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FUELLING NIGERIA'S FUTURE:

A ROADMAP FOR DOMESTIC GAS PRICING AND REGULATION (PART 2)

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INTRODUCTION

In Part 1 of this article series on Nigeria's evolving gas pricing mechanism, we discussed the foundational principles guiding Domestic Base Pricing (DBP) in Nigeria's domestic gas market. We also analysed the natural gas pricing framework overseen by the Nigerian Midstream and Downstream Petroleum Regulatory Authority ("the Authority"), as well as the pricing frameworks within the strategic sectors. In Part 2 of this series, we discuss the regulated and unregulated domestic natural gas markets, compliance measures for gas distribution licenses as well as outline the criteria for transitioning to free market status in the strategic sectors.

REGULATED AND UNREGULATED DOMESTIC NATURAL GAS MARKETS

Prior to the 1st of March each year, the Authority is to determine and publish the domestic gas demand requirements for the strategic sectors and subsequently communicate this information to the Commission.[1] These requirements represent the aggregate volume of marketable natural gas needed by all wholesale customers operating within the strategic sectors categorized as the regulated and unregulated domestic market.

1. **Regulated Domestic Market**
   The Regulated Domestic Market consists of wholesale customers of the strategic sectors who

[1] PIA 2021, sections 173(2) & 173(1).

elect to be customers of the Domestic Gas Aggregator (DGA). The role of the DGA (i.e. the Nigerian Gas Aggregation Company Limited "NGAC") is basically to bring together natural gas from various sources, both producers and suppliers, and supply it to the domestic consumers of the strategic sectors. Section 11 of the Gas Pricing Domestic Demand Regulations (GPDDR) mandates the gas aggregator to obtain from the Commission domestic gas delivery obligation volumes allocated to gas producers before March 15th annually. This aggregation helps streamline the distribution and utilization of natural gas within the country.

The DGA is also empowered to among other things; upon notification of the domestic gas demand requirement from the Authority, support the implementation of the DGDO, implement a natural gas management model, through which the demand and supply of natural gas for use in the strategic sectors are monitored, ensure transparency in dealing between natural gas suppliers and wholesale customers of strategic sectors. The DGA is also mandated to establish an escrow account into which customer clients shall contribute their payments for the marketable natural gas received and from which the domestic gas aggregator shall pay the producer clients for their supplies of natural gas.[2]

[2] Ibid, section 154 (g).

A wholesale customer who has reported the required volumes of gas under the domestic gas requirement to the Authority, and who wishes to be a client of the DGA shall propose such volumes and apply to the DGA for a corresponding gas purchase order. Upon satisfactory due diligence, the DGA shall issue the gas purchase order to a wholesale customer which shall specify the following:

a. The lessee expected to supply the required natural gas.
b. The quantity and quality of marketable natural gas to be supplied.
c. The price payable by the wholesale customer in line with the principles for setting the DBP.
d. The location for the delivery of the gas volumes as determined by the DGA.
e. The delivery schedule and other details required by the DGA.

The issuance of the gas purchase order by the DGA to the gas producer is sufficient evidence that the required quantity of gas has been allocated to the wholesale customer pursuant to the domestic market demand requirement. The DGA may make the necessary modifications in order to ensure that each producer provides all the required volumes of the wholesale customers.[3] Upon receipt of the gas purchase order, the producer and wholesale customer are empowered to initiate a Gas Purchase and Sale Agreement (GPSA). The Domestic Gas Delivery Obligations (DGDO) of the producer will be managed according to the terms of the GPSA, which may retain the option of utilizing the escrow account mechanism offered by the DGA. Should the parties choose to maintain the escrow account mechanism, they are to adhere to the aggregated prices established by the DGA, formulated based on the DBP, the yearly wholesale price for the power and commercial sectors, and the monthly price for the gas-based industries set by the Authority. Any

[3] DGPDDR, 2023, section 11 (9) (10) (11).

GPSA executed before the effective date of the Act is to be modified by the DGA to comply with the provisions of the Act.[4]

Where the parties assigned the gas purchase order by the DGA opt to forego the utilization of the escrow account mechanism and instead enter GPSAs based on voluntary and free market principles, they are required to notify the DGA, the Commission, and the Authority regarding these contracts. Should the volume of these contracts match or exceed the DGDO for the lessee, the lessee will be considered to have fulfilled its DGDO. Consequently, the associated gas volumes will no longer be considered part of the regulated domestic market, and the parties will cease to be clients of the DGA.[5] Failure of a producer or purchaser of gas or their agent under a DGDO to accept the aggregate price or refusal to pay the proceeds of gas into the escrow account for the purposes of aggregation attracts an administrative penalty prescribed by the Authority.[6]

Where the volume of allocated DGDO falls short of the domestic gas demand requirement due to inadequate voluntary supplies, the DGA is mandated to devise and implement a curtailment scheme, endorsed by the Authority, to align with the needs of wholesale customers, ensuring volume consistency. The DGA may also suggest that the respective wholesale customers engage in agreements with producers based on free market principles.

2. **Unregulated Domestic Market**
Unregulated volumes of natural gas within the strategic sectors of the domestic market can be acquired by wholesale customers exercising their rights to negotiate supply contracts directly with lessees or suppliers, as outlined in section 110 (2) of the Act. Where a wholesale customer can determine that the volumes of its contracts are equal to or higher than its domestic gas delivery obligations, it must notify the Authority, the Commission, and the relevant lessees from which the required marketable natural gas

[4] PIA 2021, section 156.
[5] DGPDDR, section 11 (16).
[6] Ibid, section 16(3).

was obtained, indicating that there is no necessity to be a client of the DGA. The wholesale customer's election not to be a client of the DGA is notwithstanding its obligation to comply with environmental regulations stipulated in the Act.[7]

Unregulated pricing for marketable natural gas encompasses the sale of raw gas by a producer or licensee of a gas conditioning plant, which shall occur at free market prices and transfer prices. Free market prices are dictated by the interplay of demand and supply within an open market, influenced by factors like production costs, availability, geopolitical occurrences, and market speculation. On the other hand, transfer prices denote the prices of natural gas exchanged between various divisions within the same producer or supplier. This occurs, for instance, when a wholesale customer, having multiple subsidiaries, conducts internal buying and selling of natural gas.
Unregulated free market prices for marketable natural gas shall apply to the following categories of customers:

a. Sales to wholesale customers of the strategic sectors who are not customers of the DGA;
b. Wholesale customers of sectors other than the strategic sectors;
c. Independent gas retailers;
d. Gas distributors;
e. Exporters;
f. Lessees; and
g. Wholesale gas suppliers.

COMPLIANCE MEASURES FOR GAS DISTRIBUTION LICENSES

Only holders of retail or gas distribution licenses may supply gas to retail customers. A person supplying gas to retail customers prior to the commencement of the DGPDDR 2023 is required to obtain a license from the Authority within 90 days of the commencement of the Regulations. A Gas Distributor is required to within 90 days from the commencement of the DGPDDR 2023 submit to the Authority information necessary for the review of the prices charged, services

[7] PIA, 2021, sections 102 (2) & (4).

provided and tariffs applied by such distributor. The Authority is to ensure customer protection, as well as prevent anti-competitive behaviour and discriminatory conduct with respect to prices charged and services provided by retail gas distributors.[8] If within one year of the DGPDDR 2023 taking effect, the Authority determines that the prices set by the gas distributor violate the Regulations, it will mandate the distributor to make necessary adjustments. Failure to secure the appropriate licenses, furnish accurate information to the Regulators, adhere to license conditions or the submission of false information may result in an administrative penalty of $100,000 or, alternatively, the suspension or revocation of the permit or license.[9]

CRITERIA FOR TRANSITIONING TO FREE MARKET STATUS IN THE STRATEGIC SECTORS

If the Authority establishes that a sector or all strategic sectors have attained free market status, it will in consultation with the Commission inform key stakeholders, providing at least one year's notice. This notification indicates that the regulated pricing regime and associated obligations concerning domestic gas delivery and aggregation will cease to apply. To determine whether a free and unregulated market has been achieved in the strategic sectors, the Authority is to consider the following:

1. Whether the respective sector is largely unregulated pursuant to the information supplied in the Federal Gazette published by the Authority in line with Section 4(1) of the GPDDR;
2. Whether gas delivery by pipelines or trucks is adequate to ensure liquidity and that there are no monopoly or significant cartels in the market;
3. The existence of a trading platform approved by the Authority to publish prices from time to time;
4. The availability of key delivery infrastructure and observance of third-party access rules; and
5. The existence of bilateral and over-the-counter trading, balancing rules and standardised trading contracts.[10]

[8] DGPDDR 2023, section 13.
[9] Ibid, section 15.
[10] GPDDR, 2023, section 14 (1).

CONCLUSION

In conclusion, the recent establishment of a new pricing framework for natural gas in Nigeria marks a significant step towards achieving a more balanced and sustainable approach to gas pricing. With the Domestic Gas Delivery Obligations (DGDO) and the Gas Pricing and Domestic Demand Regulations (GPDDR) in place, there is a clear framework to ensure the availability of gas for domestic utilization while also considering the broader strategic benefits to the economy. Also, the pricing adjustments made by the Authority reflect a commitment to align with the directives of the PIA and promote investment in domestic gas infrastructure. By setting the Year 2024 Domestic base Price (DBP) and introducing tax credit incentives for Non-Associated Gas (NAG) greenfield developments, the government aims to stimulate production and meet domestic demand.

Furthermore, the delineation of regulated and unregulated domestic natural gas markets provides clarity for stakeholders, fostering transparency and fair competition. The inclusion of principles guiding the DBP in the strategic sectors ensures that pricing remains competitive and responsive to market dynamics, while also considering inflation and international benchmarks. Overall, these regulatory measures lay the groundwork for a more robust and dynamic natural gas sector in Nigeria, poised to support economic growth, industrial development, and energy security. By seeking to balance the interests of producers, wholesale customers, gas distributors, and retail customers, Nigeria is positioning itself as a key player in the global energy landscape while meeting the needs of its domestic market.

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