The Petroleum Industry Act (PIA) – Host Communities Development

Background

Communities that host petroleum operations are critical stakeholders in guaranteeing a prosperous petroleum industry, which is why, relative to other communities, they deserve priority status in deriving direct social and economic benefits from petroleum operations within their communities.

Prior to the enactment of PIA, there were two broad categories of host community development initiatives. The first category is voluntary and it involves operators (of oil mining leases) instituting community development initiatives managed mainly under (Global) Memoranda of Understanding (MOU), which are negotiated between individual operators and the respective host communities; these MOUs are sometimes midwifed by the host state government. The second broad category are government-led initiatives, in particular the Niger Delta Development Commission (NDDC) initiatives. NDDC Act requires oil/gas producing (including gas processing) companies within the Niger Delta basin to pay an annual NDDC levy, which is equal to 3% of their annual budget.

With the enactment of PIA, settlors[1] are required to set up a host community development trust ('HCDT' or 'Trust'), for the benefit of their respective host communities and contribute 2.5% of the operating expenses of their previous financial year to the Trust's fund. The costs of disruption of petroleum operations attributable to actions of the host community are deductible from the settlor's contribution to the Trust's fund.

It is expected that all voluntary host community development initiatives will now be managed under the HCDTs. Host community initiatives managed by government parastatals, such as the NDDC, and the associated levies payable by companies, will continue to be in force.

Set up of host communities development trust

1. Each settlor is required to incorporate a HCDT, based on the rules of Corporate and Allied Matters Act (CAMA) and relevant provisions of PIA, for the benefit of its host communities[2]. When registering, the name of the HCDT must include "host communities' development trust".
2. Where more than one settlor has entered into a joint operating agreement (JOA) in respect of upstream petroleum operations, the operator will be required to perform host community development obligations on behalf of other settlors in the JOA.
3. PIA imposes different incorporation timelines depending on the nature of the underlying licence or lease, which has been analysed in the table below. Reference to designated facilities presumably relates to facilities supporting petroleum operations.

Category	Timeframe
Existing OMLs	*12 months from effective date*
Existing designated facilities	
New designated facilities under construction	
Existing OPLs	*Prior to application for field development plan*
PPLs and PMLs	
Licences for designated facilities under PIA	*Prior to commencement of commercial operations*

4. Upon transfer of an interest in a licence or lease, the associated host communities' development rights and obligations will be deemed to have been transferred to the transferee.
5. Failure to incorporate a HCDT, as required by PIA, may lead to revocation of the underlying licence or lease.
6. Where a licence or lease is surrendered (wholly or partly), revoked, terminated or expired, the holder will continue to fulfil surviving obligations of the HCDT, even where the licence or lease has been granted to a new licencee or leasee.

[1] Settlor is a holder of an interest in a petroleum prospecting licence or a petroleum mining lease whose area is located or appurtenant to any community or communities.

[2] Host communities mean 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.

Regulatory

While Section 234(2) and other aspects of PIA suggest that both Nigerian Upstream Petroleum Regulatory Commission ('NUPRC' or 'the Commission') and Nigerian Midstream and Downstream Petroleum Regulatory Authority ('NMDPRA' or 'the Authority') will regulate the activities of settlors with regards to development of host communities, it appears that reference to NMDPRA is redundant because settlors can only be holders of PMLs and PPL, which makes them outside the scope of the NMDPRA.

Governance and management

PIA contains relevant provisions which form the basis of a strong governance and management structure for the HCDT. The governance structure provides for the settlor, the Board of Trustees (BOT), management committee and an advisory committee for each host committee. We have provided highlights of the composition and roles of each element of HCDTs' governance and management structure below:

The Settlor

1. As part of setting up each HCDT, each settlor is required to consult with its host communities to appoint and authorise a BOT to incorporate the HCDT with the Corporate Affairs Commission, subject to the approval of the Commission.
2. In addition to determining the membership of the BOT, the Settlor is expected to determine:
   - i. the selection process, procedure for meeting, financial regulations and administrative procedures of the BOT
   - ii. the remuneration, discipline, qualification, disqualification, suspension and removal of members of the BOT and;
   - iii. other matters other than the above relating to the operation and activities of the BOT.
3. An annual contribution shall be made by the Settlor to the applicable host communities development trust fund of an amount equal to 3% of its actual annual operating expenditure of the preceding financial year in the upstream petroleum operations affecting the host communities for which the applicable host communities development trust fund was established.
4. The settlor shall undertake needs assessment that will determine the community development plan for the purpose of determining the projects to be undertaken by the host communities development trust.
5. An annual report of the activities of the host communities development trust accompanied by its audited accounts shall be submitted by the settlor to the Commission or Authority as the case may be, not later than 31 May of a particular year.

Board of Trustees

1. Members of the BOT will include persons of integrity and high professional standing, who shall come from the relevant host communities. It is not clear whether the requirement for BOT members to come from the host communities refers to residential or indigenous status.
2. BOT members shall appoint one of themselves as Chair. The secretary of the BOT shall be appointed by the settlor, presumably from among the members of the BOT.
3. Each member of the BOT shall serve a term of four years and may be reappointed for another four years term and no more.
4. The BOT is responsible for the general management of the Trust including approval and supervision of projects to be funded by the Trust's funds, appointment of fund managers to manage the reserve fund of the HCDT, set-up of the HCDT's management committee and appointment of its members.

Management committee

1. Management committee comprises two categories of members; executives and non-executives. Each host community shall nominate its representative as a non-executive member, while the BOT selects the executive members. The settlor is required to determine the number of executive members of the management committee.
2. The secretary of the management committee shall be appointed by the settlor, presumably from among the members of the management committee.
3. The settlor shall determine the management committee's selection process, meeting procedure, financial regulations, and administrative procedures. The settlor shall also determine the remuneration, discipline, (dis)qualification, suspension, and removal of members of the management committee.
4. All members of the management committee shall be appointed for an initial four-year term, renewable for another four-year term and no more.
5. The functions of the management committee include budget preparation, nomination of fund managers, managing contracting process for project awards, supervision of projects and reporting on the activities of the management committee, contractors, and other services providers. Functions performed by the management committee are usually subject to the approval or supervision of the BOT.

Advisory committees

1. The management committee is required to mandate each host community to set up an advisory committee.
2. The management committee shall determine each advisory committee's selection process, meeting procedure, financial regulations, and administrative procedures. The management committee shall also determine the remuneration, discipline, (dis)qualification, suspension, and removal of members of the advisory committee.
3. The functions of each advisory committee include articulation of community development projects to be transmitted to the management committee, monitoring and reporting progress of projects executed in their communities, advise the management committee on activities that may lead to improvement of security of infrastructure and peace building and take responsibility for the first line of protection of facilities and ensure members of their communities do not interrupt petroleum operations.

Commentary

1. While PIA requires the settlor to consult with the host communities to appoint a BOT for the HCDT, there are no clear guidelines for making such appointments, which exposes the settlor to the risk of appointing persons that are not true representatives of the host communities. It is expected that the Commission will issue guidelines that provide a clear and workable framework for making representative appointments from the host communities into the BOT. Until that happens, settlors may have to consult with recognised community development associations, host state and local governments and rely on their experience of working with the host communities to make appointments into the BOT. Consultations with host communities advisory committees may also form the basis of making appointments into the BOT.
2. There is no clear provision that empowers the settlor to appoint its representatives (including its employees) into the BOT and the management committee. That may imply that the settlor has no direct involvement in how the HCDTs are governed and managed. As the settlor is empowered to appoint the secretaries of the BOT and the management committee, it may use that route to appoint its representatives as secretaries as no part of the pia provides that the secretaries must be among persons already appointed as members of the BOT and management committee.
3. The management committee is required to mandate each host community to set up an advisory committee. However, each advisory committee is empowered to nominate its representative into the management committee as a non-executive member, which then creates a chicken and egg situation. One way to make this work is for the management committee (executive members only) to first get each host community to set up its advisory committee, each of which then appoints its representative to the management committee, as non-executive member.

Funding and finance matters

1. Beyond the compulsory contribution payable to HCDTs, other sources of funding include gifts, donations, honoraria, and grants. Profits and interest accruing to the reserve fund of HCDTs are also additional sources of funding.
2. 75% of HCDT's fund is allocated to capital fund to be disbursed towards host community development projects, as determined by the management committee. Unutilised sums may be carried forward to the following year. 20% of HCDT's fund is allocated to reserve fund, which shall be invested by a fund manager on behalf of the HCDT. The reserve fund shall be utilised for HCDTs whenever there is a cessation of contributions from the settlor. The balance 5% is to be utilised against the administrative cost of running the Trust and special projects.
3. The settlor shall provide the matrix of the distribution of funds to the respective host communities. The BOT shall rely on such matrix to effect the distributions.

Reporting obligations

Host communities' development plan

1. A settlor is required to carry out a host community needs assessment from a social, environmental, and economic perspective. The host community needs assessment should demonstrate how the settlor has:
   - i. engaged with the host communities to understand their issues and develop a strategy to address those needs
   - ii. considered the concerns of women, youths, and community leaders.
2. The host community needs assessment shall metamorphose into a host community development plan which shall be submitted to the Commission to enable it to undertake its oversight function preparatory to the establishment of the trust.
3. PIA is silent on the relevant timelines for conduction of the host community needs assessment and submission of the host community development plan.
4. There are no specific requirements to revise the host community development plan after the initial submission. This may therefore not allow the host community development plan to be modified in line with changing needs of the host communities.
5. The HCDT does not get to be involved in the conduct of the host community need assessment, which only makes it an implementation apparatus that has no role in the formulation of the settlor's strategy for its host communities.

Financials and audit

1. The financial year of the HCDT shall run from 1 January to 31 December of each year, however, the BOT may choose to set a different date.
2. The BOT is required to maintain account of the financial activities of the HCDT, appoint auditors to audit the accounts of HCDT annually and issue audited accounts.

Mid-year and annual reporting

1. The Management committee is required to submit a mid-year report to the BOT by 31 August of the particular year, while it submits an annual report (alongside its audited accounts), also to the BOT, by 28 February of the succeeding year.

Tax considerations

Section 256 of the PIA exempts HCDTs from income tax. However, that exemption status does not extend beyond income taxes. HCDTs are required to comply with non-income tax obligations such as obligations relating to withholding taxes, value added tax, employees' personal income tax, stamp duties etc

The contributions payable by settlors into HCDTs are deductible for the purpose of computing hydrocarbon tax (HT) and companies income tax (CIT).

Conclusion

The institution of mandatory host community development trusts, managed by upstream licence/leaseholders, creates extensive administrative burden, which does not enable them to fully focus on their core objectives. International best practice recognises that the obligation to manage host community funds, contributed by lessees/licencees, is typically the core responsibility of the host government. Consequently, the requirement necessitating the management of HCDTs by operating companies is akin to government delegating its functions, which deserves some form of compensations, such as fiscal incentives.

The successful implementation of HCDTs across the Niger Delta and other oil producing basins is critical to guaranteeing peace and maximising oil production volumes, and that is why it deserves the right attention from government and its regulatory authorities. Raising oil production volumes, especially now that oil prices are rising helps to raise government revenue to fund critical infrastructure and reduces the need for additional borrowings.