council for funding the Federal and State Judiciaries, for servicing external debts and for funding Joint Venture Contracts and Nigerian National Petroleum Corporation priority projects. All these deductions are carried out as first line charge on the Federation Account. All the deductions are not provided for by the 1999 Constitution, ... so that even if any enactment has provided for them, like the Appropriation Act by the National Assembly, such enactment is inconsistent with the constitution and is therefore invalid to the extent of the inconsistency [3]

[2] [2002] 6 NWLR (Part 764) 542.
[3] Ibid 760-761



The import of this decision is that any legislation pertaining to payment of revenue into the Federation Account or withdrawals therefrom in a manner that does not conform strictly to the provisions of Section 162 of the Constitution shall be invalid to the extent of such inconsistency.

Since the revenue generated by NNPC Limited ought to be deposited into the Federation Account, it would, appear that a strict interpretation of section 162 of the Constitution would render sections 9(4) & (5) of the PIA invalid to the extent of its inconsistency. It is left to be seen what the attitude of the courts would be when this is litigated, especially in light of the decision of the court in **A - G of Ogun State v. A - G of the Federation [4]**, which refused the claim that all revenue from stamp duties, capital gains tax and privatisation of enterprises has to be paid into the federation account. It recognised the power of the Federal government to maintain an account other than the federation account. That being the case, an argument can be made that the revenues of the NNPC can be paid into an account different from the federation account and then applied as stated in the PIA [5].


Another issue that arises from the requirement of NNPC Limited to make contributions to the FEF is whether the contribution would qualify for deductible expenses. While under Section 263(1)(e) and (h) of the PIA, contributions to funds for purposes of decommissioning, abandonment, establishment of host communities trusts and environmental remediation are tax deductible,

the PIA is silent on the whether the contribution to the FEF would qualify for allowable deductions. However, it is noted that the list of items that will qualify for allowable deductions under Section 263(1) is not exhaustive. To qualify for allowable deductions under the section, an expense has to be wholly, reasonably, exclusively and necessarily incurred. Perhaps, a good case can be made that the 30 per cent of NNPC profits from PSCs and risk service contracts qualify for deductibility because the contribution forms part of its duty under the PIA, and it is doubtful that it can operate under its mandate without making that contribution.

Furthermore, it is likely that the obligation of NNPC Ltd to fund the FEF may affect the future privatisation of or private sector participation in the company because investors may be unwilling to invest in an entity where a series of statutory provisions encumber returns.

The last issue that arises from this is the potential for waste that can occur in the exploration of these frontier basins. Section 9(2) provides that when data is acquired and interpreted under a petroleum exploration licence and the Commission is of the view that there is a need for testing and drilling of identifiable prospects and leads, it may request the services of NNPC Limited to drill or test such prospects, where no commercial entity is willing to undertake the task. This could create a situation where although it may not make commercial or technical sense to spend the funds in the FEF to conduct an exploration, the exploration may yet be undertaken for other considerations.

[4] It must be noted here however that the issue was the question of whether the Federal Government is bound to pay revenue from stamp duties, capital gains tax and privatisation of enterprises into the Federation Account. What was considered was the effect of section 163(b) in the light of 162. The court noted that there was the issue of lumping the tax claim with the claim for proceeds from privatisation.



NNPC Ltd will be largely responsible for the direct exploration of frontier and inland basins. According to the PIA, the Commission may engage the services of NNPC Limited for the testing and drilling of identifiable prospects where no commercial entity has publicly expressed an intention of testing or drilling.

2. MIDSTREAM GAS INFRASTRUCTURE FUND


The Midstream Gas Infrastructure Fund (MGIF) is established under Section 52 of the PIA. It would be utilised by the government to make equity investments in midstream gas infrastructure that will increase domestic natural gas utilisation/consumption. Such infrastructure will include gas processing plants and gas transportation infrastructure. The rationale behind the establishment of the MGIF appears to be that the government's involvement as an equity investor in a midstream gas infrastructure project will help reduce (via risk-sharing with the government) the risk that investors would typically have when developing a midstream gas infrastructure project.

The MGIF will be a body corporate with powers to acquire, hold and dispose of property. It is to be funded through a charge of 0.5% on the price to be paid by wholesale purchasers of natural gas and petroleum products; other sources of funding include grants from multilateral and bilateral institutions, donations, and gas flaring penalties.

'Wholesale customer' is not defined under the Act; however, they are typically those who buy products from the refiners or processors of the product and typically sell to other retailers or use the products as fuel for utilities or as feedstock. The concern for operators in this sector of the industry is the addition of another layer of cost. There is potential for adverse trickle-down effect, especially with respect to gas for power generation, petrochemicals and other products that use wholesale petroleum products and as fuel or feedstock.

It should be noted that moneys received from gas flaring penalties by the Commission pursuant to Section 104(4) will also be remitted to the Midstream Gas Infrastructure Fund and will be utilised not for investment in midstream gas infrastructure but for the remediation of the host communities affected by gas flaring. This creates the need to ring-fence funds received from flared gas penalties to ensure it is applied as prescribed by the PIA. For gas flaring penalties from shallow water and deep offshore, it will appear that the beneficiaries of the midstream gas infrastructure projects will be the littoral communities [6]. How that would be determined and in what proportion is yet to be seen.

The application of part of the MGIF to the remediation of the host communities will blur the clarity that is required with respect to having a clear purpose for each fund under the PIA. It is important to note that there is another fund that has been established under the PIA for environmental remediation.



The MGIF has the potential to stimulate real growth in the midstream of the gas value chain in Nigeria. The ability of project sponsors to de-risk capital intensive midstream infrastructure projects in Nigeria will be enhanced if the MGIF is utilised to procure equity positions for government in projects pending when the project is self-sufficient and then, government exits. The MGIF can also increase its profits and, through such targeted interventions, take on more projects as the fund pool grows.

A high level of skill is required to manage the MGIF if its objectives are to be achieved. While the PIA provides for the appointment of a transaction adviser as needed, most of the governing council of the MGIF are drawn from other agencies of government, with at least five political appointees out of nine members. The remuneration provisions for members of the governing council will add to the administrative cost of the MGIF.

CONCLUSION

In our next article, we will be concluding the analysis of the funds created by the PIA by examining the Environmental Remediation Fund, Decommissioning and Abandonment Fund, and the Host Communities Development Trust Fund.

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