ACCESS TO NATURAL GAS – A GLARING CONCERN FOR IPPS

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One of the major concerns for investors in and proponents of reform of the Nigerian Power sector is the issue of adequate gas supply. With the majority of Nigeria's current power stations being thermal, gas supply is central to the success of the reform programme and has been the subject of debate for some time.

To put the issue on context, Nigeria has one of the largest known reserves of natural gas in the world. There is in theory more than enough gas to run the power sector. However, in practice 67% of local gas produced (which is 4.4 bcfd) is exported.

Until recently (due to the advent of power reform), the domestic gas market has not been lucrative enough to encourage local gas companies to sell domestically. So like many thorny issues associated with the Nigerian energy market, it has primarily been an issue of weak organisation, poor management of resources and inadequate development of infrastructure, rather than a more intractable problem of supply and demand.

Historically, the Nigerian gas industry has been plagued by three main problems:

1) artificially low price of gas, as a result of Government intervention . So far the government has only made small concessions on price. In the past, power stations paid as little as US$1 per million British thermal units (Mbtu) for gas – a tiny fraction of the US or European prices. Prices can now be as high as US$2 or even $2.50 per Mbtu, but state regulators must still sign off on them first.
2) lack of investment in the infrastructure for transporting the gas to the power stations
3) inadequate number of players in the gas market.

An historical perspective

Before the privatisation of the power sector, the PCHN ambled along without any real attempt to secure long term gas supply or highlight the urgent need for investment in the gas sector. Indeed, the amounts still owing by PHCN to a number of IOCs for gas 'purchased' is in the hundreds of billions. But it is purely a paper debt. And because no-one was physically out of pocket, there was no real motivation for change. The key driver for any kind of activity and sustainable change in Nigeria is profit. In the past, the absence of profitability has been at the heart of the lack of interest and development in the gas sector. Indeed, the only real progress in recent times has been the Gas Master Plan drawn up by the Nigerian Government.

The Gas Master Plan recognises the gap in infrastructure and is fairly comprehensive as an approach to the problem. But that is as far as it goes, and indeed as far as it can go. Where commerce is concerned, in the Nigerian context, nothing moves organically. Nigerians tend to react irrationally to issues facing them. However, their reactions tend to be profound and dramatic. The picture we see today will change as the private sector players in both the power and the gas industries wake up to the real business of running power plants and begin to interact and form a formidable force to face up to the Governmental impediments.

To put things in perspective, the problem has existed for many years, but was quietly ignored. It has come to the fore now, because only now is there a serious attempt to regenerate the power industry. This in itself is a sign that the problem is not an insurmountable one. It solutions rest on two things - Government realisation that it is pursuing a counter- productive policy by keeping gas prices artificially low; and the will of the Gencos and the gas companies to make things work.

The effect of privatisation

The recent privatisation and reform of the power sector makes investment in gas infrastructure more attractive and production for local consumption more lucrative. It is a potential for profit which has previously been sorely lacking in the Nigerian gas industry.

This possibility of great gains will undoubtedly propel the industry forward to increase production and divert more supply for domestic use. Gas companies are keener to deal with the new private sector owners of

Gencos than they have been with the Government-owned national company, because the private sector has a much more positive payment culture. Indeed, the gas industry is starting to respond to the prospect of dealing with a more reliable clientele. Accordingly, one of the new NIPP stations has managed to secured a ten-year agreement for the supply of gas from Seven Energy. However, the price has to be right for this effect to follow, so the Government will need to be convinced that a new era of privatisation necessitates a new approach the their pricing policy.

Potential solutions and positive developments

Transportation infrastructure
There has been some progress on the transportation front. Seven Energy, for instance, has built several kilometres of pipeline to service Ibom Station. Also the likes of Oando and Nigerian Gas Company (part of NNPC) have announced their intention to build many kilometres of gas pipeline which would support several power stations. Medium term expansion prospects are good. In 2012 Shell announced 17 gas projects worth US$6bn.

The Government has tried to address theseissues in a number of ways. The most recent is the Emergency Gas plan launched in 2012 and run by the Government-appointed Gas Aggregation Company of Nigeria (GACN). Other concrete initiatives include plans to build a petrochemicals plant by the Saudi firm Xenel industries, a fertiliser plant by India's Nagurjama, and a US$3m gas plant for one of three central processing facilities (CPFs), by a consortium of Italy's Eni and local company Oando.

Production levels
With regard to production level, in 2011 production figures of usable gas stood at 3.9 bcfd (according to BP figures). The 2011 total shows an 11% rise on 2010, and there has been a 44% increase in the production of gas in 2012.

The World Bank's efforts
In addition to the Government’s efforts, the World Bank has set aside much needed funds to guarantee the development of Nigeria’s gas infrastructure, and more specifically to support the power industry and the IPP model.

In April 2013, the Bank provided its first Partial Risk Guarantee (PRG) for US$145 million to support Nigeria’s gas sector and bring more electricity to Nigerian consumers. The PRG agreements in support of a Gas Supply and Aggregation Agreement (GSAA) were signed between the World Bank and the Power Holding Company of Nigeria (PHCN), Egbin Power PLC, Chevron Nigeria Ltd, and Deutsche Bank.

Under the 10-year GSAA, which is based on the industry template developed by Nigeria National Petroleum Corporation (NNPC), Chevron Nigeria Ltd agreed to provide gas to Egbin power plant, thereby assuring gas availability and reliability for power generation and assisting in economic growth. This was the first time that Egbin power plant had been able to procure gas under long-term arrangements.

The World Bank PRG, provided under the IDA-financed Nigeria Electricity and Gas Improvement Project (NEGIP), was key to enabling long-term gas supply arrangements. PRGs are used to cover private lenders against the risk of a public entity failing to perform its payment or contractual obligations. The NEGIP PRG was instrumental in achieving financial closure of the Egbin GSAA transaction, by providing payment security for Chevron Nigeria Ltd for the supply of gas. The payment security instrument used was a 10-year Letter of Credit (L/C) issued by Deutsche Bank.

In announcing the agreement, the World Bank said: “The absence of long-term gas supply arrangements has been one of the main causes of power shortages in Nigeria, as the gas had to be procured on a ‘best endeavour’ basis, which often was of low quality and insufficient quantity, resulting in poor performance of the power plants. The long-term contracts enabled by the PRG will also help encourage investments in upstream gas production by international and domestic oil and gas companies.”

A race against time

The measures taken by the Government and the World Bank will go some way to easing the entry of new investors into Nigeria's gas market and provide some succour for existing gas companies. However, it will not improve the problem of gas supply in the short term. It is very much a race against time, but even before the gas issue, there will be pressure to source more funds to re-furbish the newly acquired assets. This will inevitably create a delay which will give the gas industry extra months to react. However, the new Gencos will likely be under pressure to forge alliances and relationships to alleviate their gas needs sooner rather than later, and the likelihood is that they will turn to the IOCs for a solution

Conclusion

The problem of access to gas is not an insurmountable one. The new demand will force more gas companies to enter the market. For now, the best hope for the supply of gas are the major IOCs - they have both access to gas and the capability to invest in the infrastructure to transport it. According to the NNPC, IOCs account for 97% of total output, excluding flaring and reinjection. Shell is the clear leader with 56%, or 2.22 mcfd; Agip is next with 17%; Chevron has 11% and Total 9.1% Exxon Mobil. However, the likes of Oando and NGC have also announced intentions to build new gas pipelines. The most significant change required, however, is the upward adjustment of price of gas. This is the catalyst that will transform Nigeria's gas industry and put paid to the long-standing problems of production and transportation.