

Flare Gas

(Prevention of Waste and Pollution) Regulations, 2018

KPMG in Nigeria

March 2019



1. Introduction

The Federal Government of Nigeria (FGN) published the Flare Gas (Prevention of Waste and Pollution) Regulations, 2018 ("the Regulations") in October 2018 (although it was signed on 5 July 2018)¹. The thrust of the Regulations is to facilitate the conversion of Flare Gas to a marketable gas product, and the development of a competitive bidding process for entities wishing to access and utilise gas that is currently being flared.

The objectives of the Regulations are essentially, to:

- (i) reduce the environmental and social impact caused by the flaring of natural gas,
- (ii) protect the environment,
- (iii) prevent waste of natural resources, and
- (iv) create social and economic benefits from gas flare capture.

2. Key Highlights

The key provisions of the Regulations are as follows:

I. Ownership of Associated Gas (AG)

Section 2 of the Regulations reaffirms the rights of the FGN as enshrined in the provisions of Paragraph 35(b)(i) of the First Schedule to the Petroleum Act, to take all natural gas associated with crude oil free of cost and without payment of royalty.

II. Assignment of Flare Gas

To facilitate the reduction in Flare Gas, The Minister of Petroleum Resources ("the Minister") may, by the issuance of a Permit, authorise a qualified applicant (QA) selected through an open competitive bidding process to acquire Flare Gas on behalf of the FGN.

III. Qualification as a Permit Holder

The Regulations defines a QA as an interested bidder who meets the requirements/qualifications for the tender process and intends to utilise gas for its own purpose or for sale to third parties. QAs will be required to submit a bid bond (i.e., 1% of the estimated project capital expenditure not exceeding

\$1 million) alongside their proposal, which will be valid for a period not less than six months after the bid submission due date. Subsequent to the bid process, the QA with the highest ranking proposal will be selected as a preferred bidder (PB). The PB will be required to pay a milestone bond and meet certain conditions set out by the Department of Petroleum Resources (DPR) to access Flare Gas before becoming a Permit Holder (PH). PHs will be required to pay performance bonds.

According to the DPR, Flare Gas sites accessible to a PH are only those specified in its permit. The permit can be revoked by the Minister where a PH is unable to fulfil the conditions stated therein, and may be deemed to have forfeited its status. Although a Non Resident Company (NRC) can participate in the bid process as a QA and be selected as a PB, such NRC must incorporate a company in Nigeria, to obtain the permit to access Flare Gas from the Minister (i.e., to become a PH).

Holder of Oil Mining Lease or Assignee of Marginal Fields ("Producers") who intend to utilise Flare Gas for commercialisation will also need to apply to the Minister. However, the application has to be made on behalf of a midstream subsidiary that exists, or that will be incorporated.

IV. Flare Gas Data

The DPR may request Producers to provide Flare Gas Data (FGD) in a prescribed format within 30 calendar days. The FGD provided will be held by the DPR and any interested bidder will have to apply to the DPR for a Data Access Permit (DAP).

Based on the Regulations, the submission of inaccurate or incomplete FGD by a Producer, or any person acting on behalf of a Producer, shall be deemed to be an offence which is liable upon conviction to a fine of ₦50,000 or to imprisonment for a term of not more than 6 months, or both.

¹The Regulations were made pursuant to the provisions of the Petroleum Act and the Associated Gas Re-Injection Act. It aims to implement the NGFCP objectives, which include the implementation of the National Gas Policy recommendations on ending gas flaring.

V. Access to Flare Gas

The bidding/licensing process to obtain the permit will entail certain milestones, with the first step being the registration and submission of Statement of Qualification (SoQ) by interested bidders. The SoQ will be used to request qualification for the Nigeria Gas Flare Commercialization Programme (NGFCP).

The submission deadline for the registration and submission of SoQs was initially set for 20 January 2019, but was recently extended by the FGN to 28 February 2019. Consequently, other implementation steps, including: shortlist of QAs; issuance of request for proposal; submission of proposals; and selection of preferred Bidders, would be delayed. However, the general elections in Nigeria which are scheduled to take place around this period may impact this process timelines.

A PH is not allowed to assign or transfer its interest or rights in the Permit to a third party except such third party satisfies the minimum technical and financial requirements necessary to become a QA under a Flare Gas bid process. Any transfer will be subject to the approval of the DPR.

VI. Payment for Flaring Gas

Producers and PHs are still prohibited from flaring and venting gas from any facility or Greenfield project without an approval/ certificate issued by the Minister, subject to certain conditions which include payment for the flaring of the gas.

The current Flare Gas payment of ₦10 per 1000 Standard Cubic Feet (scf) has been increased significantly. A production based method of calculating the flare payment is being proposed in the Regulations. The Regulations provide that if 10,000 barrels of crude oil or more are produced per day in any Oil Mining Lease (OML) area or in any field designated as a Marginal Field (MF), the Producer shall be liable to pay US\$2 per 28.317 scf of gas flared within such OML area or MF, irrespective of whether the flaring is routine or non-routine. However, if crude oil production is less than 10,000 barrels of oil per day, the Producer and PH shall be liable to a flare payment of US\$0.50 per 28.317 scf of gas flared in the OML area or MF.

No flare payment shall be due if the flaring was caused by an act of war, community disturbance, insurrection or any natural phenomenon beyond the reasonable control of the Producer. Similarly, there will be no flare payment in respect of an agreed volume of Flare Gas that the Producer is committed to deliver to the PH, except the Producer does not comply with the requirements of the Regulations.

Furthermore, if a Producer fails to prepare, maintain, or submit logs or records, or reports or install metering equipment, amongst others, the Producer shall be liable to pay additional sum of \$2.50 per 28.317 scf of gas flared or vented within the OML or MF. In the event of the continued failure of the Producer to comply with any of the requirements of the Regulations, the Minister may direct the Producer to suspend its operations or revoke the OML/MF licence.

In our view, the first step in facilitating the achievement of these Regulations is to address the sensitive issue of domestic gas pricing.

VII. Mandatory Reporting Obligation

A Producer and a PH are required to maintain a daily record of gas flaring, venting and Associated Gas (AG), and submit the information to the DPR within 21 days following the end of each month. Such records are required to be kept in safe custody for not less than 36 months. Furthermore, they are required to prepare and submit annual report to the DPR by 31 March of each year for the preceding year. The report by the Producer will cover the FGD derived from each flare site and the list of all flare sites where the Producer does not have a Connection Agreement, while the report of the PH will include information on the volume of Flare Gas utilised from each flare site and the volume of Flare Gas that was flared and vented. The DPR is expected to publish this report on its website on an annual basis.

VIII. Suspension/ Revocation of Licence or Permits

By the provision of section 9 of the Regulations, the Minister may revoke any Permit to access Flare Gas where the PH or Producer:

- fails to comply with the terms and conditions of the Permit or the Regulations,
- intentionally provides inaccurate information in connection with the issuance of the Permit or withholds significant information during the application or bidding process,
- fails to replace any bond issued to secure the Permit within 30 days of the expiration of such bond,
- is dissolved or becomes bankrupt,
- Gas Supply Agreement signed with the FGN is terminated in accordance with the terms of Permit, or
- if the Producer commercialises any Flare Gas except in relation to its approved flare out project.

IX. Exemption from Royalties

Flare Gas utilised or commercialised by any Producer or PH will not be liable to royalties.

X. New Guidelines Issued Pursuant to the Regulations

In December 2018, the DPR issued the following four guidelines pursuant to its powers under the Regulations. :

a. Guidelines for Grant of Permit to Access Flare Gas:

These guidelines provide direction on the conduct of an open and competitive bidding for PHs. Also, it stipulates the rights and responsibilities of a PH and a Producer with respect to the achievement of the NGFCP as follows:

- the right to the title for Flare Gas in a Gas Sales Agreement and continuous operations on the flare sites,
- the design and construction of Producer Gas Connection Assets,
- determination of the location for the operations and maintenance of the Assets,
- conduct of its operations in a safe manner and in a way that the operations of the Producer is not hindered.

b. Guidelines for Flare Gas Measurement, Data Management and Reporting Obligations

These guidelines specify the criteria, general requirements and obligations of Producers and PHs in respect of Flare Gas measurement, data management and reporting obligations for processing facilities.

c. Guidelines for Flare Payments

These guidelines specify the procedure for accounting for flare payment by a PH and Producer. The information that will form the basis for the flare gas payment will include data obtained by the DPR from the collation and reconciliation of monthly oil production figures in OMLs, MFs, and FGD.

The flare payment amount shall be computed monthly as a product of the Chargeable Flare Gas Quantity in 1000 scf multiplied by the applicable flare payment rate² and shall be in accordance with the procedures for payment of royalties to the FGN provided for in Section 3 of the Associated Gas Re-Injection Act

d. Guidelines for Producers' Associated Gas Utilisation Project

These guidelines set out the procedure for granting permit to Producers to access Flare Gas for Producers' Approved Flare Out Project (PAFOP). It also specifies the framework for AG utilisation projects by Producers for their own consumption and commercialisation. Under the guidelines, a Producer may apply to the Minister to obtain a Permit to access Flare Gas for a PAFOP through an existing or newly incorporated midstream subsidiary corporate entity.

Furthermore, the guidelines provide that on the date upon which a Flare Gas buyer declares its start of commercial operations or the date upon which it starts delivering its Flare Gas-to-Market product(s) to its off-taker(s), whichever comes earlier, the Milestone Bond shall be replaced by the PB, which shall be valid for the term of the Permit to access Flare Gas.

3. Our Comments

The Flare Gas Regulations demonstrates the FGN's continued resolve to eliminate gas flaring and improve AG utilisation through the NGFCP. However, the existence of a huge infrastructural gap which is necessary to address the five gas market essentials, namely, gas availability, affordability, deliverability, funding and the regulatory framework, may hinder the successful implementation of the Regulations. In our view, the first step in facilitating the achievement of these Regulations is to address the sensitive issue of domestic gas pricing. Current domestic pricing of gas in the country is not economically viable to make the domestic gas market attractive to investors, who have continued to clamour for a willing buyer and a

willing seller gas pricing regime, which is yet to be fully implemented.

Furthermore, as indicated in the National Gas Policy (NGP), the Government is yet to pass a new legislation to treat gas as "stand alone" resource for fiscal purposes, as opposed to the current regime where it is closely tied to crude oil. Given that the proposed commercialisation of flared gas for supply to the domestic market is a high priority strategy for the Government in achieving the mandate for Flare Out by 2020, it is imperative that the fiscal regime be given utmost priority. A quick win might be to finalise the commercial terms for gas development under existing oil and gas arrangements.

The successful implementation of the Regulations is also hinged on investor's readiness to apply and bid for Permits to access and purchase Flare Gas from the Producers of AG. However, there are currently no indications on how the FGN intends to attract investors and stimulate additional investment into the sector. As the Regulations appear not to have provided for any transition arrangements, the Producers may accumulate increased Flare Gas payments during the interval between the bidding process and final award of Permits to potential PHs.

Lastly, from tax perspective, companies will also have to consider the tax deductibility of gas flare fees as the Regulations is silent on this. Based on the Regulations, gas flare fees are due, whether the flaring is routine or non-routine. In addition, the Regulations provides that the Minister would issue a permit for continued flaring of gas where the re-injection of gas is not appropriate or feasible in (a) particular field(s). Thus, the pertinent question of the tax deductibility of the gas flare fees remains unanswered as the Regulations did not address the issue. Based on the provisions of Section 10(1) (l) of the Petroleum Profit Tax Act, the gas flaring fees would qualify for tax-deductibility. However, from the judgement of the Federal High Court in the case between the *Federal Inland Revenue Service and Mobil Producing Nigeria Unlimited*, gas flare fees will only be considered as wholly, exclusively and necessarily incurred for tax purposes, if the gas was flared and the flaring fees was paid subsequent to obtaining the above referenced certification from the Minister. Thus, the current position of the tax authority treating any gas flare payment prior to obtaining the Ministerial certification as non-tax deductible may persist.

In view of the above, it is imperative that the FGN prioritises the resolution of the issues hindering the growth of the sector to ensure that any policy or regulation issued pursuant to the NGP can achieve its objectives. This will in turn attract the much needed investment from the private sector for the development of our gas resources and infrastructure.

²US\$2 or US\$0.50 per Mscf

For further enquiries on the above, please contact:

Wole Obayomi

NG-FMTAXEnquiries@ng.kpmg.com

home.kpmg/ng
home.kpmg/socialmedia

