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FUELLING NIGERIA'S FUTURE:

A ROADMAP FOR DOMESTIC GAS PRICING AND REGULATION (PART 1)

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INTRODUCTION

The Nigerian natural gas sector is a critical component of Nigeria's energy mix and has significant potential to drive economic growth and development. Nigeria is blessed with abundant gas resources, standing at 209.26 trillion cubic feet (TCF)[1] of Associated and Non-Associated gas as of January 2024, with reserves reported at 102.59 TCF. In light of Nigeria's abundant gas resources, the Federal Government has prioritised the rapid advancement of the domestic gas sector as a key strategy to drive substantial GDP growth. While gas exports yield significant financial returns to the government in the form of tax revenue and equity dividends, the government acknowledges that there are broader strategic advantages to be gained from enhancing domestic utilization and value addition of natural gas. Hence, the Petroleum Industry Act (PIA) of 2021 appropriately mandates all lessees to adhere to the Domestic Gas Delivery Obligations (DGDO) before the 1st of March each year. These obligations are tailored to meet the domestic gas demand requirements specified by regulators, necessitating lessees to supply volumes of marketable natural gas (MNG) to the domestic market, either through the regulated or free market channels.

The escalation of gas prices in major global markets has incentivized increased exports, leading gas suppliers within the country to heavily prioritize liquefied natural gas (LNG) projects. Consequently, this has created a substantial shortage in gas availability for

[1] https://www.nuprc.gov.ng/nigerias-oil-and-gas-reserves-soar-nuprc-unveils-impressive-figures/#:~:text=Engr%20Komolafe%20revealed%20that%20as, trillion%20cubic%20feet%20(TCF). Accessed on 14th May 2024.

domestic use. Recognizing the pressing need to address this shortfall and establish a pricing mechanism that fosters the active involvement of all gas suppliers in ensuring a consistent gas supply to the domestic market, the Petroleum Industry Act (PIA) empowers the Nigerian Midstream and Downstream Petroleum Regulatory Authority ("the Authority")to formulate the Gas Pricing and Domestic Demand Regulations (GPDDR) 2023.[2] The GPDDR aims to oversee the pricing of Marketable Natural Gas (MNG) within the strategic sectors of the nation and delineate the unregulated markets. It revoked the National Gas Supply Pricing Regulations, 2008 but preserved the gas pricing framework under the defunct regulations till April 1st, 2023.[3] This two-part series will explore Nigeria's gas pricing framework and the Authority oversight of both regulated and unregulated gas pricing in strategic sectors. Moreover, it will elucidate the principles guiding the Domestic Base Price (DBP) of Marketable Natural Gas (MNG), explore compliance requirements for gas distribution licenses, and outline the criteria for strategic sectors to achieve a 'Free Market Status'.

PRICING MECHANISM FOR MARKETABLE NATURAL GAS

In March 2024, the Authority introduced an updated pricing framework for natural gas within the strategic sectors. This framework entails an 11% increase in the pricing of natural gas for the power sector from the previous year. . The Domestic Base Price (DBP)

[2]PIA 2021, section 32.
[3]GPDDR 2023, section 17. .

for the power sector for the year 2024 was set at $2.42 per MMBTU, marking a notable rise from $2.18 per MMBTU observed in 2021. Similarly, the pricing for natural gas in commercial sectors was reviewed upward to $2.92 per MMBTU from the previous $2.50 per MMBTU. These reviews were made pursuant to the provisions of the PIA,[4] which mandates the Authority to declare the DBP annually. Notably, this price increase coincided with President Tinubu's executive orders, offering tax credit incentives for Non-Associated Gas (NAG) greenfield developments in specified areas with gas production starting by January 1st, 2029.[5]

While the PIA aims to establish a free market for petroleum products in Nigeria, the Authority retains the power to regulate certain aspects related to costs and pricing in specific circumstances. The Authority is empowered to set cost benchmarks for midstream and downstream petroleum operations,[6] to ensure a standardized approach in the industry. Similarly, the Authority has the power to establish pricing and tariff frameworks for natural gas in midstream and downstream gas operations and for petroleum products. These frameworks are based on the fair market value of the applicable petroleum products,[7] promoting transparency and fairness in pricing. It is also empowered to monitor the application of petroleum product prices, pricing formulas and frameworks and regulate the DBP and prices applicable to wholesale customers of the strategic sectors, gas distributors, and retailers.[8] These Strategic sectors are the power sector, the commercial sector, and the gas-based industries.

DEFINING STRATEGIC SECTORS AND THE PRICING PARAMETERS

The Authority is required by a notice in the Federal Government Gazette to publish the list of industries constituting the strategic sectors.

1. **The Power Sector:** This encompasses the generation, transmission and distribution of electricity and it involves power generating companies (GENCOS), transmission companies (TRANSCOs), distribution companies (DISCOs) and other

[4] PIA 2021, section 167 (1).
[5] https://africaoilgasreport.com/2024/04/gas-monetization/gas-price-hike-nigeria-nods-again-to-upstream-producers-demand/#:~:text=Under%20the%20new%20pricing%20regime,been%20at%20%242.18%20since%202021. Accessed 14th May 2024.
[6] Section 32(d) PIA 2021.
[7] Ibid, s 32(e).
[8] Ibid s 32 (y) & (rr).

stakeholders involved in the production and delivery of electricity to consumers. However, mini-grids that are self-contained, disconnected from the national grid, operated on renewable energy sources, but have fossil fuels as backup power in some cases, and captive & embedded power plants that supply electricity exclusively to a single user or customer such as factories, mines or private investors are exempted from the power sector under the strategic sectors.[9] The price for MNG for the power sector shall correspond to the Domestic Base Price (DBP) at the marketable natural gas delivery point.[10]

2. **Commercial Sector:** This consists of industrial and commercial activities which utilise gas as an energy source and are energy intensive such as manufacturing, services, retail, hospitality etc. This sector relies on energy sources for operations, including heating, cooling and industrial processes. The marketable natural gas price for the commercial sector shall be the Domestic Base Price (DBP) at the marketable natural gas delivery point plus an additional USD 0.50 per **MMBTU.**[11]

3. **Gas-Based Industries:** These industries heavily rely on natural gas as either a feedstock or energy source for their operations. Among them are petrochemicals, fertilizer production, and steel manufacturing, which produce commodities such as ammonia, urea, methanol, polypropylene, and low-sulphur diesel (GTL). Monthly, the Authority will determine prices for gas-based industries, specifically for feed gas. This determination will rely on the average product prices at month-end for the ongoing month, along with information periodically provided by the Licensee of the gas-based industry. The floor price for these industries is set at USD 0.90 per MMBtu, while the ceiling price is the DBP established by the Authority for that year. These prices are defined at the marketable natural gas delivery point, with transport costs added for delivery to the respective gas-based industries. The Authority reserves the right to

[9] Gas Pricing and Domestic Demand Regulations (GPDDR)2023, Section 4(1) (a) & (b).
[10] PIA 2021, section 167(5).
[11] Ibid, section 167 (6).

adjust the price mechanism to incorporate other gas-based industries in accordance with market realities through regulation.[12]

A wholesale customer, not initially categorized within the strategic sectors, but which deems itself eligible for inclusion, may submit an application to the Authority for consideration and the Authority is expected to within a timeframe of 90 days, review the application and communicate its decision to the applicant.[13]

It is important to highlight that gas distributors do not fall within the scope of the strategic sectors. Consequently, they are tasked with directly negotiating both the supply and pricing of their natural gas. However, it's crucial to note that the price applicable to gas distributors for marketable natural gas at the delivery point must not surpass that of the commercial sector.

PRINCIPLES GUIDING THE DBP IN THE STRATEGIC SECTORS

The Nigerian Upstream Petroleum Regulatory Commission (the Commission) is responsible for establishing the price for domestic gas supply annually by March 15th. Subsequently, the Commission communicates this determination to the Authority, which then sets the DBP. Serving as a pivotal benchmark for natural gas prices across Nigeria's domestic market, the DBP takes effect on April 1st and remains valid until March 31st of the following year, applicable at all gas delivery points. The DBP is calculated as the lesser value between the export parity price and the domestic gas supply price and any adjustments to the DBP must consider the energy content in the gas. Notably, producers retain the flexibility to supply the domestic market at prices below the DBP if they so desire.[14] Generally, the pricing classification for natural gas markets in Nigeria shall be in accordance with the Third Schedule of the Act and in setting the DBP, the Authority will require the following information:

1. **Reporting by Gas Industry Players:** Before February 1st of each year, companies involved in selling natural gas (producers, suppliers, distributors, retailers,

[12] Ibid, section 168.
[13] GPDDR 2023, section 4 (3).
[14] Ibid, section 8(8).

and wholesale customers) must report to the Authority how much natural gas they sold and at what prices during the previous year in accordance with the guidelines provided by the Authority.[15] This is to enable the Authority establish the quantity of gas being sold and the cost of sale.

2. **Reporting of Export Parity Price:** Similarly, before March 1st of each year, producers who sell natural gas to other countries must give the Authority information about the average export parity price they sold gas for in the previous year, which shall be the applicable export parity price where marketable natural gas is exported by such producers rather than raw gas. They are to also furnish the Authority with details of the quality specifications of the gas. This helps the Authority keep track of gas exports and prices.[16]

The DBP at the marketable gas delivery point shall incorporate the following principles:

1. The price must be sufficient to bring forward sufficient natural gas supplies for the domestic market on a voluntary basis by the upstream petroleum industry.
2. Unless required to bring forward sufficient natural gas supplies for the domestic market, the price shall not be higher than the average of similar international natural gas prices in major emerging countries that are significant producers of natural gas. The Authority will determine and publish before 1st February each year, the average international gas prices of chosen countries, which shall not be higher than the DBP.
3. Subject to the limitation of (b) above, the price shall be adjusted upward on a yearly basis to account for inflation on a yearly amount or percentage basis, and;
4. The Authority shall determine the DBP within 3 months following the effective date of the GPDD

[15] Ibid, section 5(7).
[16] Ibid, section 8(3).

Regulations and modify this price where required by the circumstances in the domestic market.[17]

5. The DBP shall be based on the lowest cost of gas supply based on the three-tier cost of supply framework.

REPORTING OBLIGATIONS OF THE AUTHORITY

(i) **Reporting on Spare Capacity of Supporting Infrastructure:** Before the 1st of February each year, the Authority must report to the Commission regarding the available spare capacity of gas conditioning plants, gas processing plants, gas transportation pipelines, and the gas transportation network as of December 31st of the previous year. Prior to December 31st of the current year, the Authority is to notify the Commission after forecasting the expected spare capacity for the following five (5) years. This forecast will be based on projected investments intended for expanding and constructing new capacity for gas infrastructure.[18]

(ii) **Determining Transport Tariffs and Processing Allowances:** Prior to March 1st of every year, the Authority is expected to determine the cost of transporting raw gas to a gas processing plant, and the tariff for processing natural gas at a median capacity-sized gas processing plant aimed solely for the domestic market. Until the Authority makes these decisions, the applicable transport tariff shall be $0.15 per Million Metric British Thermal Units (MMBtu).[19]

CONCLUSION

As Nigeria charts its course towards harnessing its vast natural gas resources for economic growth and development, the regulatory landscape governing the domestic gas sector assumes paramount importance. Part 1 of this article series delved into the foundational aspects of Nigeria's gas pricing mechanism, discussing the pivotal role of the Authority in shaping regulated pricing frameworks within Nigeria's strategic sectors. From

[17] PIA 2021, 3rd Schedule (1).
[18] Ibid, section 6.
[19] Ibid, section 8 (5) & (6).

the formulation of the GPDDR to the definition of strategic sectors and pricing criteria, the Authority's directive emphasizes a dedication to transparency, equity, and market sustainability. The incremental review of natural gas prices in the power and commercial sectors demonstrates a carefully balanced strategy aimed at harmonizing domestic pricing trends with international market shifts, thereby stimulating investments and enhancing supply chain effectiveness. Part 2 will further explore the nuanced interplay between regulated and unregulated pricing frameworks, unravelling the complexities of market dynamics and the imperative for adaptive regulatory oversight as Nigeria's domestic gas market transitions to a 'Free Market Status'.

PLEASE NOTE THAT THIS ARTICLE IS FOR INFORMATION PURPOSES ONLY AND DOES NOT CONSTITUTE LEGAL ADVICE

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