

# Regulating the relationship between host communities and upstream petroleum operators

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## Background

An important offshoot of the Petroleum Industry Act, 2021 (the “**PIA**” or the “**Act**”) is the creation of a statutory and regulatory framework that allows host communities of oil and gas companies to directly enjoy socio-economic benefits from petroleum operations with the aim of facilitating sustainable prosperity/development to such communities, as well as peaceful relations between the communities and petroleum operators.<sup>1</sup> To this end, the PIA requires a settlor to:

- a. incorporate a host community development trust (the “**Trust**”) for the benefit of the host communities for which it is responsible and with the objectives specified in the PIA;<sup>2</sup>
- b. appoint, in consultation with the host communities, a board of trustees (the “**Board of Trustees**”) to be registered by the Corporate Affairs Commission as a corporate body under the Companies and Allied Matters Act 2020; and

- c. conduct a needs assessment on the basis of which a host community development plan will be prepared.<sup>3</sup>

A settlor is defined in the Act as a holder of interest in a petroleum prospecting license (“**PPL**”) or petroleum mining lease (“**PML**”) whose area of operations is located in or appurtenant to any community or communities.<sup>4</sup>

The PIA further provides for the establishment of host communities development trust fund (the “**Fund**”) to be funded primarily through contributions from the relevant settlor<sup>5</sup> and utilized exclusively for implementing the applicable host communities development plan.<sup>6</sup> It also sets out

1. Section 234 of the PIA.

2. The objectives of the Trust are as set out in Section 239(3)(a)-(e) of the PIA.

3. Section 235(1), (4), and (7) of the PIA.

4. Section 318 of the PIA.

5. Section 240 of the PIA. In particular, Section 240(2) requires the settlor to make an annual contribution of an amount equal to 3% (three percent) of its actual annual operating expenditure of the preceding financial year in the upstream petroleum operations affecting the host communities for which the applicable Fund is established. Section 240(3) permits the Trust to receive donations, gifts, grants, or honoraria that are provided to it for the attainment of its objectives and Section 240(4) stipulates that profits and interest accruing to the reserve fund of the Trust shall also be contributed to the Fund.

6. Section 241 of the PIA. Also note that Section 252 of the PIA requires the host communities development plan to: (a) specify the community development initiatives required to respond to the findings and strategy identified in the host communities needs assessment; (b) determine and specify the projects to implement the specified initiatives; (c) provide a detailed timeline for projects; (d) determine and prepare the budget of the host communities development plan; (e) set out the reasons and objectives of each project as supported by the host communities needs assessment; (f) conform with the Nigerian content requirements provided in the Nigerian Content Development Act; and (g) provide for ongoing review and reporting to the Commission.

broad requirements for the administration and management of the Trust through the Board of Trustees, a management committee,<sup>1</sup> and an advisory committee,<sup>2</sup> and empowers the Nigerian Upstream Petroleum Regulatory Commission (the “**Commission**”) on areas within its competence and jurisdiction with respect to host communities development in general, and the administration and safeguard of the Fund in particular.<sup>3</sup>

In keeping with the powers conferred on it, therefore, the Commission has recently issued the Nigerian Upstream Petroleum Host Communities Development Regulations, 2022 (the “**Regulations**”). The commencement date of the Regulations is stated to be 23 June 2022 and some of its key provisions are highlighted below.

## Overview of the Regulations

1. **Objectives:** The Regulations set out to achieve the following objectives:
  - a. provide substantive and procedural requirements for establishing and administering the Trust and the Fund;
  - b. outline the parameters for the administration and safeguard of the Fund;
  - c. prescribe a grievance resolution mechanism for settlement of disputes between host communities and settlers;
  - d. provide general rules for the implementation of specified provisions of the Act with respect to the development of Host Communities.<sup>4</sup>

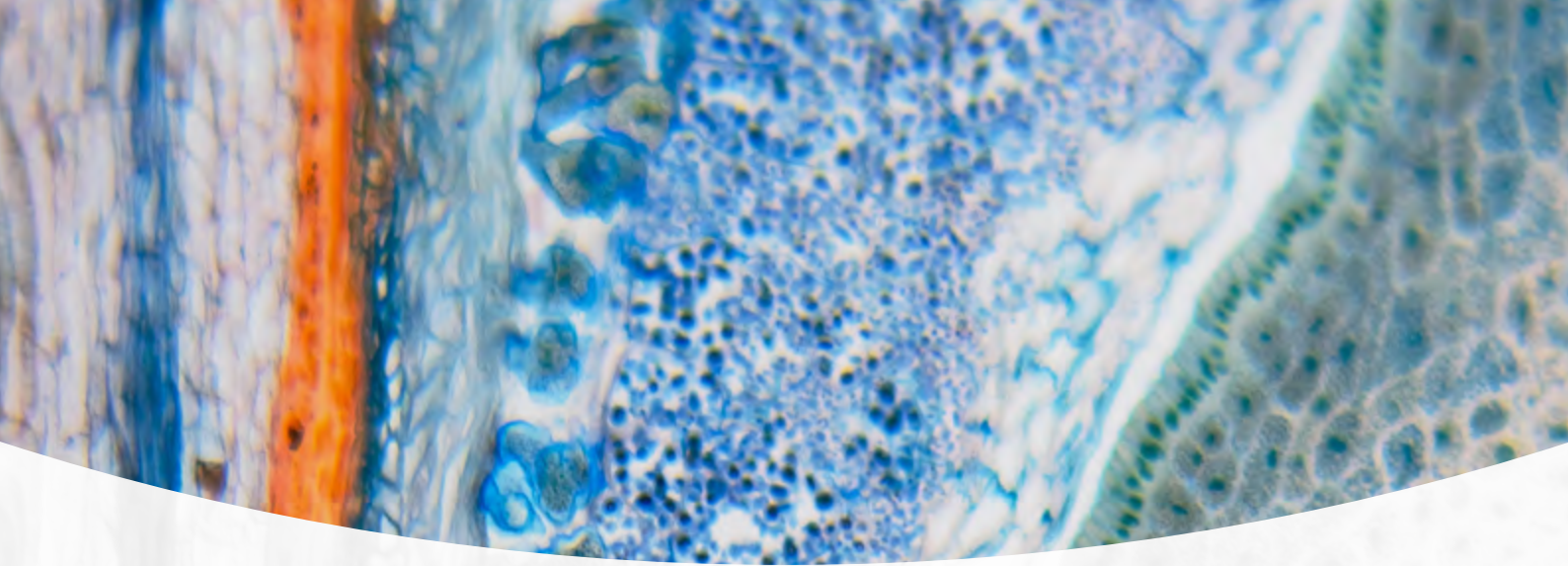
2. **Scope of the PIA and the Regulations on Host Communities Development:**

The obligations created by the provisions of the PIA on host communities development, as set out in Chapter 3 of the PIA, (the “**Host Communities Development Provisions**”) are imposed specifically on settlers. In defining a settlor, the PIA only refers to holders of interest in PPLs and PMLs. By so doing, the PIA suggests that the application of the Host Communities Development Provisions is intended to be limited to such interest holders and should not extend to holders of interest in oil mining

leases (“**OMLs**”) and oil prospecting licenses (“**OPLs**”). Nonetheless, in setting timelines for the incorporation of the Trust, the Host Communities Development Provisions also provide timelines applicable to OMLs<sup>5</sup> and OPLs<sup>6</sup>. This clearly introduced some ambiguity as to the contemplated scope of the Host Communities Development Provisions. It would however appear that the uncertainty in the Act has now been clarified by the Regulations which is expressly stated to apply to “Nigerian Upstream Petroleum host communities and a holder of a license or lease engaged in upstream petroleum operations as defined in section 318 of the Act”.<sup>7</sup>

Notwithstanding the foregoing, what is evident is the lack of reference, in both the PIA and the Regulations, to existing marginal fields. On this basis, it would seem that upstream petroleum operators holding interests in marginal fields have no statutory obligation to deal with their host communities based on the provisions of the PIA and the Regulations. Thus, such operators may, as required, continue to regulate dealings with their host communities using contractual mechanisms established through memoranda of understanding – as was the prevalent practice prior to the PIA regime.

1. Sections 247 and 248 of the PIA.
2. Sections 249 and 250 of the PIA.
3. Sections 234(2) and 235(6)(a) of the PIA.
4. Paragraph 1 of the Regulations.
5. Section 236(a) of the PIA.
6. Section 236(d) of the PIA.
7. Paragraph 2 of the Regulations, emphasis ours.



**3. Responsibility for Compliance:** In cases where multiple settlors operate under a joint operating agreement with respect to upstream petroleum operations, the PIA simply provides that the operator appointed under the agreement shall be responsible for compliance with the provisions of the PIA on host communities development on behalf of the settlors.<sup>1</sup> The Regulations, however, go a step further to state that notwithstanding the responsibility of the operator in this regard, a licensee or lessee shall be liable for any failure on the part of the operator to comply with the relevant provisions of the PIA or the Regulations.<sup>2</sup> By making non-operating joint venture partners liable for the non-compliance of the operator with the host communities development obligations set out under the PIA and the Regulations, the Regulations may also help to compel cooperation among operating and non-operating joint venture partners on matters relating to the said obligations (where such cooperation may otherwise be lacking), for the sake of avoiding liability for non-compliance in this regard. However, it is not clear whether in the case of multiple settlors operating under a joint operating agreement with respect to joint operations, penalties imposed pursuant to the Regulations and the Act will apply to the joint venture partners

independently or collectively.<sup>3</sup> Nonetheless, the expectation is that the liabilities of the joint venture partners (among themselves) will be as stipulated in their respective joint operating agreements.

**4. Determination of Host Communities:**

The PIA defines host communities generally as communities situated in or appurtenant to the area of operation of a settlor, and any other community as a settlor may determine under Chapter 3 of the PIA.<sup>4</sup> The Regulations set out in further details how host communities are to be determined.<sup>5</sup> It is worth noting that in some instances, a settlor may identify and determine or select additional communities as host communities<sup>6</sup> and in other instances communities may be assigned to a settlor by the Commission.<sup>7</sup> In any case, any host community that is a beneficiary of a Trust may only be excluded from such Trust where –

- a. the boundary of the area of operation changes as a result of relinquishment, such that a community previously selected as a beneficiary is no longer within the area of operation of the retained area of the lease; or
- b. a court of competent jurisdiction determines, by a final unappealed judgment, that a community previously selected as a host community, does not qualify as a host community under the PIA or by any other law.<sup>8</sup>

1. Section 235(2) of the PIA.  
2. Paragraph 4(3) of the Regulations.  
3. See Paragraph 6 below for such penalties.  
4. Section 318 of the PIA. Note that Chapter 3 of the PIA is the portion of the PIA that contains provisions on host communities development.  
5. Paragraph 6 of the Regulations.  
6. Paragraph 6(2)(b) and (c) of the Regulations.  
7. Paragraph 6(2)(d) of the Regulations.  
8. Paragraph 6(3) of the Regulations.

## 5. Approvals to be Obtained from the Commission:

Prior to registering a Trust at the Corporate Affairs Commission (and no less than 60 (sixty) days prior to the deadline for the same as prescribed under the PIA), the settlor is required to submit certain information/documents in relation to the Trust to be registered to the Commission for approval. Such information/documents include: the proposed constitution of the Trust; details of the proposed trustees who would form the Board of Trustees; the criteria for the selection of trustees; a copy of the applicant's licence or lease, the list and location of host communities to be covered by the trust; and the host community development plan.<sup>1</sup> The Commission is required to notify the settlor of its approval or refusal of the application within 30 (thirty) days of the receipt of the required information/documents, failing which the application shall be deemed to have been approved and the settlor may proceed with the incorporation of the trust.<sup>2</sup> The appointment of trustees and the dissolution of the Trust are also subject to the approval of the Commission<sup>3</sup>.

Regarding obtaining prior approval from the Commission for the registration of the Trust, it is worth pointing out that while the deadline for the registration of the Trust is 15 August 2022 (i.e., 1 (one) year from the effective date of the PIA which is 16 August 2021), the Regulations were only issued on 23 June 2022 (being less than 60 (sixty) days prior to the deadline). It is therefore unclear how the Commission will determine or treat compliance (or otherwise) by OML and OPL holders with this provision of the Regulations. Nonetheless, it would be prudent for lease or license holders to immediately take steps towards making an application to the Commission for the registration of a Trust.

## 6. Administration and Management of the Trust:

Under the PIA, the Board of Trustees is given the responsibility for the general management of the Trust including but not limited to determining the criteria, process, and proportion of the Fund to be allotted to specific development

programs, providing general oversight of the projects for which the Fund shall be utilized, and determining the allocation of funds to each of its host communities based on the matrix provided by the settlor for distribution of the Fund to host communities.<sup>4</sup> For its own part, the Regulations impose a responsibility on the Board of Trustees to ensure that the Trust and the Fund are equitably administered and managed in accordance with the provisions of the Act and the Regulations.<sup>5</sup> The Regulations also set out the procedures for appointment of trustees, the minimum qualifications for trustees, the grounds for removal of trustees, and terms relating to resignation by a trustee.<sup>6</sup>

## 7. Penalties for Non-Compliance with Obligations on Host Communities Development:

The PIA provides generally for a penalty of revocation for failure to comply with the obligation to incorporate the Trust, albeit enforceable at the discretion of the Commission.<sup>7</sup> The Regulations, however, also provide for administrative penalties in specific instances of non-compliance with certain obligations on host communities development, such as the following:

- a. for failure to comply with the prescribed timeline for incorporating a Trust, an administrative penalty of \$2,500 (two thousand, five hundred United States Dollars), or its equivalent in Naira, per day commencing from the date of expiration of the notice/remedy period permitted to allow the settlor to remedy its default (being 45 (forty-five) days from the issuance of a notice of default by the Commission to the settlor) until the Trust is incorporated.<sup>8</sup>
- b. for failure to take any remedial actions prescribed by the Commission in any event where it appears to the Commission that there has been, is likely to be, a contravention of the Act, the Regulations or the constitution of the Trust, or a misconduct or mismanagement in the administration of the Fund, an administrative penalty of \$2,500 (two thousand, five hundred United States Dollars), or its equivalent in Naira, for each day that the settlor remains in default.<sup>9</sup>

1. Paragraph 8 of the Regulations.
2. Paragraph 8 of the Regulations.
3. Paragraphs 13 and 11(1) of the Regulations.
4. Section 243 of the PIA.
5. Paragraph 10(4) of the Regulations.
6. Paragraphs 13 – 17 of the Regulations.
7. Section 238 of the PIA.
8. Paragraph 9 of the Regulations.
9. Paragraph 10 of the Regulations.



- c. for failure to remove a trustee as specified by the Regulations or any applicable law, an administrative penalty of \$2,500 (two thousand, five hundred United States Dollars), or its equivalent in Naira, for every day that the disqualified trustee continues to hold office.<sup>1</sup>
- d. for failure to comply with the requirements relating to: (i) the conduct of a host communities needs assessment; (ii) the preparation of and compliance with a host communities plan; and (iii) the preparation of and compliance with a fund distribution matrix, in each case, an administrative penalty of \$20,000 (twenty thousand United States Dollars) or its Naira equivalent and an additional administrative penalty of \$1,000 (one thousand United States Dollars) for each day during which the offence continues.<sup>2</sup>

- e. for other offences relating to non-compliance with contribution to the Fund, making false, inaccurate, incomplete, or misleading information in any record or report, failure to comply with an official notice or directive issued by the Commission, or failure to provide any information, document or report required to be provided to the Commission pursuant to the Act of the Regulations within the prescribed period, a penalty issued by the Commission not exceeding \$250,000 (two hundred and fifty thousand United States Dollars) or its equivalent, and the Commission may also make a recommendation to the Minister for the revocation of the license or lease of the defaulting settlor.<sup>3</sup>

An interesting point to note in relation to the above is that the liability for non-compliance with the obligations relating to host communities development lies exclusively with the settlors, notwithstanding the obligations also imposed on the Board of Trustees by the Act and the Regulations. For instance, while the Regulations make it the responsibility of the Board of Trustees to ensure the equitable administration and management of the Trust and the Fund in accordance with the Act and the Regulations, the penalty for non-compliance in this regard is only for the settlor.<sup>4</sup>

The above position deviates from the essential feature of a trust that requires the settlor to relinquish ownership, management, and control of trust property (being the Fund in this case) to the trustee (being the Board of Trustees in this case), with the consequence of such relinquishment being that obligations regarding management and control of trust property become binding on, and enforceable against, the trustee primarily – save, perhaps, where the settlor reserves any rights or powers under the trust.

Additionally, imposing penalties for non-compliance with the obligations regarding host communities development solely on settlors may cause settlors to require indemnities from members of the Board of Trustees in order to mitigate the risk of settlors incurring liabilities for acts of members of the Board of Trustees.

1. Paragraph 16(4) of the Regulations.
2. Paragraph 36(1) of the Regulations.
3. Paragraph 36(2) of the Regulations.
4. Paragraph 10(4) – (6) of the Regulations.

## 8. Effect of Vandalism by Host Communities:

The PIA provides that where in any year, an act of vandalism, sabotage, or other civil unrest occurs that causes damage to petroleum and designated facilities or disrupts production activities within the host communities, the host communities shall forfeit its entitlement to the extent of the costs of repairs of the damage that resulted from the activity with respect to the provisions of the Act within that financial year, provided that the interruption is not caused by technical or natural cause.<sup>1</sup> The basis for computation of the trust fund in any year shall, therefore, always exclude the cost of repairs of damages to the facilities used in upstream petroleum operations or cost of disruptions to production activities, which costs are attributable to any act of vandalism, sabotage, or other civil unrest.<sup>2</sup>

With respect to the above, the Regulations: (a) specify that such damage shall not include loss of profits, losses due to delay of production of reserves or other losses not specifically set out in the Regulations as such losses shall be deemed to be a business risk of the settlor;<sup>3</sup> and (b) require the settlor to notify the Commission of any such disruption within 24 (twenty-four) hours of the disruptive act and to submit a report setting out

specified details within 30 (thirty) days of the disruptive act.<sup>4</sup>

The Regulations empowers the Commission to determine (on the basis of the report of the joint investigation team) whether any interruption is caused by technical or natural cause or third-party interference, and stipulates that the decision of the Commission in this regard shall be binding on the settlor and the host communities.<sup>5</sup>

## 9. Grievance/Dispute Resolution Mechanism:

This issue is not addressed in the PIA which empowers the Commission to make regulations on the same. Accordingly, the Regulations provide that any dispute which cannot be resolved by the parties within 30 (thirty) days after the service of a dispute notice by the aggrieved party may be referred to the Alternative Dispute Resolution Centre of the Nigerian Oil and Gas Excellence Centre for mediation.<sup>6</sup> Where the parties are unable to resolve the dispute by mediation, the dispute may be referred to the Commission. In turn, where the Commission is unable to resolve the dispute in question, then the disputing parties may refer it to an Arbitrator under the Arbitration and Conciliation Act, 1988.<sup>7</sup>

1. Section 257(2) of the PIA.

2. Section 257(3) of the PIA and Paragraph 37(3)(f) of the Regulations.

3. Paragraph 37(4) of the Regulations.

4. Paragraph 37(1) and (2) of the Regulations.

5. Paragraph 37(6) and (7) of the Regulations.

6. The Alternative Dispute Resolution Centre of the Nigerian Oil and Gas Excellence Centre was set up by President Muhammadu Buhari (GCFR) to offer arbitration, mediation and conciliation services for the oil and gas industry and was launched by the erstwhile Department of Petroleum Resources in April 2021.

7. Chapter A18, Laws of the Federation of Nigeria, 2004.



## Conclusion

The important role that host communities play in the success of upstream petroleum operations in Nigeria, as well as the impact (both positive and negative) of such operations on host communities is not only undisputed, but also makes it imperative that relations between host communities and upstream petroleum operators are satisfactorily managed.

While the contractual framework through which such relations were regulated prior to the enactment of the PIA may have proved helpful in some regard, such contractual relations may also have been subject, or prone, to other factors such as: the limited/weaker bargaining powers of the host communities, lack of cooperation from host communities for a variety of reasons, lack of follow-through on the part of upstream petroleum operators, mismanagement of funds earmarked for host communities by representatives of the host communities, and long-drawn-out battles in court.

Thus, the backing of a statutory and regulatory framework that clearly spells out the rights and obligations of upstream petroleum operators and their host communities, as well as the involvement of an independent regulator having oversight and powers over the implementation and enforcement of such framework, should indeed be considered a welcome development in the Nigerian upstream petroleum industry. The PIA provisions on host communities development and the Regulations therefore inspire hope that upstream petroleum operations can, on a sustainable basis, directly impact development of host communities for good. It is however pertinent that the implementation of the relevant provisions of the PIA and the Regulations at all levels be very closely monitored by all parties responsible for the same.

### 10. Transfer of Existing Host Community Development Projects and Schemes:

Both the PIA and the Regulations require the settlor to make arrangements to transfer existing host community development projects and schemes under its corporate social responsibility or any other agreement to a Trust established pursuant to the PIA.<sup>1</sup> The Regulations further require the settlor to notify the Commission of compliance with this requirement.

Given that implementing the above would ultimately result in the termination of existing memoranda of understanding or such other contracts or agreements among upstream petroleum operators and the host communities, the transition process would need to be delicately managed with transparency. Deliberate efforts may also need to be taken by upstream petroleum operators to engage and properly sensitize the host communities of the imminent change in regime and the steps needed to comply with the statutory and regulatory framework now applicable to the involvement of upstream petroleum operators in the development of their host communities.

1. Section 316 and Paragraph 40 of the Regulations.