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IMPACT OF THE NEW PRICING OF NATURAL GAS FOR THE NIGERIAN DOMESTIC GAS MARKET

Introduction

Nigeria is said to have 206.53 trillion cubic feet (tcf) of untapped proven gas reserves with an estimated recoverable gas reserve of 139.4 tcf.¹ Despite the abundance of gas reserves, the production and development of gas have not been optimally harnessed. This is largely attributable to the capital-intensive nature of gas production. However, the Federal Government of Nigeria (FGN) has continued to formulate policies², enact laws and make regulations that will enhance the development and utilization of Natural Gas and availability of Natural Gas for the domestic market.

To meet Nigeria's increasing domestic gas demands, the FGN through the Petroleum Industry Act, 2021 (PIA) made several provisions for gas development including Domestic Gas Delivery Obligation.³ A Domestic Gas Delivery Obligation mandates gas producers to allocate a percentage of their total gas production for sale to the domestic market. The obligation is aimed at increasing the supply of natural gas to the domestic market and particularly achieve the government's objective of Gas to Power and encouraging the utilization of Natural Gas generally.

¹ According to a report by the Nigerian Upstream Petroleum Regulatory Commission issued in 2021.

² Recently, the President of the Federal Republic of Nigeria, Bola Ahmed Tinubu issued an Executive Order known as the Oil & Gas Companies (Tax Incentives, Exemption, Remission, ETC) Order 2024. This Order aims at encouraging Non-Associated Gas greenfield projects for onshore and shallow water. See the link to our article published on this subject - <https://ao2law.com/nigerias-presidential-order-on-gas-incentives-an-attempt-to-tend-to-the-golden-goose/>

³ Section 110 of the PIA



Who determines the Domestic Gas Delivery Obligations?

The allocation of a Domestic Gas Delivery Obligation (DGDO) to upstream producers is exercised by the Nigerian Upstream Petroleum Regulatory Commission (Commission)⁴ based on the Domestic Gas Demand Requirements (DGDR) determined by the Nigerian Midstream and Downstream Petroleum Regulatory Authority (Authority).⁵ The DGDR is an estimate of the total amount of natural gas that is needed to satisfy the energy demands of the domestic market. It is used by gas producers and aggregators to plan their gas production, aggregation, and distribution activities to ensure that the required amount of gas is available to meet the market's needs. However, gas producers may, voluntarily, conclude contracts with wholesale customers of the strategic sectors or with wholesale gas suppliers, supplying the strategic sectors for delivery of marketable natural gas on a free market basis to these customers or suppliers and notifying the Commission of the contracts. Where the volume of contracts is equal to or higher than the DGDO for the gas producers who are not clients of the gas aggregator, the gas producers shall be deemed to have

⁴ Section 110(1)(a) of the PIA and the Domestic Gas Delivery Obligation Regulations 2022 issued by the Commission.

⁵ Section 173(1) of the PIA

fulfilled their DGDO. Additionally, the gas producer is to inform the gas aggregator of its status in adherence to these provisions.⁶

Who determines Domestic Base Price?

Section 167 of the PIA and Regulation 8(2) of the Gas Pricing and Domestic Demand Regulations 2023, provides that the Authority is empowered to determine the Domestic Base Price for the strategic sectors.⁷ The Domestic Base Price which must be the lower of the export parity price or the domestic gas supply price is determined by the Authority on the 1st of April each year.

In line with Section 167 of the PIA and the Third and Fourth Schedule of the PIA, the Authority has determined the Domestic Base Price for the year 2024 to be USD2.42/MMBTU.

The Domestic Base Price for the Power Sector is USD2.42/MMBTU while the base price for the “Commercial Sector” is USD2.92/MMBTU. With respect to Gas Based Industries, the floor domestic price is USD0.9/MMBTU with a maximum price of USD2.42/MMBTU. Gas based industries include industries or projects that process or utilize ammonia, urea, methanol, polypropylene, low sulphur diesel and others that the Authority may add by way of Regulations.⁸

What does “Commercial Sector” mean as a “Strategic Sector”?

The New Wholesale Prices of Natural Gas lists: (i) the Power Sector, (ii) Gas – Based Industries and (ii) the Commercial Sector as the Strategic Sectors to which the new pricing structure should apply. While it appears that there is clarity as to the power sector and gas – based industries being referred to as strategic sectors, the use of “commercial sector” appears wide and nebulous which has elicited questions as to which sector would qualify as “commercial sector”. In our view, any domestic project, venture, industry, or commercial undertaking which utilizes gas within the domestic market may qualify as “commercial sector”.

What are the principles that guide determination of the Domestic Base Price?

The following are the relevant principles that guide determination of the Domestic Base Price:

⁶ Section 110(2) of the PIA

⁷ The Strategic Sectors include Power, Commercial and Gas-based Industries.

⁸ The basis for calculating the relevant Domestic Bas Price will be in accordance with the formula prescribed in the 4th Schedule of the Act.

- a. Pricing must be cost and market reflective: the Domestic Base Price must be of a level to bring forward sufficient natural gas supplies for the domestic market voluntarily by the upstream producers.
- b. Relative Benchmarking with jurisdictions similar to Nigeria: the Domestic Base Price shall not be higher than the average similar natural gas prices in major emerging countries that are significant gas producers of natural gas.
- c. Cost of Gas: lowest cost of gas supply based on the three-tier cost of supply framework.
- d. International pricing Benchmark: market-related prices tied to international benchmarks.



Is there the likelihood of renegotiation of Gas Sale and Purchase Agreements?

Most likely! Gas supply to the domestic market is presently priced around \$2.18 per scf.⁹ Therefore, an increase of the base price to \$2.42 would most likely lead to an increase in the gas pricing under existing gas sale and purchase agreements for the supply of natural gas to the domestic market. That said, the devil is in the detail of the relevant gas sale & purchase agreements with respect to the triggers for price escalation.

Can a gas producer who has met its Domestic Gas Delivery Obligations sell above the Domestic Base Price to a buyer in the domestic market?

⁹ <https://energycapitalpower.com/market-report-nigeria-reduces-domestic-natural-gas-base-price/#:~:text=Market%20Report%3A%20Nigeria%20Reduces%20Domestic%20Natural%20Gas%20Base,feet.%20...%20%20GABON%20...%203%20GLOBAL%20>

It is our view that a gas producer who has satisfied its DGDO is at liberty to enter into bilateral agreements with a wholesale customer on a willing buyer–willing seller basis. Implicitly, parties would be free to negotiate the gas price without any statutory obligation. Additionally, a wholesale customer of the strategic sectors has the right to negotiate its supply contracts directly with gas producers where the wholesale customer is of the view that the contracts are satisfactory for its requirements. In such instances, the wholesale customer shall inform the Authority that there is no need to be a customer client of the domestic gas aggregator and shall also inform the Commission of the gas producer.¹⁰

How does the Domestic Base Price affect electricity tariff?

The Power sector is said to be the largest user of natural gas in Nigeria.¹¹ An increase in the applicable Domestic Base Price would lead to a corresponding increase in the electricity tariff of the power sector’s value chain. Specifically, the Generating Companies (Gencos) – most of which generate electricity through gas-fired plants – are likely to increase the electricity tariff of electricity supplied to the Distribution Companies (Discos) and Eligible Customers. Incidentally, the Discos would increase their electricity tariff payable by end users to reflect the price paid to the Gencos for the supply of power.

Conclusion

Upon the issuance of the Gas Pricing and Domestic Demand Regulation 2023 by the Authority, gas prices under the revoked National Gas Supply and Pricing Regulations, 2008 were preserved till 1st April 2023.¹² The determination of the Domestic Base Price by the Authority is a welcome development as it aims to continuously ensure transparency, deepening of the domestic gas market and creating investor-friendly business environments. It is hoped that stakeholders in the gas sector will take advantage of the Domestic Base Price to ensure the increasing gas demands are met. That said, the resultant effects such as increase in electricity tariffs may create unintended consequences given the recent inflationary trends in Nigeria as at the time of this briefing note.

¹⁰ Section 173(3) of the PIA

¹¹ The International Energy Agency’s 2019 report states that 80% of power generation comes from gas.

¹² Section 17(3) of the Gas Pricing and Domestic Demand Regulation 2023