KPMG

Nigeria's Electricity Supply Industry Highlights

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The COVID-19 pandemic has continued to ravage the world with its attendant impact on all sectors of the global economy. The Nigerian power sector ("the Sector") has not been immune from the challenges caused by the pandemic. KPMG had discussed some of these challenges in our COVID-19 newsletter issued in April 2020. However, there have been some developments in the Sector since then and these are discussed below:

Impact of Finance Act on the Power Sector

The Finance Act, 2019 ("the FA" or "the Act"), which was signed into law by the President on 13 January 2020, amends specific provisions of some existing tax laws in Nigeria. One of such amendments introduced by the FA is the change in the minimum tax (MT) rules. Every company in Nigeria, other than those in the agricultural sector or within their first 4 calendar years of operation, is expected to pay a minimum amount of income tax annually, irrespective of their financial performance. The computation of MT used to be complex. The primary intention of the amendment was to simplify the process by making it a percentage (0.5%) of gross turnover.

This simplification may have an immense impact on the power sector especially distribution companies (DISCOs). DISCOs report significant revenues even though they are mostly unprofitable. The DISCO is the collecting agency for the entire sector and, therefore, consolidates the sector's revenue in its books. Furthermore, in 2019, the DISCOs were beneficiaries of tariff shortfall "payments" for 2015 to 2019 from Government. These receipts would also have increased their gross revenue for the year. Based on the new rule, the DISCOs may be liable to significant MT for that year and going forward. The Sector continues to struggle with liquidity and it will be unfair to use cash that may be better applied towards infrastructure development for payment of taxes, especially by companies with significant losses carried forward from years of unprofitability. It is, therefore, important that the industry and Government come together to address this challenge as quickly as possible.

There are other issues from the FA which may negatively impact the power sector and it may be necessary to conduct a wholistic review of the FA, identify these issues and put together a plan to proactively engage the Government.

National Assembly Postpones the Minor Review Order ("the Order") to 2021

The National Assembly (NA) recently announced the postponement of the proposed date for the implementation of the Order, which was scheduled for 1 July 2020, to the first quarter of 2021.

Generating Companies (GENCOs) have since registered their displeasure with the announcement threatening a force majeure. However, it is unlikely that this will change the decision as it appears that the NA has gotten the approval of the Presidency and the relevant regulators in the sector.

The postponement leaves a lot of questions unanswered. The Nigerian Electricity Regulatory Commission (NERC) has recently issued a report, which shows that the power sector loses about ₦122billion every month with the top three losses recorded by Ikeja, Ibadan and Eko DISCOs, as a result of tariff shortfalls. It is debatable if the Government will be able to cover this amount consistently, given its own revenue challenge with the fall in oil prices. There is also the issue of additional funding for the sector as this will continue to be difficult without adequate planning for long term sustainability that the tariff adjustments are meant to provide for the industry.

Another unanswered question is whether there would be changes to the economic indices used in determining the tariff when the Order is implemented in 2021 as it would have been more than a year since the Order was initially contemplated. There have been concerns that the indices already were not reflective of current realities especially with the impact of COVID-19 but this may change again in another 6 to 9 months.

NERC issues Guidelines ("the Guidelines") on Distribution Franchising

On 2 July 2020, NERC issued the Guidelines on distribution franchising in the Nigerian Electricity Supply Industry (NESI). The Guidelines, dated 24 June 2020, were introduced to primarily establish a regulatory framework for franchising arrangements by DISCOs as contemplated by section 69(1) of the Electric Power Sector Reform Act 2005 (EPSRA).

The Guidelines highlight four (4) franchising models that the DISCOs can adopt. Further, it allows the DISCOs to propose other innovative models which may best suit the peculiarities of their franchise areas. DISCOs, however, need to obtain NERC's approval before entering into any franchising arrangement. NERC may also, either on its own based on available information or pursuant to a petition

received from a stakeholder or other licensee, initiate an inquiry into the conduct and performance of a franchise arrangement. Depending on the outcome of the inquiry, NERC may revoke the franchise arrangement where certain operating parameters are not fulfilled.

The tariff applicable to the franchising arrangement must be in accordance with the multi-year tariff order methodology approved by NERC.

It is not clear how the franchising arrangements will impact the current agreements between the DISCOs and Meter Asset Providers (MAP), especially as the Guidelines anticipate that metering, billing and collection can be within the scope of franchise arrangements. However, NERC seems interested in giving significant flexibility to licensees and their franchisees to devise strategic solutions appropriate for their unique circumstances.

The promotion of franchising arrangements by NERC is a welcome development which will improve the service delivery as the terms will be based on a "willing buyer, willing seller" model. It is, however, expected that NERC will provide clarity on some grey areas in the Guidelines to enable investors make informed decisions.

World Bank donates funds to Power Sector.

The World Bank recently approved a US$750 million International Development Association (IDA) credit for Nigeria's Power Sector Recovery Operation (PSRO) to improve electricity supply, enhance accountability and enable the power sector to achieve financial and fiscal sustainability. The PSRO is expected to increase annual electricity supplied to the distribution grid, enhance power sector financial viability while reducing annual tariff shortfalls and protecting the poor from the impact of tariff adjustments.

Inconsistent power supply has remained one of the major constraints to economic development and growth of Nigeria's private sector. The IDA fund is earmarked to support the implementation of the Government's Power Sector Recovery Programme (PSRP) to improve electricity supply and ensure that more Nigerians have access to grid electricity. Thus, it is expected that improving the power sector performance will have major economic impact especially in the non-oil sectors of manufacturing and services that are pivotal to unlocking economic growth post-COVID-19 pandemic. Given that this is not the first time the sector has received funding aimed at revamping its performance, it is hoped that the funds will be put to good use in order to achieve and sustain the desired growth in the sector.

Senate seeks restructuring of power privatization program

The Nigerian Senate, in a recent deliberation, has noted that there is an urgent need for the Federal Government of Nigeria (FGN) to consider an in-depth review of the power privatisation program with a view to revamping the current arrangement. The Senate argues that there is a likely risk that Nigerians may not enjoy stable power supply in the next 10 years if there is no review and restructuring of the DISCOs' current operations.

The Senate President, Ahmed Ibrahim Lawan, opines that the privatisation of the power sector has, so far, not been successful as the expected efficiency and effectiveness have not been achieved. He notes that the continuous need for government bailout funds is an indication that the sector is not self-sufficient.

Further, the Chairman Senate Committee on Power, Sen. Gabriel Suswan, notes that the provisions of the current Reform Sector Act 2005, which enabled the government to privatise the electricity entity, are no longer enough to drive sustainability and scalability of the sector. He argues that, beyond privatisation, there is a need to have an Electricity Act, which will address specific issues affecting the power sector, prescribe penalties for issues relating to energy theft, and create an environment that gives current and potential investors assurance that their investments are protected.

In recent times, there have been call for enactment of policies that will address the specific issues faced by the power sector. It is hoped that the National Assembly will consider all recommendations proposed by the relevant stakeholders to develop a coherent legal framework for the power sector.

NERC may sanction DISCOs for failing to cap payment of unmetered customers

NERC has stated that they will sanction seven (7) DISCOS that have not complied with the rules of the Order on the Capping of Estimated bills ("the Capping Order") in the NESI. The regulatory commission listed the defaulting DISCOs as Benin DISCO, Enugu DISCO, Eko DISCO, Ikeja DISCO, Kano DISCO, Kaduna DISCO and Port Harcourt DISCO.

In February 2020, NERC issued Order No: NERC/197/2020. The Order places a cap on estimated bills that can be issued to unmetered customers to N1,875=per month. The Commission had ordered that all unmetered R2 (residential customers who consume more than 50 kilowatt/ hour in a month) and C1 (small businesses) customers should not be invoiced for the consumption of energy beyond the cap it had stipulated. According to NERC, the Order replaced the Estimated Billing Methodology Regulation as a basis for computing the value of energy consumption of unmetered customers by DISCOs.

However, the DISCOs had complained that the limit placed by the NERC on the estimated bills was not reflective of the energy consumed by these unmetered customers. They also stated that the assumptions used by the Commission were inaccurate and would lead to an increase in losses due to unbilled energy of between 20 to 35 percent depending on the DISCO. The cap, in their opinion, would also disincentivize customers from procuring meters through the MAP scheme. Consequently, the DISCOs proposed that the cap should rather be implemented after the metering deadline of 31 December 2021.

It is hoped that the NERC and DISCOs can reach a position that will be mutually beneficial to all parties, and which will also consider the peculiarities of each DISCO's coverage areas.

The Impact of Duty on Metering Targets

The DISCOs, through the Association of Nigerian Electricity Distributors (ANED), disclosed that the huge duties and charges on importation of meters and components for local meter productions may impact their ability to meet the 31 December 2021 deadline set by NERC in line with the MAP Regulations.

There is a backlog of imports awaiting clearing for distribution and/ or production to meet the current demand as the DISCOs and MAPs are unable to settle the import duties and charges promptly.

We understand that the FGN is currently reviewing the concerns raised by the DISCOs/ MAPs regarding the import duties and charges on electricity meters and components for local production. Hopefully, this review will have an impact on the recent increment in the prices of meters announced by NERC if the import duties issue is resolved.

Conclusion

The power sector is in dire need of implementation strategies that will bring it out of the current debt crisis and address its various challenges. It is, therefore, important that all relevant key stakeholders work together to develop coherent policies and measures to improve the sector.

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