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TEMPLARS ThoughtLab

Gas Trading, Settlement and Exchange Platforms: A focus on Nigeria's Gas Sector

Introduction

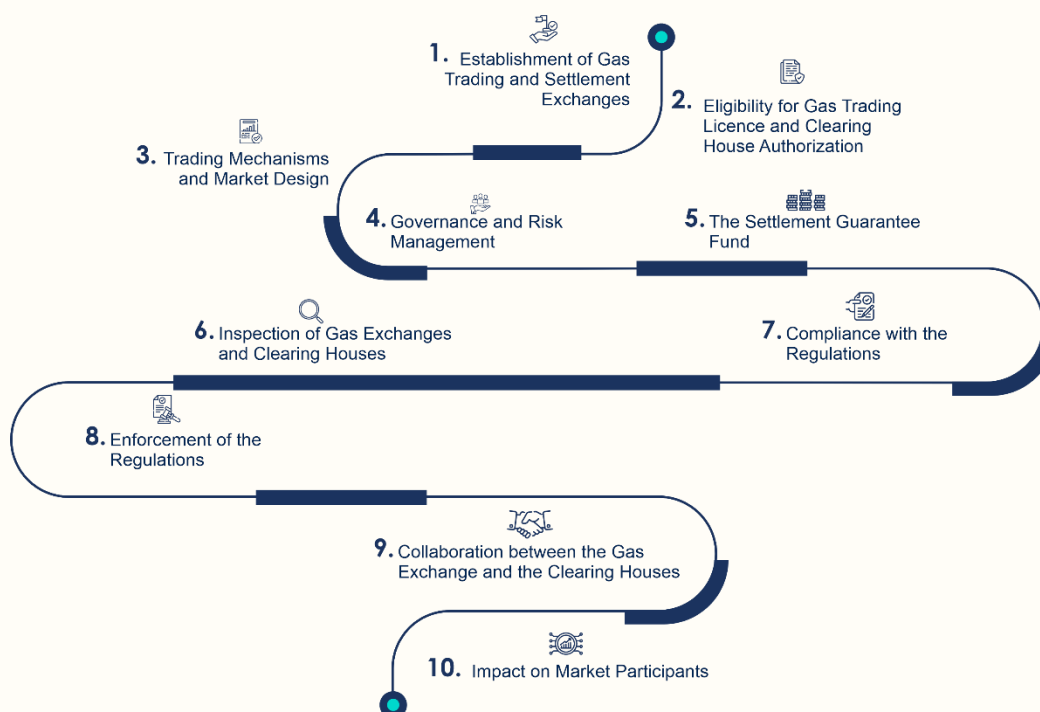
Nigeria boasts impressive natural gas reserves, currently standing at 209.26 trillion cubic feet (TCF)¹, positioning it as one of the world's major energy producers. Recognizing the strategic importance of this resource, the Nigerian Midstream and Downstream Petroleum Regulatory Authority issued the Gas Trading and Settlement Regulations, 2023 (the "**Regulations**") pursuant to its powers under the Petroleum Industry Act, 2021. The Regulations provide a legal framework aimed at promoting the development of a structured and efficient market infrastructure for the trading and settlement of natural gas and related commodities in Nigeria.

The Regulations set clear guidelines on the establishment and operation of gas exchanges and clearing houses, addresses governance and risk management standards, and introduces measures for compliance, enforcement, and market transparency.² This thought leadership piece explores the key provisions of the Regulations, the potential impact on market participants, and the opportunities and challenges posed by this transformative framework.

¹ NUPRC, <https://www.nuprc.gov.ng/nigerias-oil-and-gas-reserves-soar-nuprc-unveils-impressive-figures/>

² Regulation 1, Gas Trading and Settlement Regulations 2023

Our Assessment of the Key Provisions of the Regulations



1. Establishment of Gas Trading and Settlement Exchanges

The Regulations require entities involved in gas trading activities or acting as clearing houses to obtain a gas trading license or authorization, respectively, from the Nigerian Midstream and Downstream Petroleum Regulatory Authority (the "**Authority**")³. The licensing process ensures that only financially stable and technically proficient participants operate in the gas market.

The Regulations also emphasize the need for compliance with the Securities and Exchange Commission's ("**SEC**") rules regarding commodities trading.⁴ Gas exchanges must be financially and technically sound, and must have the necessary operational infrastructure to support their activities.⁵ Licenses are granted for a maximum period of 10 years.⁶ Renewals can be applied for 12 months before expiration,⁷ but the Authority has the discretion to withdraw licenses if necessary,⁸ ensuring that the integrity of the market is maintained.

While the Authority has the power to withdraw licenses or authorizations, there is concern about the potential for this power to be abused. The criteria for withdrawal, such as acting in the "interest of trade or public interest,"⁹ are vague and open to subjective interpretation. Without clearly defined grounds, the risk of inconsistent application exists, which could disrupt the market. The provision would benefit from more specific and articulated conditions for withdrawal, offering clearer guidelines for both regulators and participants.

³ Regulation 10, Gas Trading and Settlement Regulations 2023.

⁴ Regulation 22, Gas Trading and Settlement Regulations 2023.

⁵ Regulation 12, Gas Trading and Settlement Regulations 2023.

⁶ Regulation 16, Gas Trading and Settlement Regulations 2023.

⁷ Regulation 17, Gas Trading and Settlement Regulations 2023.

⁸ Regulation 19, Gas Trading and Settlement Regulations 2023.

⁹ Regulation 19, Gas Trading and Settlement Regulations 2023.

Moreover, it is not immediately clear whether the specific grounds outlined in Regulation 19(2) (such as violations of regulations or failure to maintain net worth) are directly linked to the broader triggers of "interest of trade or public interest." This lack of clarity could lead to uncertainty in enforcement. The concern also exists in relation to licence renewal as the renewal process is subject to such conditions as the Authority may deem fit.

However, a positive aspect of the Regulations is that contracts predating the withdrawal will remain valid,¹⁰ safeguarding market participants from sudden disruptions in existing obligations.

2. Eligibility for Gas Trading Licence and Clearing House Authorization

The below sets out some of the requirements to be eligible for the following:

- a. Eligibility for Gas Trading Licence: Applicants must be demutualized companies and limited by shares, have an online, screen-based trading system, and establish an adequate Settlement Guarantee Fund. Directors must also pass fit and proper person assessments.¹¹
- b. Eligibility for Clearing House Authorization: Applicants must have the necessary infrastructure and resources for timely trade settlement, including robust risk management frameworks and a Settlement Guarantee Fund. They must also demonstrate connectivity with banks, gas exchanges, and members, and publish real-time trade information.¹²

These requirements are designed to ensure only qualified entities operate in the market, promoting stability, transparency, and accountability.

3. Trading Mechanisms and Market Design

To ensure that the gas exchange functions efficiently, the Regulations require gas exchanges to adopt transparent price discovery mechanisms and ensure competitive market conditions. At the core of these provisions is the requirement for exchanges to adopt fair, neutral, and competitive price discovery mechanisms. This is crucial for determining accurate and fair prices based on real-time supply and demand dynamics, fostering a transparent and liquid market environment.¹³

Gas exchanges must also incorporate various contract types and bidding mechanisms—either auction-based or continuous—to enhance market liquidity and enable participants to hedge against price volatility. The physical infrastructure of the market, including pipeline operations, must comply with the Authority's guidelines, ensuring that gas transactions flow smoothly from producers to consumers.¹⁴

This structured approach to trading and market design is intended to align Nigeria's gas exchange with global best practices. By fostering a transparent and reliable trading environment, the Regulations aim to attract both local and international participants to the market.

¹⁰ Regulation 19(3), Gas Trading and Settlement Regulations 2023.

¹¹ Regulation 12, Gas Trading and Settlement Regulations 2023.

¹² Regulation 13, Gas Trading and Settlement Regulations 2023.

¹³ Regulation 8, Gas Trading and Settlement Regulations 2023.

¹⁴ Regulation 8, Gas Trading and Settlement Regulations 2023.

4. Governance and Risk Management

The Regulations require gas exchanges to comply with governance standards set by the SEC and additional disclosure and corporate governance norms.¹⁵ The board of directors must confirm quarterly compliance of the Regulations to the Authority, ensuring consistent oversight.¹⁶

Risk management practices are also a core requirement. Gas exchanges and clearing houses must adopt best practices, including managing participant credibility, margin requirements, and the adequacy of the Settlement Guarantee Fund.¹⁷ The Authority may direct them to develop a comprehensive risk management framework covering these areas.¹⁸

A critical component is the Exit Scheme, which mandates an approved exit plan to ensure orderly settlement of contracts in the event of operational closure or license withdrawal.¹⁹ This scheme minimizes market disruption by guaranteeing that contracts are settled or transferred, providing continuity and reducing uncertainty.

By implementing these frameworks, gas exchanges create a stable, attractive environment for investors, with the Authority's oversight providing confidence through a financial safety net for defaults.

5. The Settlement Guarantee Fund

The **Settlement Guarantee Fund ("SGF")** is a critical financial safeguard designed to protect the gas trading market from potential defaults by ensuring that settlement obligations are met. Gas exchanges and clearing houses are required to establish and maintain this fund as part of their risk management framework.²⁰

The SGF must maintain a minimum balance of USD 500,000 at the start of operations, providing an immediate financial cushion.²¹ It is replenished quarterly through contributions from the gas exchange or clearing house, equal to 5% of its gross revenue.²² The fund also grows through returns on investments and penalties charged by the exchange or clearing house.²³

In the event of a default, the SGF serves as a safety net, ensuring that settlements can be completed without disrupting the market. This financial buffer strengthens market integrity, enhances participant confidence, and supports continued trading activity. A well-funded SGF reduces the risk of settlement failure, making the gas market more stable and attractive for investment. However, it is not immediately clear if there is any flexibility with the potential domicile of an SGF.

¹⁵ Regulation 22, Gas Trading and Settlement Regulations 2023.

¹⁶ Regulation 23, Gas Trading and Settlement Regulations 2023.

¹⁷ Regulation 24, Gas Trading and Settlement Regulations 2023.

¹⁸ Regulation 24(5), Gas Trading and Settlement Regulations 2023.

¹⁹ Regulation 20, Gas Trading and Settlement Regulations 2023.

²⁰ Regulation 32, Gas Trading and Settlement Regulations 2023.

²¹ Regulation 32(3)(a), Gas Trading and Settlement Regulations 2023.

²² Regulation 32(b), Gas Trading and Settlement Regulations 2023.

²³ Regulation 32(c), Gas Trading and Settlement Regulations 2023.

6. Inspection of Gas Exchanges and Clearing Houses

The Regulations grant the Authority the power to conduct thorough inspections, investigations and audits of gas exchanges and clearing houses. These inspections are conducted to ensure that market participants adhere to established standards, practices, and legal requirements, while also maintaining market oversight, conducting surveillance, and safeguarding market integrity.²⁴ The Authority can launch inspections if there is any suspicion of market manipulation, price distortion, anti-competitive behavior, or violations of any regulatory requirements.²⁵

Inspections may include reviewing records, conducting audits, and investigating specific activities within gas exchanges or clearing houses.²⁶ This helps maintain transparency and provides the Authority with an opportunity to intervene early if any irregularities or unethical practices are detected.

7. Compliance with the Regulations

Compliance refers to the obligation of market participants to operate within the framework of the Regulations and other applicable laws. The Authority imposes strict compliance requirements to ensure that gas exchanges and clearing houses conduct their activities ethically and in line with market standards. These requirements include adherence to licensing conditions,²⁷ maintaining financial transparency,²⁸ and submitting regular reports²⁹ to the Authority.

Compliance also involves having robust systems in place for risk management, including mechanisms for preventing market manipulation, price volatility, and unethical behavior.³⁰ Market participants are required to confirm, on a quarterly basis, that they are in compliance with the Regulations.³¹ Furthermore, exchanges are obligated to maintain mechanisms for grievance redressal,³² ensuring that members and clients can address complaints effectively.

8. Enforcement of the Regulations

When compliance is lacking, the Authority has broad enforcement powers to ensure corrective action is taken. If inspections uncover misconduct, the Authority can issue directives,³³ impose penalties,³⁴ or even withdraw licenses in extreme cases.³⁵ Penalties may include fines, suspensions, or other corrective measures³⁶ to address regulatory breaches and restore market integrity.

For example, if gas prices surge due to market manipulation or unwarranted speculation, the Authority can impose penalties on those responsible and take actions to stabilize the market. In cases where a participant consistently violates regulations or fails to meet the required standards, the Authority can withdraw their license to prevent further harm to the market.³⁷

²⁴ Regulation 38(1), Gas Trading and Settlement Regulations 2023.

²⁵ Regulation 38(2), Gas Trading and Settlement Regulations 2023.

²⁶ Regulation 38(2), Gas Trading and Settlement Regulations 2023.

²⁷ Regulation 10, 11, 12, 13 & 15, Gas Trading and Settlement Regulations 2023.

²⁸ Regulation 35, Gas Trading and Settlement Regulations 2023.

²⁹ Regulation 35, 46, 47, Gas Trading and Settlement Regulations 2023.

³⁰ Regulation 24, Gas Trading and Settlement Regulations 2023.

³¹ Regulation 47(2), Gas Trading and Settlement Regulations 2023.

³² Regulation 28, Gas Trading and Settlement Regulations 2023.

³³ Regulation 38(3), 39 & 59, Gas Trading and Settlement Regulations 2023.

³⁴ Regulation 27(4), Gas Trading and Settlement Regulations 2023.

³⁵ Regulation 19, Gas Trading and Settlement Regulations 2023.

³⁶ Regulation 39(2) & 43(4)(b), Gas Trading and Settlement Regulations 2023.

³⁷ Regulation 19, Gas Trading and Settlement Regulations 2023.

This enforcement mechanism ensures that only reliable and compliant entities operate in the gas exchange market, thereby protecting the interests of all participants and ensuring a fair, transparent trading environment.

9. Collaboration between the Gas Exchange and the Clearing Houses

The Regulations place significant emphasis on the collaboration between gas exchanges and clearing houses. Gas exchanges are required to use the services of an authorized clearing house for clearing and settling its trades, ensuring that both entities operate in close coordination to manage financial and operational risks.³⁸

The gas exchange and clearing house must establish a formal agreement that delineates their respective rights and responsibilities. This agreement should include the admission of gas volumes for settlement, risk management measures, and the management of defaults.³⁹ This partnership guarantees the efficient settlement of trades, mitigates systemic risks, and fortifies the financial infrastructure of the market.

Moreover, the SGF and other financial resources will be employed to finalize settlements in the event that a clearing house or gas exchange fails to fulfil its settlement obligations.⁴⁰ This collaboration further improves market stability by guaranteeing that trades are settled equitably and efficiently, even in the event of a participant's default.

The close interaction between gas exchanges and clearing houses is critical for maintaining market integrity, reinforcing investor confidence, and providing a seamless trading environment for all market participants.

10. Impact on Market Participants

The Regulations significantly impact gas producers, shippers, marketers, aggregators and other stakeholders in Nigeria's gas industry. Gas producers and shippers must now comply with stringent licensing and reporting requirements, including maintaining accurate records and adhering to corporate governance norms. While this increases administrative burdens, it also promotes transparency and trust within the market.

Moreover, the shift toward an exchange-based market introduces dynamic pricing models, moving away from long-term fixed contracts to arrangements that reflect real-time market conditions. This increased transparency can lead to potential cost savings for consumers but also exposes them to price volatility. As the exchange grows, these impacts will become more pronounced, affecting both pricing strategies and contract structures.

Regulated vs. Unregulated Market Dynamics

As our previous analysis explained⁴¹, Nigeria's gas market operates within both regulated and unregulated frameworks. The unregulated gas market, where prices are determined through direct

³⁸ Regulation 29, Gas Trading and Settlement Regulations 2023.

³⁹ Regulation 30, Gas Trading and Settlement Regulations 2023.

⁴⁰ Regulation 31, Gas Trading and Settlement Regulations 2023.

⁴¹ <https://www.templars-law.com/knowledge-centre/the-interplay-between-the-domestic-gas-pricing-framework-and-the-unregulated-gas-market-a-focus-on-nigeria/>

negotiations between producers and consumers, caters primarily to industrial and commercial users with the bargaining power to secure favorable terms. In contrast, the Regulations introduce a form of regulated trading platform which will be subject to price oversight by the Authority and must follow competitive market principles that ensure fair pricing and transparency. Whether market participants will favor gas exchanges over traditional willing-buyer, willing-seller agreements remains to be seen. The full implementation of the Regulations has not yet been realised, and it will take time for the benefits of structured trading, such as increased liquidity and price discovery, to become evident. However, as the market matures, it is expected that the regulated framework will provide a more stable and transparent platform for gas trading, offering advantages that may outweigh the flexibility of the unregulated market.

Opportunities and Challenges under the Regulations

The Regulations present significant opportunities for Nigeria's energy sector. The creation of a regulated gas exchange is likely to attract foreign investment, increase market liquidity, and improve Nigeria's foreign reserves. Moreover, the establishment of transparent trading platforms will spur investment in gas infrastructure, including pipelines and storage facilities.

However, there are challenges to implementing the Regulations. Infrastructure and technology costs associated with establishing a gas exchange will be significant as well as maintaining the Settlement Guarantee Fund and the quarterly contribution to the Fund, particularly for new entrants to the market.⁴² Additionally, the high cost of compliance, including a USD 100,000 application fee and annual charges (USD100,000 or 20% of the exchange commission on the transaction value (whichever is higher), plus 20% of renewal fees for members of the exchange ; and USD50,000 or 20% of the commission for clearing houses (whichever is higher),⁴³ may deter smaller participants from entering the market. For example, a new entrant aiming to establish a gas trading platform may struggle with the initial costs, particularly if they lack access to substantial capital. On the other hand, larger, established players are better positioned to absorb these costs and benefit from the regulated market.

Conclusion

The Gas Trading and Settlement Regulations, 2023 represent a bold step toward transforming Nigeria's gas market. By establishing a comprehensive legal framework for gas trading and settlement, the Regulations create an opportunity to improve market transparency, attract foreign investment, and drive innovation in the energy sector. However, the success of this regulatory framework will depend on overcoming several challenges, including high infrastructure costs, potential abuse of power or dominance, potential barriers for new market entrants and the financial burdens of compliance and licensing fees.

For Nigeria to fully realize the potential of its gas market, a balance must be struck between regulatory oversight and market flexibility. As the gas exchange evolves, market participants will need to adapt to new trading conditions, invest in technology, and develop strategies to manage the risks and opportunities presented by this dynamic regulatory environment. Ultimately, the successful implementation of the Regulations could position Nigeria as a global leader in natural gas trading, enhancing the country's economic prospects and energy security for years to come.

⁴² Regulation 32(3)(a)&(b), Gas Trading and Settlement Regulations 2023.

⁴³ First Schedule, Gas Trading and Settlement Regulations 2023.