Trapped Capital & Asset Retirement: Navigating D&A Funds in Nigerian Energy Deals

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Introduction

The enactment of the Petroleum Industry Act (PIA) 2021 did far more than reform Nigeria's oil and gas industry. It fundamentally changed how operators, investors and financiers must think about the entire lifecycle of petroleum assets, including what happens long after production has ceased.

Imagine acquiring a producing field with strong cash flows, only to discover that millions of dollars are locked away in a statutory escrow account that cannot be accessed, refunded or redirected, even after an exit from the asset. Alternatively, imagine funding decommissioning obligations on behalf of a defaulting joint venture partner, only to realise that your capital could remain tied to the licence for decades. These are no longer hypothetical commercial risks. They are legal and financial realities under the PIA.

Sections 232 and 233 of the Act introduced a mandatory framework for funding Decommissioning and Abandonment (D&A) obligations, transforming what was once viewed as a distant end-of-life responsibility into an immediate financial and legal commitment. These provisions now shape how petroleum assets are valued, how transactions are negotiated, how capital is allocated and ultimately, how investors plan their exit strategies.

Understanding these obligations is essential for structuring transactions, allocating capital efficiently and avoiding costly surprises throughout the life of an oil and gas asset.

The Statutory Framework: Ring-Fencing Asset Retirement Capital

Under Section 233 of the PIA, every holder of a Petroleum Prospecting Licence (PPL), Petroleum Mining Lease (PML) or a midstream or downstream processing or transportation licence must establish, maintain and manage a dedicated D&A fund.

The statute and tax laws impose strict governance controls over these funds:

- Independent Escrow Structure: D&A funds must be deposited into an escrow account held with an approved commercial bank or financial institution that is not an affiliate of the operator.
- Regulatory Oversight: Access to the escrow account is strictly controlled. Withdrawals require joint authorisation from the relevant regulatory authority, the Nigerian Upstream Petroleum Regulatory Commission (NUPRC) for upstream operations or the Nigerian Midstream and Downstream Petroleum Regulatory Authority (NMDPRA) for midstream and downstream infrastructure.
- Exclusive Usage: Escrowed funds are legally restricted and may be applied solely to cover approved well plugging, platform removal and environmental restoration programmes.
- Tax Deductibility Conditions Under NTA 2025: While annual contributions into an approved D&A fund are treated as tax-deductible operating expenditure (OpEx), Section 86 of the Nigeria Tax Act (NTA) 2025 conditions this tax deductibility on strict domiciliation rules. Specifically, D&A contributions are only tax-deductible if the licensee or lessee deposits at least 30% of the fund in an escrow account with an accredited Nigerian bank that is directly accessible by the Commission or Authority.

The Fiscal Lifecycle of Residual Escrow Balances

A critical consideration in long-term financial modelling is the treatment of residual funds following the completion of an approved decommissioning programme. Where actual execution costs are lower than the accumulated escrow balance, the treatment of surplus capital is governed by Section 233(12) of the PIA in conjunction with the fiscal provisions of the NTA 2025.

Because annual D&A contributions enjoyed tax-deductible status during the operating life of the field, any unspent surplus loses its tax-shielded status upon field closure. Under Section 233(12) of the PIA and Chapter 3 (Part I) of the NTA 2025, the remaining balance is reclassified as gross taxable income in the final year.

Before any net residual capital can be remitted to the operator;

- If the asset operates under a Production Sharing Contract (PSC), the surplus must first pass through the contractual Profit Oil or Profit Gas allocation mechanism.
- The remaining amount is then subjected to applicable corporate taxes under Chapter 3 of the NTA 2025, including Hydrocarbon Tax (HT) and Companies Income Tax (CIT).

Only the net balance, after tax and profit oil deductions, is released to the licensee or lessee.

Investment committees and transaction advisers must therefore evaluate end-of-life residual cash flows net of these statutory fiscal deductions rather than assuming a gross refund.

The Partner Exit Trap: Asymmetric Cash Calls and Trapped Capital

In joint venture (JV) operations, commercial friction frequently arises where one partner solely funds or over-contributes to the D&A escrow account because of cash call defaults by co-venturers.

Consider a scenario where Partner A solely contributes US$20 million into the statutory D&A escrow account over several years to maintain regulatory compliance because Partner B defaulted on its JV cash calls. If Partner A subsequently decides to sell its equity interest and exit the asset, a significant legal obstacle emerges.

The Legal Reality

Escrow Funds Attach to the Licence, Not the Shareholder: Regulators will not authorise withdrawals from an active D&A escrow account to resolve internal partner disputes or facilitate share redemption requests. The funds remain legally ring-fenced for the asset's future environmental remediation.

No Direct Recourse to Escrow Capital: Partner A cannot demand reimbursement from either the bank or the regulator. Without express contractual mechanisms negotiated before exit, Partner A's US$20 million remains trapped liquidity within the escrow account until the field reaches the end of its productive life, which may be decades away.

Strategic Imperatives for Operators and Dealmakers

To mitigate the risk of trapped capital and facilitate efficient transactions under the PIA and NTA frameworks, asset managers and prospective investors should implement three **key legal and commercial strategies:**

- Structure D&A Capital in Share Purchase Agreements (SPAs): When a partner exits a venture, its previous contributions to the D&A escrow account represent an economic asset associated with the target company. Departing investors should ensure that accrued D&A escrow balances are expressly reflected within the Completion Accounts or Working Capital Adjustment provisions of the Share Purchase Agreement, enabling reimbursement by the incoming purchaser upon completion.
- Secure Defaulting JV Interests Under the Joint Operating Agreement (JOA): Where a non-defaulting partner funds another participant's share of D&A cash calls, those advances should be documented under the Joint Operating Agreement as default loans carrying agreed contractual interest. The advances should also be secured through a fixed charge over the defaulting partner's participating interest or production revenues.
- Conduct Robust Technical and Actuarial Due Diligence: Acquirers should reconcile the target asset's D&A escrow balance against its current depletion profile and approved decommissioning plan, keeping in mind the 30% local bank deposit threshold under Section 86 of the NTA 2025 for tax deductions. Where historical contributions are insufficient or non-compliant, the regulator may require immediate post-completion capital injections to eliminate the funding shortfall.

Conclusion

Under Nigeria's modern energy regime, Decommissioning and Abandonment governance sits at the intersection of regulatory compliance, environmental stewardship and structured corporate finance.

Whether managing ongoing joint venture operations, structuring cross-border M&A transactions or evaluating upstream asset acquisitions, market participants should treat D&A escrow obligations as active balance sheet commitments requiring proactive legal, financial and contractual management throughout the asset lifecycle.

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