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The National Gas Policy, 2017

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INTRODUCTION

Although Nigeria has been described as a gas province with proven reserves of 188 trillion cubic feet(tcf) of gas and an enviable position as the 9th largest gas reserves holder in the world, minimal efforts have been made by the Federal Government to give priority consideration to the exploitation of gas and the development of critical gas infrastructure. Several decades after the discovery of gas, the legal landscape is still being framed by the dated Petroleum Act which focuses more on oil. The Petroleum Act has very lean provisions on the commercialization of gas as an independent hydrocarbon and lacks a framework for the development of the gas midstream-downstream value chain.

In 2005, an attempt was made to partly resolve the dearth in legislation through the Downstream Gas Bill, but this was unsuccessful. Gas export projects remained the national priority until 2008, when the Federal Government approved the implementation of the Gas Master Plan. The Gas Master Plan was supposed to provoke an entirely different vista of opportunities for Nigeria to launch itself as a mature domestic market.9 years after, the dream of industrialization remains at best, a figment of imagination.

In December 2016, the Federal Government took another bold step which led to the launch of the 7 Big Wins Initiative. This reinforced its commitment to the acceleration of the gas revolution. And on June 28, 2017, the Federal Government approved the new National Gas Policy (the "Policy") which essentially builds on the policy goals of the 7 Big Wins Initiative. The Policy clearly articulates the policy goals, strategies, and implementation plan of the Federal Government of Nigeria to reposition Nigeria as an attractive gas based industrialised nation through the prioritization of local gas demand requirements. Access to infrastructure, a clearly articulated pricing path and institutional capacity strengthening are key aspects of any effective gas policy.

The Policy clearly defines the direction for gas infrastructure ownership by prescribing full legal separation of gas infrastructure ownership and operations and trading. With regards to pricing, the Policy stipulates that the transitional pricing framework will be retained until sufficient gas supply volumes are built up and a mature gas market is established. The Policy exhibits a strong focus on strengthening the capacity of the Ministry of Petroleum Resources to provide leadership to the gas industry in terms of policy making and surveillance capabilities. It also recommends the establishment of a single independent petroleum regulatory agency.

OUR COMMENTARY

COMMERCIAL FRAMEWORK

The Policy clearly defines the direction for gas infrastructure ownership by prescribing a full legal separation of gas infrastructure ownership and operations and trading, such that separate companies will carry out the different activities outlined for the different parts of the gas value chain. This is designed to break unhealthy monopolies and prohibit business models where the same entity holds the upstream producing asset and runs and controls the gas processing or transportation infrastructure.

Guaranteed access to existing infrastructure on the basis of transparent pricing methodologies, subject only to capacity constraints and gas quality standards is a much welcome development. As such, the Policy proposes to introduce open access to all pipelines and other essential midstream infrastructure irrespective of the location, and prescribes the formulation of a gas network code which will regulate all matters relating to pipeline pressures, gas specifications, metering and other technical and commercial details relating to infrastructure access.

The Policy is flexible on the deployment of various commercial arrangements to develop market position and market players are free to adopt gas swaps provided that such arrangements are not being used to avoid Domestic Supply Obligations ("DSOs"). With regards to export gas ownership and tolling, the national oil and gas company will retain ownership of its equity gas destined for export markets until sale to suppliers or the final consumers in the international markets.

The Policy provides that the existing gas pricing framework will be revised by an amended National Domestic Gas Supply & Pricing Regulation. It also stipulates that the transitional pricing framework will be retained until sufficient gas supply volumes are built up and a sufficient gas market has been established as the market is now demonstrating growing appetite for bilateral negotiations of wholesale gas supply transactions. During the transition period, the wholesale gas price for the domestic market will remain subject to the Export Parity Netback Gas Price ("EPP") i.e. the average export market price less the costs of regasification, shipping and liquefaction will be taken as the production price to be applied to the domestic market. Under this approach, gas producers are expected to be indifferent as to whether they deliver gas to the LNG export market or the domestic Nigerian market because, combined with a modest DSO, producers will have sufficient market incentives to produce for the domestic market. However, given the incessant breaks in the gas to power chain, the question arises as to whether the EPP pricing will incentivise increased supply of gas to the power sector. Also, the Gas Master Plan recognises three strategic categories of gas purchasers with different pricing methodologies. It is not clear if the real intention of the Policy is to replace the different pricing plans with one transitional pricing.

Ultimately, wholesale gas pricing will morph into a market-led approach without gas price regulation, except for monopoly infrastructure. The Policy sets out a number of triggers for the transitioning to wholesale gas pricing. These triggers are essentially related to the increased availability of both gas and gas transportation infrastructure, most critically the OB3 and Oben pipeline which will allow the transportation of gas from the Eastern part to the Western and Northern part of the country. Given the lengthy amount of time it has taken to complete critical infrastructure, it is hard to predict when all sections of OB3 will finally be completed. This therefore increases the uncertainty around when the Minister of Petroleum Resources would declare a wholesale gas market, which is supposed to end regulated gas pricing and usher in, in its real form, wholesale contracts on a willing buyer- willing seller basis.

The Policy recognizes the need to finalise commercial terms for gas development under the Production Sharing Contracts ("PSCs"), and also recognizes that such a framework will need to allow for bespoke adjustment to cater to each circumstance. This is a welcome development because currently, Nigerian PSCs are structured more for crude oil exploration and development. The PSC merely provides that in the event of the discovery of a viable quantity of natural gas, the contractor shall investigate the discovery and submit proposals to the Nigerian National Petroleum Corporation ("NNPC") for the development of the gas, and a separate agreement is then negotiated between NNPC and the contractor for gas development. The absence of clarity regarding terms of development means that significant discovered gas resources remain undeveloped in Nigeria's PSC blocks, especially in offshore basins. As such, the current policy direction is for the Government to develop a Gas Development Agreement that will clarify the commercial and fiscal arrangement.

THE FISCAL REGIME

A new fiscal policy which is to be embedded in a separate and complementary National Petroleum Fiscal Policy document has been proposed for the Nigerian petroleum sector. The purpose of the fiscal framework is to make gas a standalone commodity, separate from oil. Hence, gas projects will be developed based on their economics and not dependent on or consolidated against oil taxation. The fiscal regime will be framed by fiscal rules of general application that are designed to ensure stability, progressivity, competitiveness, and cost efficiencies. Also, there will be non-consolidation/ non-recovery of gas costs from oil income, in addition to separate fiscal treatment for exploration, production and midstream gas activities to relax royalty and tax rates for gas and incentivise entry into the midstream sector. The overall objective being to ensure that gas projects can be economically viable from a fiscal viewpoint. For upstream gas development, the fiscal regime may introduce favourable upstream terms such as reduced royalty rates for gas and favourable production allowances and hydrocarbon tax.

GOVERNANCE

To address the age long legislative neglect for gas, one of the focal points of the Policy is the creation of a robust legislative framework for gas. This will be achieved through the passage of a principal legislation that will address gas commercialization from development to off-take and with very clear calibration of gas activities into the upstream, midstream and downstream sectors. The new legislation is expected to treat gas as an independent commodity rather than a by-product of oil production and clarify the fiscal regime. Gas infrastructure ownership and operations are to be separated from gas trading. The new legislation will also introduce a simplified but clearly defined licensing regime which will regulate the licensing of operators throughout the entire value chain of gas exploitation. As laudable as this initiative may be, the experiences with the draft Petroleum Industry Bill ("PIB") and the more recent draft Petroleum Industry Governance Bill ("Governance Bill") do not signal a positive actualisation of this objective.

INSTITUTIONAL FRAMEWORK

The Policy exhibits a strong focus on strengthening the capacity of the Ministry of Petroleum Resources ("MPR") to provide leadership to the gas industry in terms of policy making and surveillance capabilities. The Policy recommends the creation of a National Petroleum Policy Directorate which will serve as the technical back office for the Minister, along with the following specialist centres: oil policy division; gas policy division; strategic planning and policy research centre and an investment promotion office. The Policy also proposes the setting up of Dedicated Project Desks within the National Petroleum Policy Directorate. The main role will be to lobby and push projects or programmes relevant to the Policy by acting as an interface between project developers and government agencies. We are of the view that this initiative may engender corruption and favouritism.

The Policy also seeks to address the duplication of regulatory and supervisory functions by introducing a single independent petroleum regulatory agency. All regulatory and pseudo-regulatory activities will be removed from corporate entities and taken over by the single regulator. If successfully implemented, this approach will go a long way in eradicating the number of disparate and sometimes overlapping regulatory agencies and consolidate the activities of the existing petroleum regulatory authorities. The regulator will essentially be responsible for the economic and technical regulation of the petroleum sector and will have licensing, investigative, monitoring and dispute mediation powers. The main issue with this recommendation is that the Governance Bill also proposes the establishment of a single independent regulatory agency. It is unclear if the regulatory agency proposed under the Governance Bill is the same as the agency proposed in this Policy as the Governance Bill is silent on the Departments/Divisions prescribed in this Policy.

The Policy recognizes that the new regulator will require strong capacity building. In this regard, the Policy envisages the creation of six new departments under the aegis of the new regulatory authority. The standards division is expected to resolve the shortcomings in metering, measurement and fiscalisation of hydrocarbons throughout the value chain. Stringent measures will be put in place for cost monitoring and control, as Nigeria has reportedly become one of the highest cost provinces in the world. Performance based incentives that reward lower cost producers and penalize higher cost producers will also be introduced. The Policy recognizes the rights and interests of minority stakeholders and advocates the establishment of a consumer representation and protection body.

DOMESTIC GAS SUPPLY OBLIGATIONS AND AGGREGATION

The Government understands the lack of motivation on the part of market operators to sell gas to the domestic market. Therefore, the Policy retained the DSO introduced by the GMP, albeit with a slight modification. The volumes will be reduced to a reasonable quantity that the producers will see as not being onerous. It is however not clear the parameters that will be used to determine "reasonability" and "onerous volumes" in the context of the Policy.

During the transitional period, gas sector players will be permitted to engage in transactions on a willing buyer-willing seller basis once they have met their DSO obligations. However, once the wholesale market conditions set out in the Policy are fully triggered, then the domestic price will be set by the market subject to the defined rules on price publication and rigorous monitoring to prevent abuse.

The Policy recognizes the importance and priority of gas supply to the power sector, however, there is a conscious drive to move away from the historic non-cost reflective gas pricing framework towards a wholesale market where power generators will pay the market negotiated wholesale price. This paradigm shift is expected to create a better and stronger coordination between the gas and power sector, especially since the power sector constitutes one of the major demand centres for natural gas.

The development of a competitive market for gas supply inevitably means that Nigeria will ultimately move away from the concept of gas aggregation which has been largely unsuccessful under the aegis of the Gas Aggregation Company of Nigeria (GACN).

INDUSTRY STRUCTURE

The gas policy envisions an industry founded on partnership between the public and private sectors, albeit with a clear separation of roles between the government and the private sector. Notwithstanding, both the government and the private sector are considered as partners executing various functions. The Government will be primarily responsible for policy setting, legislation, regulation, and encouraging the development of fair and competitive gas markets, whilst the corporate sector is expected to create markets, and conduct safe, healthy and environmentally friendly operations while serving the need of their shareholders as well as other stakeholders. To set the tune, the NGC has been split into two companies i.e. the Nigerian Gas Processing and Transportation Company ("NGPTC") which will own and operate the government owned gas transmission network; and the Nigerian Gas Management Company ("NGMC"), which will own all the supply contracts and will operate the gas supply business.

DEVELOPMENT OF GAS RESOURCES

The Policy recognizes the need for Nigeria to diversify its gas supply sources to enhance national and energy security. There are security and supply risks emanating from the Niger Delta with consequent disruptive effects on gas production, the environment and wider economy. The Policy is set to foster deliberate gas exploration and production in other regions of Nigeria such as the offshore and inland basins.

The Policy also reflects the Government's new priority consideration for the channelling of flared gas into markets for utilisation by different downstream sectors. Gas flaring is a much cheaper option than gas utilization or reinjection, and despite consistent efforts by the government to reduce gas flaring, Nigeria has consistently flared or re-injected its associated gas. In the absence of compelling technical reasons or a viable outlet for the gas, the Government intends to restrict the undue re-injection of associated gas.

To end gas flaring, penalties that will truly dis-incentivise flaring accompanied by incentives for gas utilization projects, should be the primary focus.

INFRASTRUCTURE

Infrastructure is a major problem in Nigeria, and it is a foundational issue especially in the gas sector. The critical gas infrastructure needs will be identified and appropriate recommendations for upgrading the design of the existing National Gas Infrastructure Blueprint (the "Infrastructure Blueprint") will be made. The Policy stipulates that the amended Infrastructure Blueprint will identify resources and resource clusters, identify critical infrastructure, and prioritise developments.

The Policy also seeks to liberalise and incentivise entry into the midstream to enable private sector investors develop gas infrastructure. This is one of the least developed parts of the Policy, as the chapter only shows that gas infrastructure in Nigeria is still in its infancy, without any concrete policy directions on funding.

IMPROVED SAFETY REGULATION

The Policy advocates for a much higher standard in the maintenance, health, safety and environment systems in the Nigerian Petroleum Sector. It thus calls for the establishment and empowerment of a strong robust safety regulator that will be vested with powers of inspection and investigation, as well as the revision and creation of safety regulations that will include robust penalties for breaches of regulations and safety standards.

LOCAL CONTENT DEVELOPMENT

The Policy recognizes the need to develop Nigerian human resources, and prescribes methods for doing so. It highlights the difficulty in developing Nigerian local content in a low oil price environment, and emphasizes the importance of a policy approach which encourages indigenous participation at competitive prices which are consistent with the law. In achieving this, the strategic objectives stipulated by the Policy include: enhancing the implementation of the Nigerian Content Act; building competencies across the gas industry; institutional human capacity building for the public sector and industry; and instilling international oil and gas industry best practice in maintenance and safety.

CONCLUSION

In sum, the Policy is geared towards harnessing Nigeria's vast gas resources by removing the barriers affecting investment and development in the gas sector. If properly implemented, it will drive the institutional reforms and regulatory changes necessary to evolve into a gas based industrialised nation.

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