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THE NIGERIAN ELECTRICITY SUPPLY INDUSTRY – RECENT DEVELOPMENTS AND PROSPECTS

Introduction

With a population of approximately 186 million as at 2016[1], Nigeria has an installed capacity of 12,500 MW[2] and a meagre available generating capacity hovering around 7,000MW.[3] Yet, the Federal Government of Nigeria ("**FGN**") has set a target to achieve a whooping 20GW of available electricity capacity by the end of the year 2020. A crystal ball is not required to foresee the high possibility of the FGN's inadvertent failure to meet this target where the Nigerian Electricity Supply Industry ("**NESI**") fails to attract the required investment across the entire value chain. Unfortunately, the NESI with its acute challenges such as lack of cost reflective tariffs, huge amount of aggregate technical commercial and collection ("**ATC&C**") losses, gas supply and infrastructure constraints, under-developed transmission infrastructure, credit worthiness of the major players in the NESI and general value chain misalignment, is currently unappealing to investors. The effect of this is that there is a huge dearth of funding in the NESI resulting in a slow-paced development of the power sector.

The FGN and in conjunction with the primary regulator of the NESI, the Nigerian Electricity Regulatory Commission ("**NERC**") has in recent times embarked on a series of undertakings aimed at rescuing the ailing power sector. We have examined here, the recent regulatory pronouncements and activities of the FGN in the NESI and the opportunities presented by these developments for potential investments in the sector.

The Developments

- ***The Power Sector Recovery Implementation Plan***

  On March 22, 2017, the Federal Executive Council ("**FEC**") approved a Power Sector Recovery and Implementation Plan ("**PSRIP**"), which was prepared in consultation with the World Bank Group ("**WBG**"). The PSRIP is a set of policy actions, operational and financial interventions to be implemented by the FGN to attain financial viability of the power sector. The objectives of the PSRIP include, among other things, the elimination of the payment deficit which had accumulated in 2015 and 2016,[4] a commitment to fund the deficit (it is estimated that the sector will require an approximately US$1,500,000,000 (One Billion Five Hundred Million United States Dollars), annually for the next five (5) years to achieve sector viability), ensuring performance and implementation of credible business continuity plans by the electricity distribution companies ("**Discos**") and the Transmission Company of Nigeria ("**TCN"**), ensuring that cost reflective tariffs are achieved over five (5) years and increasing electricity access by implementing off grid renewable power solutions.

[1] See https://data.worldbank.org/country/nigeria?view=chart
[2] See https://www.usaid.gov/powerafrica/nigeria
[3] The Honourable Minister of Power, Works and Housing issued a Communique at the 18th Monthly Power Sector and Stakeholders Meeting in Kano wherein he stated that the available generating capacity as at August 10, 2017 was 6803MW
[4] Amounting to ₦473,000,000,000 (Four Hundred and Seventy-Three Billion Naira) and ₦458,000,000,000 (Four Hundred and Fifty Eight Billion Naira) in 2015 and 2016, respectively

The implementation of the PSRIP is also expected to introduce significant additional funding to ensure liquidity in the NESI. Thus, one of the key anchors of the PSRIP is to secure through, or from the WBG, financial support of up to US$2,500,000,000 (Two Billion, Five Hundred Million United States Dollars) for the NESI (this is in addition to a ₦701,000,000,000 (Seven Hundred and One Million Naira) Central Bank of Nigeria ("**CBN**") facility which the FGN approved for the Nigerian Bulk Electricity Trading Plc. ("**NBET**") on March 1, 2017). However, the injection of the funds by or through the WBG is predicated upon the implementation of other objectives of the PSRIP. The detailed implementation of the PSRIP is yet to be announced and there is a lack of clarity as to the level of implementation that will be attained. This is premised on most of the objectives of the PSRIP being difficult, if not impossible to achieve without significant financial and political implications. It is thus a classic case of the egg and the chicken causality dilemma. Notwithstanding, we understand that the WBG recently approved an International Development Association ("**IDA**") credit and an IDA scale up facility credit in the total amount of US$486,000,000 (Four Hundred and Eighty Six Million United States Dollars) provided for the rehabilitation and upgrading of electricity transmission substations and lines.[5] Whilst the WBG's funding of the NESI is a welcome development, it will be useful for the FGN to provide specific information on the proposed use of the funding in order to improve investors' confidence.

In addition to the issuance of the PSRIP, other developments that are aimed at injecting additional liquidity into the sector include the Solar Nigeria Programme, a £13,000,000 (Thirteen Million Pounds) funding programme designed and funded by the United Kingdom's Department for International Development ("**DFID**"). This programme aims to provide grants to companies involved in providing household solar energy and technologies. Another initiative is the African Development Bank's proposed investment of US$12,000,000,000 (Twelve Billion United States Dollars) in renewable energy for the next five (5) years and the Federal Government's ₦2,000,000,000 (Two Billion Naira) fund for the electrification of rural areas in Nigeria, included as part of the 2017 budget (which as far as we aware, has not been disbursed).

❖ ***Final issuance of the Mini-Grid Regulations 2016***

The NERC Mini-Grid Regulations 2016 *("***Mini-Grid Regulations***")* was issued in draft form in 2016 and subsequently adopted on May 24, 2017 by the NERC. The Mini-Grid Regulations is the first legal framework for the establishment and development of mini-grids in Nigeria and it provides for, among other things the regulatory framework for all mini-grids in Nigeria. A mini-grid as defined under Section 3(1) of the Mini-Grid Regulations is, "*any electricity supply system with its own power generation capacity, supplying electricity to more than one customer and which can operate in isolation from or be connected to a distribution licensee's network.*" The Mini-Grid Regulations also restrict the definition of the term to "*any isolated or interconnected mini-grid generating between 0kW and 1MW of generation capacity*".

(i) The Mini-Grid Regulations were issued: (a) to accelerate electrification in areas without existing distribution infrastructure ("**Unserved Areas**") as well as areas with existing but

[5] http://www.worldbank.org/en/news/press-release/2018/02/15/nigeria-world-bank-approves-486-million-to-improve-nigeria-electricity-transmission-network-and-infrastructure

poorly electrified or non-functional distribution facilities ("**Underserved Areas**"); and (b) is expected to act as a catalyst for stimulating the desired improvements along the electricity value chain. However, the Mini-Grid Regulations are not without certain shortcomings. Firstly, with an estimated stranded capacity of 2,000MW, it is not expected that the Mini-Grid Regulations will have any significant impact on the reduction of stranded capacity. This is because generators with stranded capacity of more than 1MW are restricted from participating in this regime. Other pitfalls include the potential cumbersome process for the application of a permit, particularly the requirement that developers of an interconnected mini grid must execute tripartite contract with a community connected to the Disco and the incumbent Disco. Additionally, a developer of an isolated mini-grid needs to ensure that a Disco has no plans to extend its network to its project site and the isolated mini-grid will be required to convert to an interconnected mini-grid operator or transfer all assets to the Disco (in return for compensation), where a Disco extends its network to its area of operation. This requirement may curtail investors' appetite for isolated mini grids.

❖ ***Ministerial declaration of eligible customers in the NESI***

Pursuant to Sections 27 and 100 of the Electricity Power Sector Reform Act, the Honourable Minister of Power, Works & Housing (the "**Minister**"), Mr. Babatunde Raji Fashola, SAN on May 15, 2017, declared four (4) categories of **"Eligible Customers"** in the NESI (the "**Eligibility Declaration**"). This was followed by a Consultation Paper released on June 19, 2017 (the "**Paper**") on the Eligibility Declaration by the NERC calling for comments, objections and representations from stakeholders and the general public. Notwithstanding the Discos' unanimous objection to the Eligibility Declaration and the threat by the Discos to declare *force majeure* with respect to their industry contracts in the NESI, the NERC issued the Eligible Customer Regulations No. NERC-R-111 ("**Eligible Customer Regulations**") on November 1, 2017.

The objectives of the Eligible Customer Regulations include the facilitation of competition in the supply of electricity, allowing electricity generation companies ("**Gencos**") with uncontracted capacity access to unserved and underserved customers, with the aim of improving financial liquidity in the sector and encouraging third party access to transmission and distribution infrastructure, as a precursor to full retail competition in the NESI.

The categories of Eligible Customers as enumerated in the Eligible Customer Regulations are: (a) a customer or a group of end-users registered with NERC whose consumption is more than 2MWhr/h over the course of a month, connected to a metered 11kV or 33kV delivery point on the distribution network and subject to a distribution use of system agreement for the delivery of electrical energy; (b) a customer or group of end-users registered with NERC who are connected to a metered 132kV or 330kV delivery point on the transmission network, under a transmission use of system agreement for connection and delivery of energy; (c) a customer or group of end-users with monthly consumption in excess of 2MWhr/h who are connected directly to a metered 33kV delivery point on the transmission network under a transmission use of system agreement, and has entered into a bilateral agreement for the construction, installation and operation of the distribution system used to connect the customer to the delivery point with a Disco; and (d) a

customer or group of end-users whose minimum monthly consumption is more than 2MWhr/h and are directly connected to the metering facility of a Genco, and has also entered into a bilateral agreement for the construction and operation of a distribution line with the Disco licensed to operate within its location.

The Eligibility Declaration is expected to enhance competition in the NESI and enable bilateral arrangements between multiple willing sellers and buyers of bulk electricity. It is also expected that the declaration will substantially tackle the liquidity challenge affecting the electric power value chain in the country, as Gencos will have the opportunity to supply electricity to bankable entities that have the capacity to pay for the electricity supplied.

We note that one of the unfortunate consequences of the Eligibility Declaration is the potential loss of some lucrative customers of the Discos. Although the Eligible Customer Regulations provide for measures that are expected to compensate the Discos for the potential loss of customers, such as the payment by the eligible customer of Distribution Use of System Charges and the Competition Transition Charges, these measures may inadequately compensate the Discos. Hence, we expect that the Discos will resist the implementation of the Eligibility Declaration by creating hurdles to the grant of Eligible Customers access to their distribution network. We note that the Eligible Customer Regulations clearly provide that NERC shall ensure that licensees comply with the rules relating to fair and non-discriminatory third party access to the transmission and distribution networks, by among other things, issuing an order granting access and sanctioning the relevant licensees. However, the requirement that some Eligible Customers are required to enter into a bilateral agreement with an incumbent Disco may act as a clog to the process.

- ***Communique on the liberalization of power generation and distribution between the Federal and State Governments***

At the 18th monthly power sector and stakeholders' meeting held in Kumboso, Kano State on August 14, 2017, the Minister affirmed the right of State Governments in Nigeria to generate their own power independent of the Gencos, Discos, the TCN and other operators in the NESI. The affirmation contained in the communique issued following the meeting, is aimed at underpinning the free-enterprise stance of the Act and liberating the power business in the country from the grip of inefficient supply monopoly. While the affirmation has no force of law, it is expected that NERC will treat applications from State Governments who have the financial wherewithal to generate their own power for the development of power projects, more favourably. In furtherance of this development, the Lagos State House of Assembly recently passed the Lagos State Electric Power Reform Law 2018. The Law creates the legal framework for the generation and distribution of power by the Lagos State Government and potential stakeholders. The Oyo State Government has also engaged the NERC in connection with the potential generation of 2000MW in the state.[6]

[6] https://oyostate.gov.ng/oyo-set-to-generate-2000mw-through-ipp/

❖ ***Developments aimed at improving the efficiency of the Discos***

Going by the terms of various Industry Agreements signed following the 2013 privatization exercise, the Discos now have less than a year left to deliver on the performance targets detailed in their respective Performance Agreements. Whilst it is apparent that meeting the performance targets will be a daunting task for the Discos, the NERC had nevertheless embarked on a couple of activities aimed at combatting the inefficiencies of the Discos and attempting to reduce ATC&C losses. Some the activities include:

(a) The issuance of a notice tagged "MD Customers' Verification & Validation Directives" by NERC on June 9, 2017 comprising directives on the abolition of estimated billing for customers within the threshold of 45kVA consumption and above ("**Maximum Demand Customers**") and ordering the Discos to ensure that such Maximum Demand Customers were metered within a specified timeline. Many industry stakeholders hold the belief that the "No Meter, No Payment" directives will lead to justice, fairness and engender probity and mutual trust, as Maximum Demand Customers will be willing to pay the bills for their metered consumption. However, the Discos have maintained that the abolition of estimated billing for Maximum Demand Customers (who essentially are responsible for about seventy (70) percent of the electricity bills that are successfully collected by Discos monthly) would further deepen the liquidity challenge in the industry;

(b) The issuance by NERC of an Order (Order No. NERC/172) titled "**Order on Timelines to Facilitate Distribution Grid Connection"** on May 12 2017, which became effective on June 1, 2017. The Order sets the minimum requirements for the Discos to facilitate electricity connection to customers, by providing for specific procedures and timelines for the connection of new customers to a distribution network. The Order is applicable to customers desiring dedicated supply through the installation of dedicated transformers and associated accessories with rating above 50KVA within their premises. With the effective implementation of this Order, it is generally the belief that the Discos will become more efficient and collection losses and the resultant liquidity crisis in the NESI will be significantly reduced, as more customers will be metered;

(c) Issuance of the draft of business continuity regulations for the NESI 2017: NERC on May 7, 2017 issued a draft of the **Business Continuity for the Nigerian Electricity Supply Industry Regulations, 2017** ("**Business Continuity Regulations**"). The general purpose of the Business Continuity Regulations is to provide business continuity measures for the smooth running of the NESI. There are specific provisions relating to what amounts to business continuity failure events ("**BCFE**"), conditions for NERC intervention and dispute resolution etc. There are five (5) conditions amounting to BCFE, which are a failure of a licensee to meet its performance, compliance, financial, contractual and license obligations. It is expected that when the Business Continuity Regulations become effective, it will assist with mitigating business failure risks in the NESI. However, considering the current liquidity crisis generally enveloping the NESI, we believe that until there is a semblance of stability in the sector, the Business Continuity Regulations are not ripe for implementation. The issuance of Business Continuity Regulations at this time may result in

throwing the baby out with the bath water, as it will lead to mass insolvency and liquidation as well as unending litigation in the power sector; and

(d) Issuance of Draft Regulation on Meter Assets Providers 2017: NERC issued in 2017 the draft Regulation on Meter Assets Providers to regulate meter asset providers who would on a competitive basis, provide for the financing, procurement, installation and maintenance of meters as a means of fast tracking the metering of all electricity customers in the NESI. The objectives of the Regulation include the provision of standard rules for the emergence and participation of independent and competitive meter assets providers, elimination of estimated billing practices and enhance accelerated meter roll out.

Prospects

Notwithstanding the challenges highlighted above, there are a number of opportunities for prospective investment in the NESI. There is a general trend towards defocusing on-grid power generation. Undoubtedly, some of the developments (coupled with the advantage presented by the Regulations on Feed-In Tariff for Renewable Energy Sources Electricity in Nigeria) have spurred significant opportunities and investment in renewable projects and off-grid power solutions. Although, it appears that progress may have stalled on the solar power projects estimated to cost circa US$2,500,000,000 (Two Billion, Five Hundred Million United States Dollars) due to the failure of the FGN to approve the Put Call Option Agreements for the solar projects, as a result of the FGN's disapproval of the tariff agreed by the project sponsors and NBET,[7] we expect that the issues will be resolved shortly going by the FGN's commitment to encourage renewable power projects in Nigeria.

State governments are taking the opportunity presented by the affirmation of the Minister at the 18th monthly power sector and stakeholders' meeting, to create legal frameworks for self-generation and distribution in their States. There is consequently the opportunity for stakeholders and potential investors to collaborate with viable State governments for the development of power solutions that are independent of the current transmission and distribution systems. Additionally, with the focus of the FGN on the supply of power to rural and Unserved Areas in Nigeria, it is expected that proactive ideas in the design and implementation of power projects in these areas could yield amazing results. The Declaration of Eligibility will also encourage power producers to bypass the grid and/or the Discos entirely and to supply power to institutional and credit-worthy offtakers.

We also expect that the issuance of the Draft Regulation on Meter Assets Providers 2017 will open up opportunities in the NESI. The manufacturing and supply of standardised meters in Nigeria will be an aspect of the NESI with potential opportunities for investors.

While it is commendable that the FGN and NERC have been very active in addressing the challenges facing the NESI in 2017, we believe that there is still more to be done in the area of incentivising players in the NESI. Clearly, the most significant intervention that the sector requires is the provision of additional liquidity to combat severe under-development in the transmission and distribution value chain. Closely related to the injection of funds in the sector is the need to address tariff imbroglio. It

[7] http://www.thisdaylive.com/index.php/2018/02/11/why-2-5-billion-solar-power-projects-are-stalled/

appears there is insufficient political will, on the part of the FGN, to increase electricity tariffs to a level that ensures electricity consumers pay tariffs commensurate to the services they receive. Until a pricing equilibrium is attained in the NESI, the shortfall between what is owed by the customers and what the Discos are able to collect is inevitable. The longer it takes to implement a truly cost-reflective tariff in the NESI, the larger the liquidity shortfall grows.

Additionally, the FGN and all its ministries, departments and agencies (such as CBN, NBET, Ministry of Finance, Ministry of Power, Works and Housing, TCN) must work together to reduce inter-agency bureaucracy and ensure they have an undivided goal of solving the dire electricity challenges currently facing the NESI. To win investors' confidence in the sector, the plan to resuscitate the NESI must be clear, bold and attainable and the FGN has to demonstrate a willingness and commitment to implement such a plan.

The Grey Matter Concept is an initiative of the law firm, Banwo & Ighodalo

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