



The Path to Domestic Crude Supply Obligations in Nigeria's Refinery Sector

OALP Oil & Gas Newsletter

INTRODUCTION

Nigeria's refinery sector has entered a transformative phase with the launch of the 650,000 barrels per day Dangote refinery. This, alongside the expansion of modular refineries and the recent issuance of refinery construction and operation licences, signals Nigeria's move toward refining self-sufficiency and a potential end to the import of refined petroleum products.

However, this boost in refining capacity creates a corresponding demand for increased crude oil supply to fuel these refineries. This comes at a time when Nigeria has been struggling to ramp up its upstream production, on account of several internal and external challenges.

The Petroleum Industry Act (PIA) anticipated this demand surge by requiring upstream crude producers to direct specified volumes toward domestic refineries, a requirement known as the Domestic Crude Supply Obligation (DCSO).

This newsletter explores the regulatory framework for DCSO, its implications for upstream producers and refiners, and the potential impacts on Nigeria's broader petroleum landscape.

REGULATORY FRAMEWORK FOR DOMESTIC CRUDE SUPPLY OBLIGATIONS AND IMPLICATIONS

The Petroleum Industry Act and Implementation Guidelines

The PIA grants the Nigerian Upstream Petroleum Regulatory Commission (the **Commission**) the authority to implement DCSO by mandating specific volumes of crude oil for domestic refining.¹ Under this framework, only licensed refiners with operational facilities are eligible to secure crude oil allocations.

To procure crude, refiners must enter into commercially negotiated agreements with upstream producers (on a willing seller - willing buyer basis), with prices benchmarked to international rates and agreements flexible in currency choice, either the Naira or United States Dollars (USD). Payment for the crude is required to be backstopped by payment guarantees to be provided by the refiners, as may be required by the upstream producers.²

In 2023, the Commission issued the Production Curtailment and Domestic Crude Oil Supply Obligation Regulations (**CDCSO Regulations**), setting forth conditions under which DCSO quotas are imposed.

1. Section 109 (2) of the PIA.
2. Regulation 15, CDCSO Regulations.

Twice a year, the Commission publishes on its website and in three newspapers, refining requirements based on data from the Nigerian Midstream and Downstream Petroleum Regulatory Authority (the **Authority**)³. The Commission also publishes data on the production forecasts of each producing licensee or lessee, including daily production rates, the name, location, and terminal stream of each producing licence or lease, the name of the licensee or lessee, and the crude specification or quality produced from each licence or lease. This information is intended to facilitate crude oil sales transactions between producers and refineries in Nigeria.

In cases where quarterly production dips below allocated quotas, lessees are required to meet DCSO volumes before exporting any surplus. However, if refineries do not request crude within a quarter, lessees are permitted to freely export that period's production. In July 2024, the Commission also issued the Guidelines for the Operationalization of Domestic Crude Oil Supply Obligations (the **Guidelines**), which further reinforces the principles surrounding DCSOs set out in the CDCSO Regulations.

Revenue and Pricing Considerations

The pricing structure under the DCSO regime, benchmarked to FOP differentials, requires careful financial management. Given the exchange rate dynamics between Naira and USD, the federal government's directive for naira-denominated crude payments introduces currency fluctuation risks. Lessees and refiners must proactively allocate these risks during contract negotiations to maintain profitability while meeting domestic supply needs.

Balancing Contractual Commitments

The DCSO mandate presents logistical challenges for upstream operators, particularly those balancing existing export obligations with the new domestic supply requirements. Many lessees will likely need to expand crude handling facilities or adjust evacuation options to prevent disruptions to established offtake agreements. Recognizing these complexities, Regulation 13(2) provides that the Commission shall in imposing the DCSO for any

lessee take into consideration the existing domestic refinery supply contracts and crude export contracts before assigning DCSO quotas, ensuring upstream operators meet prior commitments, especially in cases where forward sales involve loans backed by crude supply.⁴ Nigerian courts have interpreted similar provisions in a mandatory manner such that the Commission is mandated to consider these contracts in imposing the DCSO.⁵ Whilst the practical implications of these considerations remain untested, lessees can take comfort in the mandatory language of the CDCSO Regulations.



3. Regulation 10, CDCSO Regulations
 4. Regulation 13 (2), CDCSO Regulations.
 5. *Ogidi v. State* (2005) 5 NWLR (Pt. 918) 327

Strategic Oversight and Enforcement

The Commission actively monitors compliance through a blend of administrative measures and direct intervention. General administrative measures adopted by the Commission include: (x) quarterly notification of DCSOs of lessees to refinery licence holders; (y) publication and communication of the terms and conditions for selling allocated crude oil to refinery licence holders; and (z) convening monthly production curtailment and lifting programme meeting of licensees and lessees if necessary.⁶

Export permits also hinge on production quotas that incorporate DCSOs, ensuring domestic supply requirements are met before authorizing exports.⁷

Furthermore, the Commission responds to domestic supply shortages by issuing requests for quotations (RFQs) to lessees, facilitating emergency crude allocations when refinery demand exceeds forecasted supply.⁸ Prior to the issuance of the RFQ, the Commission will ensure that each lessee is capable of meeting or contributing to the crude oil needs of the refineries and has allocated a portion of its forecasted production for domestic consumption, based on a non-discriminatory metric.⁹

Upon receipt of the quotations, the Commission circulates the information to the affected refineries to facilitate contract negotiations to address the shortage on a willing buyer, willing seller basis.¹⁰ The Commission may intervene in such contract negotiations for the supply of crude between the refineries and the lessees where it is manifest that one of the parties is unreasonable. By regulating these transactions, the Commission helps prevent undue pricing and contractual conflicts, intervening if necessary to establish fair, competitive terms.

To maintain transparency, lessees submit monthly production reports detailing adherence to DCSO quotas and overall export alignment.¹¹ At the close of each half-

year cycle, the Commission publishes compliance records for both refiners and lessees, holding each accountable for their domestic supply performance.¹²

Notably, refiners are obligated to use the acquired DCSO volumes exclusively for domestic processing except where the prior written approval of the Commission is obtained for such alternative usage. The unauthorized use of this crude oil will result in suspension of the holder of the crude oil refining licence from the DCSOs allocation for a specified period, potential penalties imposed by the Commission, and possible prosecution of the offender.¹³ Similarly, a lessee entering into a long-term supply contract with a refiner to meet domestic crude oil supply obligations must ensure that the refinery is operational at the time the crude oil is to be supplied.¹⁴



Penalties for Non-Compliance

Non-compliance with DCSO mandates incurs financial penalties. Lessees who fail to respond to RFQs or fulfil DCSO volumes face administrative fines and potential export restrictions. Refiners that miss payment deadlines or fail to lift allocated volumes risk suspension from future allocations, with additional fines levied for disruptions to production. These measures incentivize both parties to prioritize domestic obligations and ensure smooth refinery operations.

6. Regulation 17, CDCSO Regulations.
 7. Regulation 9 (2), CDCSO Regulations.
 8. Regulation 12 (1), CDCSO Regulations.
 9. Sections 2.10 and 2.11, Guidelines.
 10. Regulation 12 (3), CDCSO Regulations
 11. Regulation 16, CDCSO Regulations.
 12. Section 2.15, Guidelines.
 13. Section 2.8, CDCSO Regulations.
 14. Section 2.9, CDCSO Regulations.

CONCLUSION

The DCSO framework marks a strategic shift toward energy security, reshaping Nigeria's oil landscape by emphasizing domestic over international crude supply. Whilst the system provides reliable access to crude for functional refineries, upstream producers face challenges in balancing domestic obligations with export commitments. As new refineries come online, DCSO regulations will continue to evolve, adapting to market responses and operational realities. The initiative stands as a promising step in Nigeria's energy future, fostering resilience and positioning the country closer to achieving refinery self-sufficiency.

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