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FLARE GAS (PREVENTION OF WASTE AND POLLUTION) REGULATIONS, 2018

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Introduction

On the 28th of June 2017, the Federal Government of Nigeria, through the Federal Executive Council, approved the National Gas Policy ("Policy"). Admirably, the Policy encapsulates a recurrent theme showcasing an unwavering drive and high priority objective to position Nigeria as a formidable gas-based industrial nation by the adoption of gas flare out strategies using flare capture and utilization technologies, amongst other strategies. It remains a classic irony that in spite of Nigeria's prolific gas reserves; gas centric legislation, investment and development within the Nigerian gas sector have historically been minimal, significantly lagging behind its more profitable fossil fuel counterpart- *crude oil*. The result of this inertia has been high levels of gas flaring across oil and gas producing fields in the country. In 2017, Nigeria ranked as the 6th largest gas flaring country in the world, flaring 7.6 billion cubic meters of gas in that year.

Gas flaring constitutes an egregious energy waste practice in the Nigerian petroleum industry and has significant detrimental effects on the environment and the Nigerian economy. In 1979, the Federal Government sought to address this problem through the Associated Gas Re-injection Act of 1979 ("AGRA") and its subsidiary legislation, the Associated Gas Re-injection (Continued Flaring of Gas) Regulations of 1985 ("the 1985 Regulations"). These laws prohibited gas flaring without the permission of the Minister of Petroleum Resources ("the Minister"). The Minister's permission is granted in the form of a certificate for the continued flaring of gas ("AGRA Certificate"), which contains specific terms and conditions including the payment of gas flare fees. The gas flare fees remained at NGN0.50/Mscf until 1998, when it was increased to NGN10/Mscf.

The Policy criticized the gas flaring regime as incentivizing gas flaring over utilization as the negligible flare charge of NGN10/Mscf provided a cheaper option for operators compared to gas commercialization. In reacting to routine gas flaring, the Policy advocates a vision 2020 flare out target that will be enabled by the development of flare capture projects and the enforcement of applicable sanctions. To birth the Nigerian flare free era, the Federal Executive Council, in 2016, approved the Nigerian Gas Flare Commercialization Programme ("NGFCP"). And in 2018, the President of the Federal Republic of Nigeria, in his capacity as the Minister of Petroleum Resources and in reliance on section 9(1) of the Petroleum Act and section 5 of the AGRA, issued the Flare Gas (Prevention of Waste and Pollution) Regulations of 2018 ("the 2018 Regulations"/ "Regulations").[1] The Regulations focus on the reduction of the environmental and social impacts of gas flaring, prevention of waste of natural gas resources and creation of social and economic benefits from gas flare capture. The Regulations aim to incentivize the commercialization of flare gas because of the zero royalty regime but disincentivize continued gas flaring through the imposition of a new flaring fee regime. The Regulations will also underpin the implementation of the NGFCP, especially the permit bidding process. If properly implemented and enforced, this piece of subsidiary legislation will erase the historical narrative of Nigeria's associated gas wastage.

[1] No. 88 of 2018, S.I No.9 with a commencement date of July 5, 2018

COMMENTARY

An Evolving Era for Flare Gas Commercialisation

In order to actualize the nation's associated gas flare out target, the Federal Government has now decided to assert and enjoy its rights enshrined in section 1 of the Petroleum Act and paragraph 35(b)(i) of the First Schedule to the Petroleum Act, to **take associated gas at the flare free of cost and without payment of royalty**. This right, which is more than 5 decades old, applies to any natural gas discovered under petroleum leases and licenses issued pursuant to the Petroleum Act. Under the 2018 Regulations, the Minister may through a **'Permit to Access Flare Gas'** authorise a **"Qualified Applicant"** to take flare gas on behalf of the Federal Government at any flare site specified in the Permit.

To reduce the likely controversies that may arise on the scope of the 2018 Regulations and the type of gas caught by the provisions of the 2018 Regulations, flare gas is characterized using three components – *production*, *diversion* and *intention*:

- The gas is produced in association with crude oil by an upstream oil producer.
- Such produced gas is finally diverted toward a site where produced associated gas is flared commencing at a flare header and going to the point of the flare within an OML or Marginal Field area or within an oil terminal or refinery.
- The diversion to the flare site is done by the upstream oil producer with the intention to flare such gas.

Once identified as flare gas, such molecules may become the subject of a Permit to Access Flare Gas (the **"Permit"**) which may be granted to a qualified applicant selected through a competitive bid process conducted by the Federal Government. The Permit authorizes the holder on an exclusive basis to take flare gas from the sites designated in the Permit on behalf of the Federal Government and to utilize the flare gas or otherwise dispose it any manner authorized by the Federal Government. It is however useful to note that the Permit may only be granted to a Nigerian company who is not a holder of an Oil Mining Lease or an allottee of a Marginal Field, and is not transferable except with the prior written approval of the Director of the Department of Petroleum Resources ("DPR"). It is interesting to note that the transfer approval stops at the level of the Director of the DPR and does not have to be escalated to the Minister. However, the power to revoke a Permit resides in the Minister. The Regulations do not specify any duration for a Permit and it seems that the duration of each Permit may vary depending on the life cycle of the relevant upstream asset and status of the concession.

The permitting regime creates an entirely new class of stakeholders in the oil and gas industry, called Permit Holders, whose primary purpose is to commercialize flare gas without a corresponding obligation to pay royalties to the Federal Government. The Regulations expressly stipulate that a Permit Holder must be a company that is not *a holder of an Oil Mining Lease or an*

allottee of a Marginal Field. Pending any regulatory clarification in this regard, one wonders whether companies that hold pure economic as against "ownership" interests in oil and gas upstream concessions pursuant to other contractual upstream arrangements would qualify as "Qualified Applicants" within the context of the 2018 Regulations, and may therefore bid for a Permit. This development lends further credence to the Federal Government's policy initiative to treat gas as a commodity separate from crude oil, develop a viable gas midstream sector and create a diverse industrial base that is fired by natural gas. It also signifies the Federal Government's readiness to enforce its ownership rights to gas at the flare.

The above nonetheless, Regulation 14 of the 2018 Regulations provides a platform for an upstream producer to commercialise flare gas under a "Producer's Approved Flare Out Project", without the need to incorporate any midstream company for that purpose. This seems to contradict the provisions of Regulation 3 which requires a producer who seeks to utilize the flare gas from its E&P efforts to incorporate a midstream company for that purpose. The Regulations do not resolve this inherent controversy as it only makes a tacit reference to the "Producer's Approved Flare Out Project". Perhaps, the intention of the drafters is to retain a residual right of a producer to commercialise flare gas volumes subject to the terms and conditions applicable to the Producer's Approved Flare Out Project and therefore provide a Producer the option to choose either a) to incorporate a midstream company or b) undertake the Producer's Approved Flare Out Project.

The 2018 Regulations also create an additional operational interest for the Permit Holders, in the form of easements and other forms of rights of way, within the OMLs and Marginal Fields. Upstream producers may not resist or contravene the Permit Holder's interests created under the 2018 Regulations, as they may be liable to fines, penalties and the ultimate revocation of their concessions. The Regulations also compel upstream producers to enter into connection agreements with Permit Holders, to connect their facilities to one another, or risk steep fines and the revocation of their licenses.

The 2018 Regulations contain certain ancillary provisions, including a requirement that no person shall have access to flare gas data without first obtaining a Data Access Permit from the DPR. The DPR is also required to develop operational safety standards, within 12 months of the effective date of the 2018 Regulations, to be complied with by all producers and Permit Holders in connection with flare gas.

This commercialization and utilization strategy has significant implications regarding the transfer of technology because of its reliance on the use of flare reduction and capture technology, including the execution of license and transfer of technology agreements and registration with the National Office of Technology Acquisition and Promotion.

Gas Flare Commercialization and the status of the Upstream Producer

With the introduction of a new category of midstream players within the industry, any producer who desires to utilize flare gas emanating from its E&P efforts may only do so through its midstream subsidiary (existing or prospective) or under the aegis of an Approved Flare Out Project.

Notwithstanding the fact that the production of flare gas is borne out of the E&P efforts of an upstream concessionaire, an upstream producer who intends to commercialize the flare gas may only undertake this through its midstream subsidiary (existing or prospective) or under the aegis of an Approved Flare Out Project. In the former, the application is expected to be made by the producer on behalf of its midstream subsidiary and the venture must be

developed and implemented by that midstream subsidiary. It remains unclear from the Regulations whether a producer's application on behalf of its midstream subsidiary will follow the same process as the prescribed process for the qualified applicants for the Permit to Access Flare Gas or whether it would be a more relaxed regime. There is also no telling whether a producer's application which has satisfied the stipulated requirements in the Regulations could still be rejected and if a right of recourse would be available in the event of a rejection.

To ensure that the implementation of the flare commercialization programme is not jeopardized, the Regulations restrict the utilization of associated gas by a producer if such utilization will affect or impact the flare gas volumes that is the subject of a bid process. This provision has generated controversies as it is capable of being interpreted as a restriction on the right of a concessionaire to claim title to produced wellhead associated gas. There is another school of thought that suggests that the restriction only applies to production going on in locations already designated as flare sites. Ideally, the provision should not be interpreted as being targeted at producers who are currently commercializing wellhead associated gas. In the same vein, it should not affect green field producers whose intentions are to commercialize wellhead associated gas.

Zero Flaring and Venting

Importantly also, the 2018 Regulations contain varying degrees of prohibition against gas flaring depending on whether the subject is a greenfield or brownfield producer or a Permit Holder.

A producer of a green field project is absolutely prohibited from engaging in routine flaring or venting of natural gas. This provision expresses the Federal Government policy initiative to prohibit green field projects from proceeding without proper integrated plan ensuring that no gas flaring occurs. This would imply that there is no scope at all for a green field producer to flare gas, contrary to what was applicable under the AGRA which did not prefer brownfield projects over green field projects in terms of their ability to procure an AGRA Certificate to flare gas. It is also noteworthy that a Permit Holder is under the same absolute prohibition from engaging in the routine flaring or venting of natural gas on its facilities.

Greenfield producers and Permit Holders are absolutely prohibited from routine gas flaring or venting.

On the other hand, a brown field producer may flare gas only where it has been issued an AGRA Certificate by the Minister. While the requirement to procure an AGRA certificate is a reproduction of AGRA and the 1985 Regulations, the 2018 Regulations further provide that an AGRA Certificate may be revoked in the event of non-compliance with the 2018 Regulations. The ongoing practice in the industry has been for producers to apply for an AGRA Certificate, pay the gas flare fees, receive a receipt for such payments and continue gas flaring, without actually receiving the AGRA Certificate. The reasons behind the Minister's delay or otherwise implicit refusal to grant AGRA Certificates after application are yet to be substantiated. However, with the strong emphasis on the issuance and revocation of AGRA Certificates and the severe penalties attached to non-compliance with the provisions of the 2018 Regulations, producers must give the AGRA Certificate issuance process serious consideration and comply with it, or risk the forfeiture of their concession. It is also important to note that the Federal High Court *in Federal Inland Revenue Service v. Mobil Oil Producing Unlimited*, called the industry's ongoing practice of flaring

The current practice of flaring gas without procuring an AGRA Certificate may no longer be sustainable. Brownfield producers must give the AGRA Certificate process serious consideration and comply with it, or risk enormous economic consequences possibly including a forfeiture of their concession.

without procuring an AGRA Certificate, illegal. The AGRA Certificates and the flare charge provisions of the 2018 Regulations also have tax implications, which are addressed in the '***Increase in Gas Flare Fees***' section of this Newsletter.

Increase in Gas Flare Fees

The 2018 Regulations introduce a graduated gas flare fee regime that is tied to the producer's production levels. Producers producing 10,000 or more barrels of oil a day, shall be liable to the Federal Government for flare fee payment of USD2.00 per 28.317 standard cubic metres of gas flared within the OML or Marginal Field, irrespective of whether the flaring is routine or non-routine flaring except where the flaring occurs as a result of events or phenomena beyond the producer's reasonable control. The fee reduces to USD0.50/Mscf where the field produces less than 10,000 barrels of oil a day. These fees, when considered cursorily, represent a significant increase from the previous rate of NGN10/Mscf. However, when one considers the corresponding deleterious effects of gas flaring on the life and health of Nigerians, the impact on the environment and the economy, one may reach the conclusion that these effects far outweigh the projected increase in revenue that will be generated by the Government from gas flare fees.

One great impact of the Regulations is the astronomical increase in gas flare fees. Producers (with no less than 10,000 barrels of oil per day) will be liable to circa 6000% increase in Gas Flare Fees- from N10 per Mscf to USD 2.00 per Mscf. (For producers of less than 10,000 barrels per day, the applicable Gas Flare Fee is USD 0.50 per Mscf).

By increasing the gas flare fees, it has been argued that the Federal Government intends that the new regime will change the ongoing practice where gas flare fees paid by an AGRA Certificate holder are tax deductible. Under the AGRA, gas flare fees were introduced as a condition for being issued an AGRA Certificate and not as a penalty for flaring gas. This inadvertently subjected those fees to section 10(1)(e) of the Petroleum Profits Tax Act which provides that any sums paid to the Federal Government by way of charges are tax deductible expenses. Consequently, producers have taken advantage of these provisions to deduct their gas flare fees from their annual profits for the purposes of tax assessment. The Ministry of Finance recently lamented the practice, noting that it has cost the government billions of dollars in potential tax revenue and stating that the government was approaching lawmakers to amend the AGRA to use the word 'penalty' in describing gas flare fees. However, the 2018 Regulations do not change the nature of the charge. The issuance of the AGFA Certificate, which in essence is a flaring permit, will still be on terms prescribed by the Minister which may include the payment of gas flare fees. As such, the characterization of the gas flare fees may not necessarily be affected by the steep increase. Also, the 2018 Regulations cannot purport to change the nature of the charge which is provided for in AGRA itself, since a subsidiary legislation cannot overreach or amend a principal act. Without amending the AGRA, it may be a flawed presumption by the Federal Government to assume that these new fees will not be tax deductible. The Federal Government may consider amending the relevant provisions of the Petroleum Profits Tax Act to achieve this.

It is also important to note that the Federal High Court has halted the prevalent practice where producers who apply for but are not awarded AGRA Certificates from the Minister regard their gas flare fees as tax deductible. The Federal High Court held that only an AGRA Certificate holder may treat its gas flare fees as tax deductible.

New Operational Burdens

The 2018 Regulations include detailed requirements to maintain accurate records and make reports to the DPR. Producers are required to maintain and report the following records: flare gas data, daily logs of gas flaring and venting within their facilities, daily records of associated gas produced from their fields, and annual reports containing flare gas data and a list of flare sites that are not the subject of a connection agreement. Permit Holders are required to maintain and report the following records: daily logs of gas flaring and venting within their facilities and annual reports containing information on the volume of flare gas utilized, flared and vented within their facilities. The 2018 Regulations also require that these records be retrieved from metering equipment installed and maintained in producers' facilities which must comply with the standards issued by the DPR. Ostensibly, these reporting obligations are put in place to allow DPR monitor the rate of gas flaring and gas utilization on an ongoing basis.

These new recording and reporting obligations constitute additional operational costs to producers, ranging from the purchase, installation and maintenance of the prescribed metering equipment to the compilation and submission of the requested data. These obligations are enforced with severe financial penalties of USD 2.50 per Mscf of gas flared within the OML or Marginal Field, which are to be paid in addition to any other relevant gas flaring payments that an upstream producer may be subject to under the 2018 Regulations. The penalties for an upstream producer's breach of its reporting obligations are more stringent than those for a Permit Holder. While an upstream producer is subject to financial penalties which may culminate in the revocation of its license, it seems that a Permit Holder may not be liable to financial penalties for the breach of its reporting obligations but may have its Permit revoked. The 2018 Regulations impose new responsibilities on the DPR, which include enforcing the reporting obligations in the 2018 Regulations, issuing its own annual reports on the state of gas flaring in the country, issuing and enforcing the new standards for the metering equipment and the operational safety standards and issuing Data Access Permits. These responsibilities will involve new bureaucratic processing fees and possible time delays, especially because the 2018 Regulations do not prescribe response time periods for the DPR. This is a factor that participants within the industry must consider, as the Federal Government begins implementing the 2018 Regulations.

Producers will have extensive reporting obligations to the DPR. These include: providing flare gas data, daily logs of gas flaring and venting within their facilities, daily records of associated gas produced from their fields, and annual reports containing flare gas data and a list of flare sites that are not the subject of a connection agreement. The fine for default is USD 2.50 per Mscf of flared gas.

New Revenue Sources for Producers

The 2018 Regulations allow producers to charge the Permit Holders handling fees under the approved connection agreements and guarantee fees under the approved deliver or pay agreements. Although this provides a platform for producers to earn fees for enabling gas flare commercialisation, the language of the 2018 Regulations seek to ensure that the connection agreements and the deliver or pay agreements conform to the DPR template and the terms are approved by the DPR. This could be seen as unnecessary oversight by the DPR on the commercial undertakings of private parties. The Regulations are however silent as to whether the DPR has any discretion to regulate the fees payable to the producers under those agreements.

Fines and Penalties

Fines and Penalties applicable to a Producer

In general, where a producer fails to abide by the Regulations, the Minister may revoke the AGRA Certificate; in particular, where the producer commercialises flare gas in breach of the Regulations (for example, where the producer neither has an Approved Flare Out Project nor has midstream company through which it commercialises flare gas, or the producer otherwise interferes with the rights of a Permit Holder over flare gas). Where a producer is in breach of its recording and reporting obligations to the DPR, its obligations to install the required metering equipment, and its obligations to provide a Qualified Applicant or a Permit Holder with access to any flare site for any purpose described in the 2018 Regulations, it shall be liable to pay a fine of USD2.50/Mscf of gas flared or vented within the OML or Marginal Field, for each day that the producer fails to meet these obligations. This fee is in addition to the required penalties for gas flaring stated above. Where the non-compliance continues for an extended period, the Minister may require the producer to suspend its operations or revoke any OML or Marginal Field awarded to it. The 2018 Regulations also include personal offences for individuals acting on behalf of a producer. Where such person provides inaccurate or incomplete flare gas data to the DPR or any other duly empowered lawful authority, such person commits an offence and is liable upon conviction to either or both of a NGN50,000 fine and an imprisonment term of no more than 6 months.

Fines and Penalties applicable to a Permit Holder

Where a Permit Holder fails to prepare and submit accurate gas flare logs and reports or fails to install the required metering equipment, the Minister is empowered to revoke the Permit.

Conclusion

The 2018 Regulations have created a whole new framework for the governance of flare gas, geared principally towards gas utilization and commercialization. With the new rates, the robust reporting requirements, the zero royalty regime and regulated landscape for new midstream players, the Federal Government is clearly moving away from the previous regime that incentivized gas flaring towards a system that will reverse the classic irony.

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