DUALE, OVIA & ALEX-ADEDIPE

Considerations for Investors Intending to Participate in the State Electricity Markets in Nigeria

www.doa-law.com

Introduction

Financing remains a major problem across all the segments of the NESI, partly due to absence of cost-reflective tariffs. Yet each segment of the NESI also faces its unique challenges. The generation segment is also equally impacted by the problems of energy security and inefficiencies in other segments. The challenges in the transmission segment lie in the lack of modern transmission infrastructure, gross mismanagement, poor maintenance of available infrastructure and inefficient grid design. Similarly, distribution companies face the perennial problem of huge aggregate technical, commercial and collection ("**ATC&C**") losses. In all of this, it is crystal clear that there is need for fresh investment to upgrade the service delivery and consequently, earn the trust of consumers who would rather spend more than ₦967 per kilowatt-hour on diesel/petrol for self-generated electricity than ₦206 per kilowatt-hour for grid-supplied electricity.[1]

We have, in our earlier notes,[2] explored extant considerations for State governments and licensees. In this article, we will address considerations for investors intending to participate in the State electricity markets in Nigeria.

Investments barriers in the Nigerian power sector

The Nigerian power sector is faced with a number of challenges that have stifled investment. Some of these factors are discussed below.

Regulated Tariffs

Tariffs in the NESI are regulated by the Nigerian Electricity Regulatory Commission ("**NERC**") through the Multi-Year Tariff Order ("**MYTO**"). This discourages investors from financing these projects as revenue generated by licensees is primarily tied to the prevailing tariff which typically constitute the target sources for repayment of financial obligations due from the borrowing licensees under the relevant financing documents.

Regulatory Challenges

Investors have in the past been faced with regulatory challenges such as complex consent processes, incoherent policy standards, inconsistent application and interpretation of rules etc.

Lack of predictability and political continuity

Investment follows certainty, and investors, in feeling the pulse of an investment destination, will typically examine the prevailing regulatory framework, predictability of consequences, and political stability when assessing its investment opportunities. Also, investors are often

[1] *Comparative Analysis of Electricity Prices: Grid Tariff vs. Generators* | accessed at < https://www.linkedin.com/posts/energy-market-and-rates-consultants-emrc_comparative-analysis-of-electricity-prices-activity-7201920696740900864-C5xd?utm_source=share&utm_medium=member_desktop> on the 5th of June 2024

[2] First note (accessible here: https://lnkd.in/dp-sMXK2) and Second note (accessible here: https://lnkd.in/ddSPXgDa)

dissuaded by the non-continuity of projects due to changes in government and the unpredictability of judicial outcomes due to conflicting judgements.

Strategies for unlocking investments in the decentralised NESI

Despite the challenges bedeviling the power sector, some provisions of the Electricity Act 2023 (as amended) (the "**Act**") seek to address these challenges. The Act affords private investors the opportunity to invest in the national grid to improve the transmission infrastructure facilities.[3] It is believed that the input from private investors will be timely in curbing the incessant cases of grid collapse and, generally, improving the state of the transmission network.

Investors may approach State governments for collaborations, with the goal of creating State electricity markets devoid of regulatory obstacles by implementing consistent and reliable policy structures and making approval processes easier. The collaboration may exist in the form of research and knowledge-sharing of global best practices, cutting-edge electricity technologies, best practices in energy storage and related energy matters.

Considering that the electricity sector typically requires patient capital to sustain progress, investors may collaborate with the more buoyant States to establish a power bank, being a financial institution dedicated to funding power projects, particularly extending long-term, low-interest loans for power projects in rural, underserved areas and other areas with great agricultural potential.

Investors can also engage State governments with a view to amending or operationalising public-private partnership laws providing i) adequate and robust credit enhancements for investors in power projects and ii) sufficient provisions on appropriate compensation or reimbursement for expended pre-development costs where procuring public entities renege on commitments. The Azura IPP, a limited recourse project-financed Independent Power Plant (IPP) project ("**Azura Project**"), had sufficient credit enhancements, which crowded in investments to the tune of US$621,000,000(Six Hundred and Twenty-One Million United States Dollars) in debt funding and US$190,000,000 (One Hundred and Ninety Million United States Dollars) in equity investments, and Nigeria continues to benefit from the Azura IPP to this day.

[3] Section 109 of the Act.

DUALE, OVIA & ALEX-ADEDIPE

Despite the challenges bedeviling the power sector, some provisions of the Electricity Act 2023 (as amended) (the "Act") seek to address these challenges. The Act affords private investors the opportunity to invest in the national grid to improve the transmission infrastructure facilities.

CONSIDERATIONS FOR INVESTORS INTENDING TO PARTICIPATE IN THE STATE ELECTRICITY MARKETS IN NIGERIA

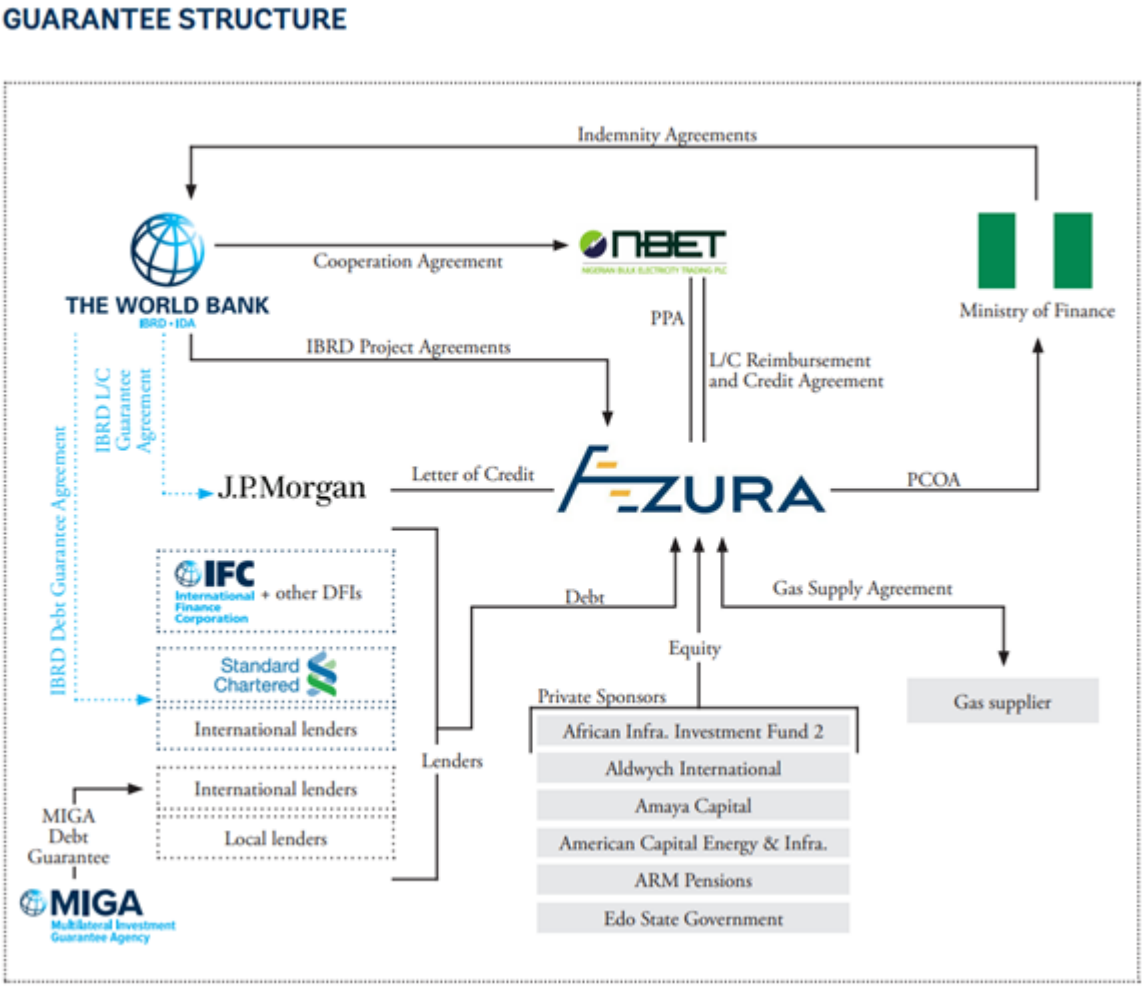

Figure illustrating Guarantee Structure of the Azura Transaction[4]

As shown from the above guarantee structure, the Azura Project is clear proof of the existence of investment and the funding will only come as long as Nigeria is willing to derisk it.

Fortunately, the Act provides for a number of fiscal incentives to promote the consumption of energy generated from renewable energy sources.[5] The existence of these fiscal incentives may potentially attract fresh investors in the sector. Additionally, the Act also provides for a feed-in-tariff, which is an incentive to guarantee investors their return on investment on renewable energy.[6]

[4] World Bank – Financial Solutions Brief – https://thedocs.worldbank.org/en/doc/629011518200593880-0100022018/original/BriefsGuaranteesNigeriaAzuraEdo.pdf accessed 9/4/2023
[5] Section 166 of the Act.
[6] Section 168 of the Act.

Opportunities for Investment in decentralised NESI

The ability of States to tailor innovative power sector-related solutions to their local needs, as made possible by extant laws,[7] is pivotal to attracting investments. As such, investors in emergent State electricity markets should largely consider sustained stakeholder engagement and constant collaboration with the States, licencees, and, most importantly, other investors in their journey towards reaping the benefits provided by the decentralisation of the NESI.

Power Distribution

In essence, the Act creates a dual electricity market by allowing states to issue licences to private investors across the supply chain. As states begin to enact laws and establish their regulatory bodies, opportunity abounds for investors who may wish to apply for a distribution licence through an entity or invest in entities with a distribution licence.

Notably, the EA 2023 contemplates that, at a point in the market stage, the Nigeria Electricity Regulatory Commission (the **"Commission**") will issue a separate licence for supply operations. When this occurs, the existing distribution licence will be split into distribution and supply licence, creating more opportunities for investment. However, before this occurs, investors can approach Distribution Companies (**"DisCos"**) to apportion a section of their licenced area to undertake the supply portion of their operations.

Also, Investors may also venture into Independent Electricity Distribution Networks, which would give them the opportunity to construct, own and operate a distribution system not directly connected to the grid.

Power Generation

It is important to note that the principle of dual electricity markets still apply here. Aside from investing in power generation companies, intending investors can also invest in captive power generation, embedded power generation, on-grid and off-grid Independent Power Plants (**"IPPs"**) and mini-grids. Generally, mini-grids are capable of serving numerous end users outside the central transmission network. This unique feature of isolation makes it a good area for investment who wish to venture into the power sector investments.

Power Transmission

The Commission may also issue Independent Electricity Transmission Network (**"IETN"**) licences in underserved or unserved Greenfield sites[8]. Independent power transmission companies, also known as Independent Electricity Distribution Network Operators (**"IEDNOs"**), are private investors who have opportunities to collaborate with the Transmission Company of Nigeria Plc (**"TCN"**) and invest in transmission assets following the Commission's

[7] The Constitution of the Federal Republic of Nigeria 1999 (as amended by the 5th Alteration (No. 33) Act) and the Electricity Act 2023 (as amended)
[8] Section 66 (2) of the Act.

regulatory framework. These independent operators are actively engaged in the distribution of power sourced from their respective embedded generation plants, with operational licenses and operational status granted to them.

Trading

Currently, the trading licence is being held by the Nigerian Bulk Electricity Trading Plc ("**NBET**"). In light of current realities, there has been propositions for the phasing out of NBET. It is believed that this move will improve the competitive state of the trading sector in the Nigerian power sector. Importantly, the EA 2023 contemplates the issuance of trading licences by NERC at a market stage where it is deemed suitable and only to the extent that the licensees have met the technical requirements, are credit worthy, and have also satisfied the conditions of the licence.[9]

Consequently, the proposed arrangement envisages that certain licensees may be able to enter into novation agreement with NBET pursuant to which NBET may effectively novate its existing contracts before the phase out. From an inventory financing perspective, there is a significant opportunity for investors, who are willing to come on board. Businesses in the power sector looking for liquidity will benefit greatly from such investment.

Metering, Billing and Collection

One of the proposed approaches to curbing collection losses in the Nigerian power sector is through metering. An investor may get a sub-franchise from DisCos to meter, bill and collect revenue from customers of the DisCos within the DisCos' franchise area.

Investors may choose to engage in the manufacturing or installation of metering systems. Following the Meter Price Deregulation Order issued on 29th of April 2024 (the **"Order"**), there is a significant investment opportunity in the meter supply and installation business. The Order opens up the metering space for increased competition and private sector participation. Investors can take a cue from this Order and invest in this aspect of the Nigerian power sector.

Sub-franchising of the electricity distribution operations

Investors may also enter into a sub-franchise arrangement with the DisCos to maintain the distribution system within the DisCos franchise area. This will encompass the total rehabilitation, upgrade, and maintenance of distribution facilities.

Innovative business models in the off-grid energy sector

Despite the emergence of the States with regulatory oversights over their territories, electricity operations will still largely be routed through the national grid and, by extension, will remain under the regulatory jurisdiction of NERC. Accordingly, there is need for investors looking to play in this State to consider the off-grid energy sector, particularly the rural, underserved

[9] Section 69 of the Act.

areas. In doing this, investors may need to consider innovative business and customer financing models such as power as a service, pay-as-you-go (PAYGO), electricity cooperatives, lease-to-own etc.

Whilst investors may be tempted to assess bankability based on the spending capacity and sufficient liquidity of their target consumers, investors may expand their risk assessment to cover the consumers' ability to pay in materials other than cash. For example, an area with high agricultural potential may make payment for energy consumed with part of their produce, and such investor strike an independent arrangement with a third-party commodities trader or exchange. The foregoing notwithstanding, players in the NESI may need to properly assess their target market and pilot with small areas to prove their model before expanding.

Conclusion

The Act is quite keen on protecting investors' interests. It guarantees asset protection, the right of disposal of licensee's undertaking in cases of revocation, or compensation in cases of coercive takeover in the interest of national security for the protection of investors' interests in the power sector. Importantly, investing in Nigeria's state electricity markets necessitates a comprehensive understanding of the legal, policy, and regulatory frameworks governing the sector. It is necessary that investors engage the services of experienced professional advisors to navigate every hurdle on their way. Commendably, the Act pays particular attention to stimulating policy measures necessary to attract investments in the Nigerian electricity value chain and recognising third-party investments in NESI[10] assets and infrastructure by private and public sectors.[11]

Investors, on their own part, must also ensure that they engage professional advisers who can assist with the procurement of the appropriate licenses before commencing business operations in cases of direct application for licenses. In May 2024, the NERC fined CCETC Suk Power Company Limited for violating section 62 of the repealed Electric Power Sector Reform Act (EPSRA) 2005 for operating an electricity generation and distribution company in Nigeria without a licence.[12]

By conducting thorough due diligence, robust local stakeholders' engagement, and continuous policy changes monitoring, investors will be well-positioned to leverage the substantial opportunities within the Nigeria's power sector.

[10] Nigerian Electricity Supply Industry
[11] Section 1 of the Act.
[12] NERC Slaps Chinese power firm with hefty penalty for operating electricity business in Nigeria without license | accessed at < https://advisorsreports.com/nerc-slaps-chinese-power-firm-with-hefty-penalty-for-operating-electricity-business-in-nigeria-without-license/ > on the 5th of June 2024

LAGOS
Plot 1B, Block 129
Jide Sawyerr Drive
Lekki Phase I
Lagos State, Nigeria

ABUJA
4th Floor, Abia House
Plot 979, 1st Avenue
Off Ahmadu Bello Way
Central Business District
Abuja FCT, Nigeria

Tel.: 0700 DOALAW (0700 362529)
Email: info@doa-law.com
www.doa-law.com

DUALE, OVIA & ALEX-ADEDIPE