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POST-PRIVATISATION PROBLEMS: MITIGATION STEPS THAT CAN BE TAKEN TO BOOST INVESTORS' CONFIDENCE IN THE NIGERIAN POWER SECTOR

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Introduction

In September 2013, the Nigerian Electricity Supply Industry (NESI) was privatised. Six generation companies (GENCOS) and 11 distribution companies (DISCOS) were sold to investors who acquired a minimum of 60% of the shares of each company. Some of the stated goals of the privatisation programme are that the privatised entities would develop and improve electricity infrastructure in the country, increase generation capacity and improve power supply to end users. To ensure that the goals are achieved, the Nigerian Electricity Regulatory Commission (NERC) developed the Multi-Year Tariff Order (MYTO), a tariff system that is designed to be both cost reflective and to reward an efficient operator.

Before the privatisation, the expectation was that NESI would be functional, when each part of the electricity chain, namely, generation, transmission and distribution functions efficiently and in a coordinated manner. Thus, contracts that would enable proper commercial behaviour amongst players in the industry were signed, and regulations that would encourage discipline and reward efficiency were issued by the sector regulator, NERC.

But, since privatisation, the Nigerian Electricity Supply Industry has been mired in crises including regulatory inconsistencies, political interference, and suspension/unenforceability of contracts, power thefts and low revenue collection. Some of the post-privatisation problems could be traced to the privatisation process itself, which, somehow, allowed entities that did not have sufficient technical and financial capabilities to take control of critical generation and distribution assets. Also during the process, NERC, the investors and the Bureau of Private Enterprises (BPE) (which superintended the privatisation process) did not have critical data on the extent of technical and collection losses of government-owned distribution companies. The post-privatisation crises have resulted in an increasing debt bubble which, if not contained, may bankrupt the entire Nigeria Electricity Supply Industry.

This article would do a short analysis of the current post-privatisation problems and discuss the steps that are being taken to ensure that the sector becomes attractive to investors.

Post Privatisation Problems

Regulatory Inconsistency: One issue which has been of concern to players and investors in the Nigerian power sector is the power of the regulator to tinker with pre-agreed tariff mechanism. This power was exercised to a devastating effect, when prior to the 2015 election, NERC reduced tariffs by removing collection losses as part of the items used in calculating electricity tariff. This regulatory action, before it was reversed in February 2016, resulted in a significant increase of debts accumulated across the electricity supply chain.

Political Interference: Although NERC is established to be an independent regulator, it has not, in practical terms, been able to act, always, free from political interference. The institution has suffered from having its commissioners removed before the end of their tenures, and has had to function for a considerable length of time without a fully constituted board.

The insecurity of tenure prevents the commissioners from discharging their duties effectively as their actions are sometimes coloured by political considerations. An example of this is the tariff reduction in the run-up to the 2015 election. Another negative effect of political interference on NERC is that, when it has no validly appointed commissioners, it is unable to make decisions, issue licences and respond to market crises promptly.

Ineffective Contracts: Different types of contracts have been signed by different participants in the power sector to give effect to different transactions in the sector. Such contracts, broadly, include gas offtake and transportation agreements, grid connection agreements and power sale agreements. Currently, gas is being supplied to power plants which, in turn, supply power to the grid and distribution networks with many of the contracts, signed across the electricity chain, being kept ineffective by regulatory fiat.

Also, there are some mismatches in the contracts signed by different participants across the electricity chain and the regulatory framework guiding certain commercial activities in the sector. A good instance of such mismatch is in the PPAs between the generation companies (GENCOS) and the Nigerian Bulk Electricity Trading Plc (NBET) which allow the GENCOS to reflect forex fluctuation in their invoices to NBET, while the tariff chargeable to end users does not automatically reflect forex fluctuations. This mismatch does not allow the tariff charged by the DISCOS to be cost reflective.

Because the contracts are not effective, it has been difficult to keep parties accountable to their contractual obligations. The non-effectiveness of the contracts has made it difficult to for the government to enforce the performance commitments of the privatised generation companies and distribution companies.

A regime that allows a contract based market would instil discipline in the sector, enable existing contractual dispute to proceed to arbitration for settlement and would boost investors' confidence.

Tariff Collection: One of the problems that were underestimated during the privatisation process is the aggregate technical, commercial and collection (ATC&C) losses of the DISCOS. The ATC&C losses heavily impact the ability of the DISCOS supply power to the end users and to collect revenue. The DISCOS were expected, under their respective performance commitments, to gradually reduce the losses by improving distribution infrastructure and becoming efficient at revenue collection. However, the DISCOS have not been able to significantly reduce the ATC&C losses because of a combination of reasons. Such reasons include the fact that tariffs charged by DISCOS are not cost reflective, DISCOS do not have the cash to make the investment required to improve distribution infrastructure, only a few consumers are metered and there is a high incidence of power theft.

Mitigation Steps

Although the challenges facing the sector are varied and many, there is a raft of solutions being proposed and steps being taken to address the challenges holistically. The solutions range from legislative intervention to financial packages being put together to de-risk commercial transactions in the sector.

Legislative Intervention: The National Assembly is considering the amendment of the Electric Power Sector Reform Act to deal with some constraints that have been identified in the sector. Some of the amendments being considered include insulating NERC from political interference, increasing licence duration from 10 years to 20 or 25 years and providing stringent penalties for electricity theft. The increase of licence duration would go a long way in making power projects in Nigeria more bankable. An independent regulator would immediately translate to a higher investors' confidence in the sector.

Funding of Tariff Shortfalls: The government of Nigeria has provided NGN701 billion (US$2.2 billion) to fund historical and future deficits in the power sector. The goal of this intervention is that government will pay for revenue deficits that had accrued as a result of end users' tariff not being cost reflective from 2013 to 2016. Since it will take about five years for the current end users' tariff to get to a cost reflective level, the government will also use the fund to pay for revenue shortfall from 2017 to 2021. In addition to paying for sector deficits, the government intends to work to restore cost reflective tariffs over the next five years. It is important to note that the World Bank Group has indicated potential support for the Nigerian power sector totalling up to US$2.5 billion as well as IFC investment and MIGA support which will unlock additional US$2.7 billion private investment.

The World Bank Group support is conditional upon the government of Nigeria implementing the Power Sector Recovery Program agreed with the World Bank Group.

Contract Effectiveness: It is expected that the intervention of the government to fund tariff shortfalls and return the sector to cost reflective tariff will enable relevant government agencies to sanction erring DISCOS which fails to meet performance commitments. It would also enable the activation of sector contracts. This will lead to the enforcement of contractual commitments and put the sector on the path to developing a competitive electricity market.

Conclusion

The demand for power in Nigeria is very high. However, this demand, alone, will not attract the investments required to unlock the potentials of the power sector. The good news is that the government is taking steps and committing resources to ensure that the sector is commercially viable. It is expected that this drive will continue. The result of consistently implementing the right policy would be higher investors' confidence that the dollars invested in the sector would yield the expected returns.

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