ASSESSING RECENT EVENTS IN THE NIGERIAN ELECTRICITY SUPPLY INDUSTRY

By

Nnanke Williams, LLM

Senior Consultant, Brooks & Knights Legal Consultants

And

Adetayo Adetuyi, LLM

Senior Consultant, Brooks & Knights Legal Consultants[1]

1. Introduction

The year 2019 represented an active year for regulatory oversight in the Nigerian Electricity Supply Industry (**NESI**). NESI saw some very newsworthy events as it continued to suffer from illiquidity and the primary regulator, Nigerian Electricity Regulatory Commission (**NERC**) worked to manage stakeholder issues within the sector. Regulatory developments followed the path charted under the Power Sector Recovery Program (**PSRP**) as NERC sought to stabilize the liquidity concerns and encourage private sector investment and financing within the sector. Notwithstanding, investment opportunities continue to exist within the sector.

This article shall consider some of the recent orders issued by NERC as well as the situational context for the orders and how the orders will affect the policy and business of electricity supply in Nigeria in the year 2020 and onward. This article shall consider the following recent NERC Orders:

a) the 2019 Minor Review of the Multi-Year Tariff Order (**MYTO**) 2015 and Minimum Remittance Order for the Year 2020 (**2019 Minor Review Order**);
b) Order on the Transitional Accounting Treatment of Tariff Related Liabilities in the Financial Records of Participants in the Nigerian Electricity Supply Industry (**2020 Transitional Accounting Order**); and
c) Order on the Mandatory Migration of R3 Class of Residential Customers, Industrial and Commercial Customers to Cashless Settlement Platforms and other Matters Relating to the Revenue Protection in the Nigerian Electricity Supply Industry (**2019 Order on Mandatory Migration to Cashless Settlement Platforms**).

[1] **Brooks & Knights Legal Consultants (BKLC)** is a law firm established in Lagos, Nigeria to provide bespoke legal advisory and policy consulting services to individuals, corporates, government agencies and NGOs.

2. Background to the Recent Orders

The liquidity crisis within the NESI is as a result of a tariff structure does not reflect the cost and market forces involved in supplying electricity to end-users. NESI's underpinning legislation, the Electric Power Sector Reform Act of 2005 (**EPSRA**), requires that tariff be regulated according to one or more methodologies adopted by NERC for regulating electricity prices.[2] Such methodologies shall consider among others that a licensee[3] is allowed to operate efficiently to cover the full costs of its business activities and earn a reasonable return on its invested capital;[4] shall give to electricity consumers economically efficient signals regarding the costs that their consumption imposes on the licensee's business[5] and shall ensure the phasing out or substantial reduction of cross subsidies.[6]

To this end, NERC developed the MYTO methodology to provide for tariffs that are cost reflective yet fair to energy consumers. MYTO-2015, the most recently issued MYTO, was to undergo bi-annual minor reviews[7] and a major review within 5 years of its issue.[8] MYTO's methodology determined end-user tariff by considering certain macroeconomic indices including the exchange rate, the inflation rate,[9] the available generation capacity and the gas price. These variables were to be analysed during the bi-annual minor reviews to determine any changes in tariff for each of the power distribution companies (DisCos).[10]

However, the assumptions upon which MYTO 2015 was derived did not reflect the cost reality for the supply of electricity.[11] While the macroeconomic indices have since risen from the MYTO 2015 forecasted levels, no minor review was undertaken in the period which has led to both a tariff shortfall and a market shortfall in the NESI. Tariff shortfall is the deficit arising from the cost-reflective tariffs

---

2 Section 76(2) EPSRA.

3 A Licensee is any person who holds any licence issued under EPSRA. The licences issued under EPSRA are electricity generation licence, electricity transmission licence, system operation licence, electricity distribution licence and electricity trading licence. See sections 62-68 and 100 EPSRA.

4 Section 76(2)(a) EPSRA.

5 Section 76(2)(d) EPSRA.

6 Section 76(2)(d) EPSRA. Cross-subsidies involves the subsidization of one class or group of consumers by another class or group of consumers. See section 100 EPSRA. For further reading on cross-subsidization within the electricity sector please see Saba, *Cross-subsidies in Electricity Sector*, The SCC Online Blog, June 20, 2018, available at https://www.scconline.com/blog/post/2018/06/20/cross-subsidies-in-electricity-sector/

7 Section 7 of MYTO-2 (2012) Tariff Orders for Generation, Transmission and Distribution.

8 Kofo Olokun-Olawoyin, Towards a Cost-Reflective Tariff in the Nigerian Electricity Supply Industry, 13 Feb 2020, Business Day Online, available at https://businessday.ng/opinion/article/towards-a-cost-reflective-tariff-in-the-nigerian-electricity-supply-industry-nesi/

9 This includes the inflation rates in Nigeria and the United States.

10 Section 11 of MYTO 2015 for Distribution Companies for the Period of 1st January 2015 to December 2024.

11 Kofo Olokun-Olawoyin, Towards a Cost-Reflective Tariff in the Nigerian Electricity Supply Industry, 13 Feb 2020, Business Day Online, available at https://businessday.ng/opinion/article/towards-a-cost-reflective-tariff-in-the-nigerian-electricity-supply-industry-nesi/

that the DisCos should ordinarily have charged the end users and what they were mandated to charge under MYTO2015.[12] As noted above, this deficit is as a result of a tariff methodology which used assumptions for its macroeconomic indices that do not represent the actual cost of supplying electricity. Market shortfall is as a result of the increase in the wholesale cost of power sold by the power generation companies (**GenCos**) to the DisCos and the inability of the DisCos to settle their GenCo invoices. While the wholesale cost of power has increased, the tariffs charged by DisCos to end users have remained unchanged which in turn has made it difficult for DisCos to settle their bills from the GenCos and the Transmission Company of Nigeria (**TCN**). This has occasioned a market shortfall.[13] Furthermore, the Federal Government of Nigeria[14] noted that while the MYTO tariff region is based on cost-reflective principles, delays in implementation has contributed to growing deficits within the NESI.[15]

These shortfalls necessitated the implementation of a new policy initiative to reset the NESI for future growth - the Power Sector Recovery Programme (**PSRP**) 2017-2021, published in January 2018 in collaboration with the World Bank Group.[16] The PSRP aimed among others, to restore financial viability to the NESI, implement clear policies that promote and encourage investor confidence in NESI and establish a contract-based electricity market.[17] PSRP highlighted the financial, operational, governance and policy interventions needed to make the market sustainable. One of the financial interventions necessary to fully fund the historical and future deficits within NESI was the establishment of sustainable and appropriate electricity tariffs.[18] Others included establishing and securing financing sources for a Financing Plan to clear historic sector deficits.

The PSRP also provided for the Federal Government's financing plan to offset the expected revenue shortfalls for the years 2017-2021 under its Medium-Term Expenditure Framework and Fiscal Strategy Paper.[19] The projected financing sources were the Central Bank of Nigeria's (**CBN**) Payment Assurance Facility (**PAF**), federal government budgetary contributions, and the World Bank performance based loan.[20]

NERC issued 2 (two) Minor Reviews of MYTO 2015 to address the need for cost reflective tariff for the years 2016-2019, to reflect the impact of changes to the macroeconomic

12 Kofo Olokun-Olawoyin, Towards a Cost-Reflective Tariff in the Nigerian Electricity Supply Industry, 13 Feb 2020, Business Day Online, available at https://businessday.ng/opinion/article/towards-a-cost-reflective-tariff-in-the-nigerian-electricity-supply-industry-nesi/

13 *Id*. for further information about the disconnect between the MYTO Projections and the present realities.

14 Federal Republic of Nigeria, Power Sector Recovery Programme: 2017-2021, January 2018.

15 *Id* at 16.

16 *Id*.

17 *Id*. at 20.

18 *Id*.

19 Federal Republic of Nigeria, Power Sector Recovery Programme: 2017-2021, January 2018 at p. 26.

20 *Id*.

variables used to set tariffs for the said period and determine the revenue shortfalls in light of the cost-reflective tariffs and the tariffs allowed under NESI.[21] The Orders also set minimum market remittances for DisCos to manage the revenue shortfalls in the sector.[22] The second Minor Review Order is discussed in section 3 below.

3. Recent Orders issued by the Nigerian Electricity Regulatory Commission and an Analysis of Effects on Law and Business

2019 Minor Review Order

The 2019 Minor Review Order replaced the assumptions in the 2016-2018 Minor Review Order. It considered the actual changes in the macroeconomic indices used to determine end user tariff and it made projections for those indices for the year 2020. Nigerian Inflation was projected at 11.3% for the years 2019-2020. US inflation was projected at 1.8% for 2019 and 2.1% for 2020. The exchange rate was pegged at NGN310 for the years 2019-2020.[23]

While the Order anticipates an increase in tariff, NERC announced that it does not envisage any increase until April 2020, and a transition to full cost reflective tariff will only occur by the end of 2021.[24]

The Order also provided the minimum remittance requirements for DisCos to settle their market invoices and further provided that the federal government intervention under the PSRP financing plan be applied to cover any tariff shortfalls. Under the minimum remittance requirements, each DisCo is only allowed to earn its revenue requirement when it has fully met its minimum remittance obligations. These obligations include the requirement to repay the CBN-Nigerian Electricity Market Stabilisation Facility (**CBN-NEMSF**), completely settle the invoices issued by the Market Operator (**MO**) based on the tariffs applied by MO in determining respective invoices prior to the issuance of the Order, and fully settle the prescribed percentage of the Nigerian Bulk Electricity Distribution Company Plc's (**NBET**) invoices applicable to the relevant DisCo.[25]

Each DisCo is required to provide and maintain and adequate, unconditional, unencumbered and irrevocable standby letter of credit covering 3 (three) months' invoice based on the minimum payment obligations to MO and NBET.[26]

---

[21] Section 6 of the 2016-2018 Minor Review Order and Section 6 of the 2019 Minor Review Order.

[22] *Id*.

[23] Sections 7 and 8 of the 2019 Minor Review Order

[24] Section 10 of the 2019 Minor Review Order.

[25] Section 10 of the 2019 Minor Review Order.

[26] Section 10 of the 2019 Minor Review Order.

2020 Transitional Accounting Order

NERC issued the 2020 Transitional Order whose objectives are to provide a guideline for the transitional accounting treatment of tariff related liabilities in the financial records of the participants in NESI, ensure that no new tariff-related liabilities accrue in the financial records of the participants and maintain the creditworthiness of the DisCos' balance sheets for the purpose of raising capital towards the improvement of electricity networks and service delivery.[27]

Under the Order, NBET shall continue to invoice DisCos for energy and capacity in accordance with the provisions of their respective vesting contracts and other NERC directives.[28] DisCos are mandated to settle their NBET invoices in full as adjusted by the applicable tariff shortfall in the 2019 Minor Review Order.[29] However, the unpaid tariff-related portion of the NBET invoice shall temporarily remain on the DisCos' books as a liability until it is paid to the GenCos from PAF or other funding sources under the PSRP financing plan.[30] The unpaid portion of the NBET invoices that is not directly attributable to the tariff deficit shall be recovered by NBET through the payment guarantee provided by the DisCo.[31]

2019 Order on Mandatory Migration to Cashless Settlement Platforms

In 2019 NERC also issued an Order on the mandatory migration to cashless settlement platforms for certain classes of customers: R3 residential customers, industrial and commercial customers. This was in implementation of the Federal Government policy directive requiring this mandatory transition to cashless settlement of bills in order to reduce leakages and losses and improve overall revenue assurance in NESI.[32]

Under the Order, DisCos are mandated to transit to cashless settlement platforms for the billing/ collection of industrial and commercial customers by 31 January 2020 and R3 class of residential customers by 31 March 2020.[33] DisCos are expected to promote the adoption of end-to-end electronic payments by all NESI stakeholders and provide customers with appropriate bank account details and other approved channels for receiving/ processing payments toward the successful implementation of the Order .[34]

Analysis of the Effects of the Orders on Law and Business

As noted above, the implications of the 2019 Minor Review Order is an eventual increase in tariffs and an easing of the liquidity crisis in

27 Section 8 of the 2020 Transitional Order.
28 Section 9(A) of the 2020 Transitional Order.
29 Section 9(C) of the 2020 Transitional Order.
30 Section 9(D) of the 2020 Transitional Order.
31 Section 9(F) of the 2020 Transitional Order.
32 Section 4 of the 2019 Order on Mandatory Migration to Cashless Settlement Platforms.
33 Sections 6 and 7 of the 2019 Order on Mandatory Migration to Cashless Settlement Platforms.
34 Section 11 of the 2019 Order on Mandatory Migration to Cashless Settlement Platforms.

the NESI. Moving to a cashless settlement platform also ensures that revenues collected by the DisCos are received by platforms regulated by NERC and the CBN and are easily auditable and transmittable to the other stakeholders within the NESI value chain. The Transitional Order also shows a desire by the federal government to implement the initiatives in the PSRP financing plan and all historic and future debts in the sector. These Orders are commendable in their efforts to achieve the market reset and make the industry attractive to private investors and financiers.

However, in setting the variables for the macroeconomic indices, loopholes exist which may result in the continued running of deficits which will be borne by the DisCos. If unaddressed, these loopholes will affect the efficacy of this Order in the long term.

For instance, while Nigerian inflation is pegged at 11.3%, year-end inflation as at December 2019 was 11.98% and on an upward trajectory. Furthermore, the exchange rate variable is pegged at the CBN official rate and does not take into account the very likely possibility that GenCos and DisCos are accessing foreign exchange at the interbank rate, a rate which is significantly higher than the CBN official rate. Gas prices and transportation costs are set at $2.50/ MMBTU and $0.80/MMBTU which is the regulated price for domestic supply of gas-to-power under the Domestic Gas Supply and Pricing Regulations. However, these rates do not consider power purchase agreements based on prices that are higher than the regulated rates.

In light of the above, any deficits resulting from the differentials in pegged and actual variables will be borne by the DisCos and may affect the federal government's efforts to ease the liquidity crunch. The Orders also represent the recent Orders by NERC on the affected subject matters and supersede all previous Orders on those issues.

4. Other Recent Events in the Nigerian Electricity Supply Industry

Some of the other recent event within NESI are highlighted below.

Metering Consumers within NESI

In 2019, NERC issued an Order on the Implementation of the Meter Asset Provider Scheme in the NESI to encourage the development of metering services and eliminate estimated billing practices within NESI.[35] The Order set out the compliance requirements by Meter Asset Providers (**MAPs**) and DisCos to the MAP Regulations of 2018. Under the Order, the prices of single-phase and 3-phase meters were set at NGN36,991.50 and NGN67,055.85 respectively.[36] According to the Order, these prices shall cover the costs of meter procurement, financing, installation, maintenance and all associated costs with the

[35] Paragraph 2 of the Recital of the Order on the Implementation of the Meter Asset Provider Scheme in the NESI.

[36] Paragraph A of the Order on the Implementation of the Meter Asset Provider Scheme in the NESI.

meter.[37] Customers may either pay upfront or opt to finance the payment of their meters with the MAPs. The Order caps the interest rates for the customer financing options at 21%[38] and subject opting consumers to a meter service charge on their monthly electricity bills.[39] The approved rate of financing costs may be reviewed by NERC every 3 years.[40]

Shortly after the price of meter was set, the federal reviewed upward the import tariff on electricity meters from 10% to 45% which subsequently increased the cost of procuring meters, as only 30% of meters are expected to be sourced locally. It may seem that the import duty increase is aimed at bolstering the local meter manufacturing market. Furthermore, the financing cap of 21% is not market friendly as MAPs may not find financing options within those rates, however, the recent drop in interest rate may prove favourable to MAPs with consumers who opt to finance their meter acquisition.[41]

Privatisation of Electricity Assets

The Federal Government, through the Bureau of Public Enterprises, shall this year conclude the sale and privatisation of certain power assets including: the Yola Electricity Distribution Company (Yola DisCo); Afam Power Limited and Afam three fast power (Afam Power transaction); Nigeria Integrated Power Project; and the sale of additional shares in Geregu Power Plc to Amperion Power.[42] The Federal Government's target revenue from these divestments is NGN268.3 billion, which it intends to use to fund its 2020 budget.[43] The Afam Power Transaction is being negotiated with Transcorp Consortium who had the winning bid of NGN105 billion. The transaction is expected to close at the end of February.[44]

The Yola DisCo bid was won by Quest Electricity Company for NGN90 billion and negotiations are ongoing.[45]

Other Investment and Development Opportunities

Nigeria is in negotiations with the World Bank for a $3 billion loan for Nigeria to expand its electricity transmission and distribution infrastructure. According to the Nigerian Minister of Finance, the loan may be provided in four tranches of $750 million each and the

37 *Id*.

38 Paragraph D of the Order on the Implementation of the Meter Asset Provider Scheme in the NESI.

39 Paragraph C of the Order on the Implementation of the Meter Asset Provider Scheme in the NESI.

40 Paragraph F of the Order on the Implementation of the Meter Asset Provider Scheme in the NESI.

41 Sam Gabriel, Banks Cut Lending Rate to Meet CBN Target, Financial Watch 27 Jan 2020, available at https://www.financialwatchngr.com/2020/01/27/banks-cut-lending-rate-to-meet-cbn-target/

42 Onyinye Nwachukwu, BPE to raise N266.6bn Privatisation Proceeds to Fund 2020 Budget, Business Day 13 Feb 2020, Vol 19, No. 498, p. 1.

43 Id. at 2.

44 *Id*.

45 *Id*.

aim is to achieve the first disbursement by April 2020.[46] The financing will cover the historic deficits occasioned by a tariff shortfall in the sector as well as an upgrade of the transmission and distribution infrastructure and allow the distribution business raise financing to invest in the distribution network.[47]

The African Development Bank recently approved a $210 million financing for Nigerian Transmission Expansion Project, which also seeks to rehabilitate and upgrade the country's transmission and distribution network.[48] The Project is to be executed by TCN and forms part of a $1.6 billion Transmission Rehabilitation and Expansion Programme.[49]

Recent Developments in Off-Grid Power

The Rural Electrification Agency (REA) recently commissioned a solar hybrid mini-grid power plant in Niger State.[50] The project is in line with the REA's emphasis on using off-grid electricity technologies to increase access to electricity across Nigeria. The then-Managing Director, Damilola Ogunbiyi, noted the opportunities for investment in the off-grid power sector and highlighted the REA's collaboration with private sector solar developers.[51] The power plant is part of the Nigeria Electrification Project Mini Grids component which aims to provide clean, safe, reliable and affordable electricity to 300,000 homes and 30,000 local businesses in Nigeria.[52]

5. Conclusion

The recent events in the Nigerian power sector will bring positive results within NESI and facilitate much needed private sector engagement and investments. However, the Federal Government must be careful to review its policies in a timely fashion to ensure that they achieve their intended objectives.

---

46 Babalwa Bungane, Nigeria to Expand Transmission, Distribution Networks with a $3 billion loan, ESI Africa 22 Oct 2019, available at https://www.esi-africa.com/industry-sectors/transmission-and-distribution/nigeria-to-expand-transmission-distribution-networks-with-a-3bn-loan/.

47 *Id*.

48 Africa Development Bank, Nigeria: African Development Bank approves $210 million financing for Transmission Expansion Project, 29 Nov 2019, available at https://www.afdb.org/en/news-and-events/press-releases/nigeria-african-development-bank-approves-210-million-financing-transmission-expansion-project-32978

49 *Id*.

50 Pamela Largue, Nigeria Electrification Project Commissions First Solar Mini-Grid, ESI Africa, 10 Dec 2019, available at https://www.esi-africa.com/industry-sectors/generation/nigeria-electrification-project-commissions-first-solar-mini-grid/

51 *Id*.

52 *Id*.