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Nigeria's New Natural Gas Pipeline Tariff Regulation: Evaluating The Tariff Methodology

A fully developed domestic gas pipeline network is an essential backbone infrastructure for connecting gas supply sources to the end-user market and actualising gas industrialization.

In recognition of the criticality of gas pipelines and gas networks to the development of an industrialized gas nation, the Petroleum Industry Act, 2021 (the "**PIA**") in ***Section 32(c)(ii)*** empowers the Nigerian Midstream and Downstream Petroleum Regulatory Authority (the "**Authority**") to design a tariff methodology to underpin the economic feasibility of gas pipeline systems in Nigeria. Pursuant to this function, the Authority has issued the Natural Gas Pipeline Tariff Regulations, 2023 (the "**Regulations**").

Transportation represents one of the significant costs of gas supply because pipeline economics is sensitive to the capacity of the infrastructure and the distance to the market. In this Newsletter, we will discuss the key provisions of the Regulations and the obligations imposed on gas transportation pipeline licensees and gas transportation network operator licensees ("**Operators**").

(1) Tariff Principles and Methodology

The tariff framework under the Regulations is underpinned by the tariff principles enshrined in the PIA which are primarily geared at: (a) cost reflective tariffs; (b)sustainability of the pipeline infrastructure by covering long-term costs of operation; (c) non-discrimination among customers with similar characteristics; (d) differentiation in the application of tariffs to customers with dissimilar characteristics, and (e) accommodating flexibility in the currency of payment with a view to avoiding currency mismatch in the operators' debt and cost portfolio.

(2) Tariff Structure

To ensure the recovery of financing costs, fixed operating costs and other costs, the Regulations provide a tariff structure which consists of a **capacity charge**, a **commodity charge** and any other charge prescribed under the relevant code such as the overrun charges payable by shippers as prescribed under the Nigerian Gas Transportation Network Code.

The commodity charge which varies in proportion to the shipper's throughput of natural gas through the gas transportation pipeline or gas transportation network may be charged in cash, or through the provision of fuel gas to the Operator in proportion to the shipper's throughput. The commodity charge assures the Operator of the recovery of variable costs of fuel and other expenses.

(3) Differentiation and Banking Enablers

Whilst the Regulations and the PIA frown on discrimination among customers with similar characteristics, the Regulations (and the PIA) embrace the principles of differentiation among customers with dissimilar characteristics. From an investor's standpoint, this signals a deliberate intention by the Federal Government to promote the development of the midstream gas infrastructure.

Although the Regulations set a reference tariff which is levelized, the tariff may be adjusted to make it real based on the interaction of the various classes of capacity charges.

Some of the principles of differentiation are set out below:

(a) In relation to gas transportation networks or gas transportation pipeline deployed on an open access basis:

   i. the capacity charge for gas transportation agreements with shippers facilitating the financing of new gas transportation pipeline will be considered differently; and

   ii. the peculiarity of the industry of the end-users will be factored into the computation of the capacity charge.

(b) In relation to gas transportation networks or gas transportation pipelines for own use:

   i. the notional capacity charge levied by the Operator on an affiliate must be determined on arms-length basis by the Operator to ensure that the tariff methodology is efficient and does not distort the project economics for the gas market; and

   ii. the capacity charge for shippers who are granted third party access must also be considered separately.

Also, and as part of the differentiation measures, the Regulations in formulating the tariff principles will consider the following matrices:

a. The status of a pipeline or the network whether it is a new pipeline/network or an existing pipeline/network.
b. The nature of access to the pipeline i.e., whether it is operated on open basis or for own account.
c. The adoption of any of the three criteria: the uniform/postage stamp tariff whereby one single tariff rate is charged to a class of tariff, regardless of the distance in which natural gas is transported on the pipeline, the distance-based tariff, or the zonal tariff.

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(4) Currency of Payment- Avoidance of Currency Mismatch

To mitigate the risk of currency mismatch, and hedge against foreign exchange volatilities, which have hitherto plagued the domestic gas market, the Regulations permit the capacity charge to be determined based on a foreign currency or its Naira equivalent converted at the open market rate.

(5) Tariff Review Triggers:

Market conditions and their forecast can be uncertain and unpredictable. As such, a standard tariff methodology should include tariff review clauses to enable the adjustment of the tariffs. The Regulations allow tariffs to be adjusted for inflation. The capacity charge may be adjusted downwards upon the default of the Operator or upon the occurrence of force majeure.

(6) Existing Gas Transportation Agreements

All existing gas transportation agreements that pre-date the Regulations and entered on an open access basis or relating to gas transportation networks are no longer effective and are deemed replaced by the gas network code framework agreements.

(7) Transparency and Accountability

To promote transparency and accountability in the tariff, Operators are required to provide their proposed capacity and commodity charges, audited financial statements; and any other relevant information requested by the Authority for the Authority's approval, within one month after the Authority has published the various tariff methodologies.

Also, Operators are required to publish the tariffs in a manner that ensures that the shippers can identify and calculate the charges for which they will become liable.

(8) Evaluating Market Behaviour

To ensure that the tariff takes into consideration market economics such as the behaviour of shippers towards the payment of agreed tariffs, the Regulations make it a requirement for shippers to recalculate the transportation tariff charged for that year, taking into account the actual performance of shippers in duly paying invoices and the commencement of additional transportation of natural gas for new or existing shippers.[1]

(9) Offences And Penalties

Any person who fails to comply with the provisions of the Regulations will in addition to the penalties associated with the network code framework agreement and gas transportation agreement, be liable to an administrative penalty of not less than USD1,000,000 or its Naira equivalent at the prevailing Central Bank of Nigeria exchange rate.

In conclusion, the issuance of the Regulations is one of the significant steps taken by the Authority to ensure the efficient running and development of the gas midstream sector. From an investor's standpoint, a tariff methodology that underpins the economic feasibility of the venture by providing sufficient revenue to yield an acceptable return after the recovery of debt, operating costs, return on equity and taxes is one that will definitely spur investments and enhance the viability of investments into the gas sector in Nigeria.

From the perspective of a shipper, the reporting obligations of the Operators will provide the transparency and predictability required to build a foreign market.

From the government's perspective, the tariff methodology should be efficient and not distort the market.

It seems the regulator refracted all these perspectives through a regulatory prism, and it is expected that the Authority will not depart from these philosophies at the point of implementation and computing the levelized and differentiated tariff.

The existing shippers are advised to review the provisions of their gas agreements and compute the impact of the change-in-law in their businesses.