

The Nigerian power sector privatisation and the declaration of a transitional electricity market

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Described as one of the world's largest privatisations, the creation of a formal electricity market through the privatisation of the Nigerian power sector by the outgoing administration is indeed a landmark in the reformation of the power sector. The sector reform, which was contained in a policy document, set the ball rolling for the privatisation process as well as other developments within the sector. The PHCN successor companies comprising six generation companies (Gencos) and 11 distribution companies (Discos) were sold, through a public open bid process, to private investors and on November 1 2013, the new owners took physical possession of these successor companies. Ownership of the Transmission Company of Nigeria (TCN) currently managed by Canada's Manitoba Hydro under a management contract, was retained by the Federal Government of Nigeria.

The reform also saw the establishment of Nigerian Bulk Electricity Trading (NBET). NBET, or the bulk trader as it is sometimes called, is the entity created to provide the status of a credit worthy offtaker with which the Gencos can confidently contract with given that many investors within the power market were not willing to take on the credit risk of the Discos which are presently viewed as not being credit worthy. It was thus set up to purchase power from the Gencos under power purchase agreements (PPAs) and in turn sell to the Discos under Vesting Contracts. NBET was highly capitalised, and in addition, there is the possibility of Gencos that meet the requirement, obtaining a partial risk guarantee from the World Bank and the African Development Bank securing the payment obligations of NBET to such Gencos.

The goal of the power sector reform was to move the Nigerian power sector from a State monopoly towards a competitive electricity market and was divided into four stages, namely: Pre-Transitional, Transitional, Medium Term and Long Term. The Pre-Transitional Stage commenced with the sale of the successor companies. Having completed the privatisation process, the next logical stage in the development of the electricity market is the Transitional Stage, the declaration of which by the Minister of Power pursuant to the Electric Power Sector Reform Act will formally signal that the sector has moved to a Transitional Electricity Market (TEM). Although recent regulations published by the Nigerian Electricity regulatory Commission (NERC), the industry regulator, seem to suggest that TEM has commenced, the Minister has made no formal declaration to that effect. With the uncertainty, there is a need to take a closer look at TEM and what it portends.

Transitional Electricity Market and Interim Market Rules

TEM is the stage in the development of the Nigerian power sector that would witness the transition from a government controlled and

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administered structure to a contract based, private sector driven competitive electricity market. Thus, under TEM, all electricity trading would be done through contracts entered into between participants within the electric power market value chain. Certain contracts (PPAs, Vesting Contracts, Gas Supply Agreements, Gas Transportation Agreements, Ancillary Services Agreements, Transmission Use of System Agreements, Grid Connection Agreements etc) were entered into by the Gencos, Discos, NBET, TCN, gas suppliers and transporters in the course of the privatisation exercise and formed the basis of the private sector investment in the power assets. It was contemplated that these agreements would become effective, and TEM declared by the Minister of Power, upon the handover of the privatised power assets on November 1 2013. This, however, did not happen.

The Nigerian Electricity regulatory Commission (NERC or the Commission), recognising that the conditions precedent (CPs) to the declaration of TEM as set out in the Market Rules had not been satisfied as at the handover date, as well as other challenges in the sector, and after due consultations with stakeholders, issued the Rules For The Interim Period Between Completion of Privatisation and The Start of the Transitional Electricity Market (otherwise referred to as the Interim Rules) on December 3 2013 but which retroactively took effect from November 1 2013 (the date the privatised assets were handed over to private investors) . The Interim Rules suspended the

implementation of the agreements entered into by the PHCN successor companies and instead established a framework for market participants to trade. It also introduced a settlement mechanism that, in the regulator's opinion, would create stability within the market until such time as the regulator considers the market viable for the declaration of TEM by the Commission. Part of this mechanism was that each Disco was required to make from its monthly revenue collections a baseline remittance on a specific date to the Market Operator's designated bank account. Gencos were to submit invoices to the Market Operator based on available capacity and energy delivered to the grid. As a result of the revenue shortfall arising from collection losses, Gencos were permitted to be paid 100% of their invoiced energy charge and only 45% of the invoiced capacity charge out of the monies available from remittances by the Discos. Any outstanding amount was credited to the Gencos and recognised as a debt. Various market participants were permitted to receive only a fraction of the revenue due to them. With a slight improvement in collections, NERC revised the revenue distribution formula in March 2014, permitting the Gencos to be paid up to 60% of their invoiced capacity charge while they continue to be entitled to receive 100% of their invoiced energy charge. 60% of the costs of ancillary services were recoverable while the balance is recognised as account payable. The Interim Rules provided a mechanism to track the revenue shortfall after privatisation and to also monitor available collection in the system.

In a move to address the severe revenue shortfall in the Nigerian Electricity Supply Industry (NESI) (arising mainly from the ATC&C losses of the Discos) the NERC prescribed in the Interim Rules a formula for determining the revenue allowable to each market participant. A direct consequence of this was that the allowable revenues were much lower than what the investors projected but, because it was, generally, understood that the Interim Rules was only a temporary arrangement meant to end on March 1 2014, investors and other market participants reluctantly accepted the outcome. As expected, the implementation of the Rules did not align with investors' financial models and projections on the basis of which they made their investments. The declaration of TEM was, therefore, highly anticipated. On February 28 2014, the NERC issued an amendment to the Interim Rules. The amendment removed reference to the Interim Rules terminating on March 1 2014 as well as the provision that the Commission would declare TEM. By the amendment, NERC stated (correctly) that the Interim Rules will cease to have effect on the date that TEM is declared by the Minister of Power.

Central Bank of Nigeria's intervention facility

The challenge created by the revenue shortfall and the problem of unpaid legacy invoices for gas supplied to PHCN (pre privatisation) threatened to create a crisis of confidence in the Nigerian electricity market. Following a series of stakeholders' consultations, the Central Bank of Nigeria (CBN), working with NERC, decided to set up a framework for a stabilisation facility to settle the revenue shortfall that accrued during the period of the Interim Rules as well as the legacy gas debts. The disbursement of the facility is conditional upon, among other things; a migration from the Multi Year Tariff Order2 (MYTO2) which is the tariff currently applicable in the market to a new MYTO 2.1 that will be more cost reflective.

In February 2015, the CBN made available a N213 billion (approximately \$1.8 billion) Nigeria Electricity Market Stabilisation Facility (CBN-NEMSF) at a concessionary interest rate of 10% per annum on a reducing balance basis to the sector. The purpose of the CBN NEMSF, as stated in a CBN regulation, is to settle outstanding payment obligations due to Market Participants, Service Providers and gas suppliers that accrued during the Interim Rules Period (Interim Rules Debt or IRP Debt) as well as the Legacy Gas Debt of the PHCN generation companies owed to gas suppliers and the Nigerian Gas Company (NGC) which has been transferred to the Nigerian

Electricity Liability Management Company (NELMCO) (the 'Legacy Gas Debt'). The objective, the CBN added, is to put the NESI on a route to economic viability and sustainability.

As expected, NERC issued a revised tariff structure MYTO 2.1 as required in the documentation for the CBN NEMSF. The revised tariff took account of the baseline study of the ATC&C Losses submitted by each Disco to and reviewed by NERC and on the basis of which each Disco was asked to prepare a ten year tariff plan. The facility is to be repaid from a line item on electricity bills paid by electricity consumers.

Shortly after publication of the revised tariff (and in what was widely viewed as a political move), the NERC issued an amendment to MYTO 2.1 by removing Collection Losses as a component of the tariff structure. Predictably, this action by NERC was not well received by the Discos as it can affect their ability to generate sufficient revenue to perform a number of their obligations under existing contracts, including the obligation to reduce ATC & C Loss. In a swift reaction, nine of the 11 distribution companies issued Notice of Force Majeure Event to the Bureau of Public Enterprises in accordance with the Performance Agreement. The Discos are claiming that the removal of Collection Loss from the tariff structure will impede their ability to meet their performance targets under the Performance Agreement.

Declaration of TEM by NERC

On January 29 2015, following execution of the documentation for the CBN NEMSF, the NERC, by an order declared the commencement of TEM. Relying on section 32 of the EPSRA, the NERC in making this declaration stated that the level of completion of all the conditions precedent set out in the Market Rule, which are required to be satisfied before the declaration of TEM, is sufficient to justify the evolution of the NESI into TEM. On that basis, NERC ordered that TEM would commence from February, 1 2015.

The declaration of TEM by the NERC has raised the question whether TEM has in fact been validly declared, and whether the Nigerian electricity market can legally be said to be at the Transitional Stage as required by the enabling statute.

Validity of NERC's declaration of TEM

The key issues at this point is who has the legal authority to declare TEM, and whether NERC has by purporting to declare TEM acted outside its authority, thereby making its action, including the instruments, regulations and orders published in furtherance of such action, null, void and of no effect. The EPSRA is quite explicit on how TEM can be declared and who has the authority do so. Section 24(3) of the EPSRA states expressly that:

"...when the Minister, in consultation with the President and the National Council on Privatisation is satisfied that the electricity market in Nigeria has developed to the point where a more competitive market ought to be established pursuant to section 26 of this Act, having regard to the criteria described in paragraphs (a), (b) and (c) of this subsection, the Minister shall issue a declaration that a more competitive market is initiated."

One clear implication of section 24(3) of the EPSRA is that declaration of TEM is a policy function, going by the government agencies that will play a role in TEM's declaration, and not a regulatory function. Other than the NERC's principal objectives set out in section 32 of the EPSRA, its role in the build up to the declaration of TEM, is to prepare for the Minister of Power, annual reports on the potential for competition in the NESI. The report which will contain analysis and recommendations as to whether NESI has developed to the point where a more competitive market should be initiated, will guide the Minister in a decision to declare TEM.

Based on the foregoing, it is the Minister of Power, and not the NERC that has the power to declare TEM. The declaration of TEM by the NERC on January 29 2015 is therefore ultra vires and void.

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As we stated earlier, following its issuance of the Interim Rules, the NERC had erroneously stated that “the Interim Period shall terminate on March 1 2014 or such other date as the Commission may determine”. Realising that this was contrary to the provisions of the EPSRA, the NERC released the amendment to the Interim Rules, deleting the provision quoted above and stating that “these rules shall... cease to have effect on the first day of the calendar month following the declaration by the Minister of Power that the Transitional Electricity Market (hereinafter referred to as TEM) is operational pursuant to the market rules”. At the time of writing this article, the Minister of Power has not issued any formal declaration signalling that TEM has commenced.

It is, therefore, unclear why the NERC, having already acknowledged that it has no power to declare TEM, would have subsequently done so.

The net effect of this, however, is that the declaration by NERC is unlawful and as such, the NESI has not yet entered into the TEM stage. It may well be that the Minister of Power may, on the basis of the NERC order, declare TEM. But until that is done, the NESI is still, as a matter of law, in the Pre-Transitional stage.

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He has also assisted clients in the negotiation of World Bank Partial Risk Guarantees for gas and power development and in the power sector, and advised on a number of derivative instruments and the applicable master agreements, including ISDA documentation repos and securities lending.

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