NERC'S ORDER ON THE TRANSITION TO BILATERAL TRADING IN THE NESI AND THE IMPACT OF NBET BEING PHASED OUT OF THE NESI

Introduction

Section 7 of the Electricity Act 2023 ("**Electricity Act**") empowers the Nigerian Electricity Regulatory Commission ("**NERC**") to assume a pivotal role during the post-privatization phase of the Nigerian Electricity Supply Industry ("**NESI**"). NERC is tasked with the responsibility of ensuring the development of the Nigerian electricity market from its current transitional electricity market stage to the medium term and long-term electricity market stages or such stages of the market in accordance with such terms, preconditions or features as may be prescribed in the Market Rules 2014 or amendment to such rules as may be approved by NERC.

As part of preparatory efforts to the initiation of the medium term and long-term electricity market stages as recognised under the Electricity Act, NERC is mandated under Section 7(2) (d) of the Electricity Act to issue a directive and establish a specific timeframe within which the Nigerian Bulk Electricity Trading Plc. ("**NBET**") is to cease to enter into contracts for the purchase and resale of electricity and ancillary services, and to also novate its existing contractual rights and obligations to other licensees. The medium-term electricity market is expected to phase out NBET with the novation of its Power Purchase Agreements ("**PPAs**") with the generation licensees ("**GenCos**"), to other licensees such as the distribution licensees ("**DisCos**") and trading licensees.

The lifespan of NBET was originally expected to be temporary and to cease upon the NESI's transition to the medium-term market stage. In this regard, NBET's initial license was issued by NERC on 15th November 2011, for the maximum statutory tenure of ten (10) years, which ended in November 2021. However, NBET's operating license was r enewed for an additional three (3) years, billed to expire in November 2024.

It is worthy of note that since the privatisation of the NESI in 2013, the NESI has experienced liquidity challenges caused by non-cost reflective end-user customer tariffs, untimely subsidy disbursement and poor billing and collections systems by the DisCos which have led to shortfalls. To combat this, NBET has relied on the Power Sector Recovery Program funding and ad-hoc payments from budgetary appropriation and the Federal Government to support the NESI. Ultimately, the NESI has largely been unable to attract new Independent Power Producers (IPPs) and investors.

The exit of NBET from the NESI is to create a bilateral contract market arrangement where GenCos will deal directly with the DisCos, trading licensees and eligible customers with the consequence of these GenCos relying directly on the financial credibility and capability of individual DisCos, trading licensees and eligible customers to settle their invoices. NERC in Section 17 of the Multi Year Tariff Order ("**MYTO**") 2024 it issued for the DisCos, had mandated the DisCos to secure adequate bilateral contracts to facilitate a seamless exit from NBET's vesting contract regime and to mitigate their exposure to volumetric energy risks. The MYTO 2024 further states that effective from January 2024, the DisCos were required to continually procure additional energy volumes to serve their customers and ensure steady migration of customers to higher service bands on account of improved level of supply.

In further preparation for NBET's exit from the NESI, NERC has since 2022 issued trading licences to ten (10) private companies to trade electricity bilaterally with DisCos and eligible customers which has further established the fact that the NESI has potential outside the NBET single trading licensee market.

This article reviews the NERC's Order on the Transition to Bilaterial Trading in the NESI dated 25th July 2024 ("**Order**") and also highlights its impact to the Nigerian power sector.

NERC'S ORDER ON THE TRANSITION TO BILATERAL TRADING

The Order [accessed *here*] which is to take effect immediately until it is amended or revoked by a subsequent order issued by NERC, has the following key objectives:

1. Promote bilateral contracting between GenCos and trading licensees with DisCos to reduce the Federal Government's market risk exposure.
2. Encourage a more competitive market structure in line with the Electricity Act.
3. Allow hydro and thermal GenCos with existing take and pay contracts with NBET to reduce their contractual capacities by trading directly with DisCos on a bilateral basis.
4. Enable DisCos to optimise their wholesale energy offtake and the improve the quality of supply to end-users by reducing their vesting contract capacity with the NBET for take and pay PPAs.
5. Shift the contractual framework for bulk energy trading in the NESI to take or pay contracts to enhance market certainty and discipline among market participants.

Some of the key changes made in the Order are as follows:

NBET is to immediately stop entering new contracts for the purchase and resale of electricity and ancillary services in the NESI. Any such contract will not be approved by NERC and will subject to regulatory sanction.

NBET will continue to administer fully effective contracts with five GenCos based on the minimum take or pay capacities contained in their respective PPAs or the average available capacity of the plants in 2023 ("NBET Firm Capacity"). The five (5) GenCos under this category are: Azura Power West Africa Limited ("Azura"), Omotosho Power Plc; Olorunsogo Power Plc, Nigerian Agip Oil Company Limited, and Shell Petroleum Development Company of Nigeria Limited.

The System Operator ("SO") will dispatch Azura at a baseload equivalent to its minimum take or pay capacity of 360MW. The SO may also issue dispatch instructions to Azura for increased generation to serve as the supplier of last resort where other on-grid GenCos are unable to meet their contracted obligations. Such GenCos shall be invoiced by NBET for the energy delivered on their behalf by Azura.

All other GenCos with take and pay PPAs or interim energy sales agreements with NBET must negotiate and enter bilateral contracts for the capacity currently contracted with NBET with DisCos within sixty (60) days of the Order.

The gross residual capacity from all the GenCos will make up the pool of energy to be traded through NBET on a take and pay basis (“**NBET Interim Pool**”).

Seventeen (17) GenCos as listed in Schedule 1 of the Order are to not later than 30 September 2024 notify NBET of the capacities that have been traded bilaterally with DisCos and/or eligible customers. Such GenCos are to further seek the approval of NERC for the bilateral transactions. If there is any residual capacity not traded with the DisCos, it shall be traded with NBET on an interim agreement basis on the same commercial terms contained in the current contract with NBET.

Hydro GenCos must equitably provide their current contracted capacity with NBET to DisCos based on the shared capacity as contained in the vesting contracts, provided that the net capacity being traded is not less than the average capacity supplied to the DisCo by the Hydro Genco in 2023.

The SO shall prioritise energy contracted bilaterally and the NBET Firm Capacity over residual take and pay capacity with NBET in the merit dispatch generation plants.

The SO shall dispatch GenCos in the NBET interim pool in response to a demand of DisCos and the electricity market.

The maximum capacity a DisCo can trade in the bilateral market as Bilaterally Tradable Energy (“BTE”) shall be the difference between its energy offtake as contained in the July 2024 MYTO Order (accessed *here*) and the NBET Firm Capacity as provided in the Order. Any deficit in the contracted capacity will be fulfilled from the NBET Interim Pool on a take and pay basis.

Within three (3) months of the commencement of bilateral contracting, all GenCos capacity under bilateral contracts shall be supported by firm gas supply agreements on a take or pay basis with adequate provision for liquidated damages for supplier defaults to sustain the bilateral market.

For energy invoicing and settlement:

DisCo revenue collection will prioritise payments of (a) bilaterally traded energy between DisCos and GenCos, (b) firm contracts of NBET with the 5 GenCos, and (c) NBET pool energy under interim take and pay framework PPAs.

NERC's monthly tariff reviews shall continue to consider and accommodate changes in macroeconomic indices to ensure that DisCos' allowed tariff is sufficient to meet its contracted BTE costs.

Firm bilaterally contracted capacity by all DisCos shall be fully aligned with the allowed recoverable generation cost from the end-user tariffs of the DisCos thus mitigating the risk of payment default.

Where the Federal Government tariff reform policies allow for more revenues from the electricity market, DisCos shall be directed by NERC to bilaterally contract for additional capacity on firm basis from the NBET Interim Pool.

NERC and NBET shall closely work together with relevant government ministries, departments and agencies to ensure the provision of a credible financing plan in support of any tariff policy approved by the Federal Government.

Where the allowed tariff of a DisCo provides revenue for the generation component of its revenue requirement in excess of its BTE, NERC shall provide regulatory direction on the amount payable to NBET under its contract with the DisCos.

COMMENTS AND IMPACT OF THE ORDER TO THE NIGERIAN POWER SECTOR

We note that the Order encourages a move towards a more competitive and efficient market. The implementation of the Order which would require fully effective PPAs with adequate bank and payment guarantees would ensure optimal performance in the NESI.

Notwithstanding, we have considered below the potential implications of the exit of NBET from the NESI on on-grid GenCos, as follows:

- The GenCos may be required to amend the terms and conditions of their generation licenses. The license terms and conditions issued by NERC specify the entities to which the GenCo may supply the power it generates, typically NBET and, in some cases, other offtakers. In light of the Order, the GenCos may need to amend their license terms to reflect their new offtakers.

- Bilateral trading with eligible customers is likely to increase but this is subject to the cooperation of the DisCos, as outlined in the Eligible Customer Regulations 2024. In the past, the DisCos have strongly opposed bilateral trading between GenCos and end-users. End-users seeking the eligible customer status and wishing to engage in bilateral trading with the GenCos are required to procure a letter of clearance of non-indebtedness from the DisCo they are connected to, a process that may be experience delays and could hinder the transition to a more competitive market.

- Under the current Minimum Remittance Order ("MRO") regime, DisCos only settle for a fraction/percentage of NBET's invoices, while the rest is absorbed by NBET and settled by the Federal Ministry of Finance, Budget and National Planning. With NBET's exit, DisCos would be directly responsible for the settlement of 100% of the GenCos invoices and NBET will no longer backstop the DisCos' payment shortfalls to GenCos. It then begs the question on whether the federal government will continue to intervene in the sector through provision of subsidy for certain customer categories/service bands.

- NBET as the middleman plays the crucial role of ensuring the stability and financial viability of the NESI by guaranteeing payments to GenCos, thereby sustaining electricity generation and supply. To the extent that electricity generated by on-grid GenCos will be sold to the national grid, there is the risk that most DisCos will be unable to pay for the power without some form of subsidy by the government.

- There is very likely to be an emergence of other traders apart from NBET in the market who would be acting as middlemen between the DisCos, GenCos and bilateral customers including eligible customers. The Order acknowledges that NERC has issued licences to ten (10) private companies who have applied for trading licenses. The nature of risks that these trading licensees would be willing to take on and the potential impact on the market is yet to be determined.

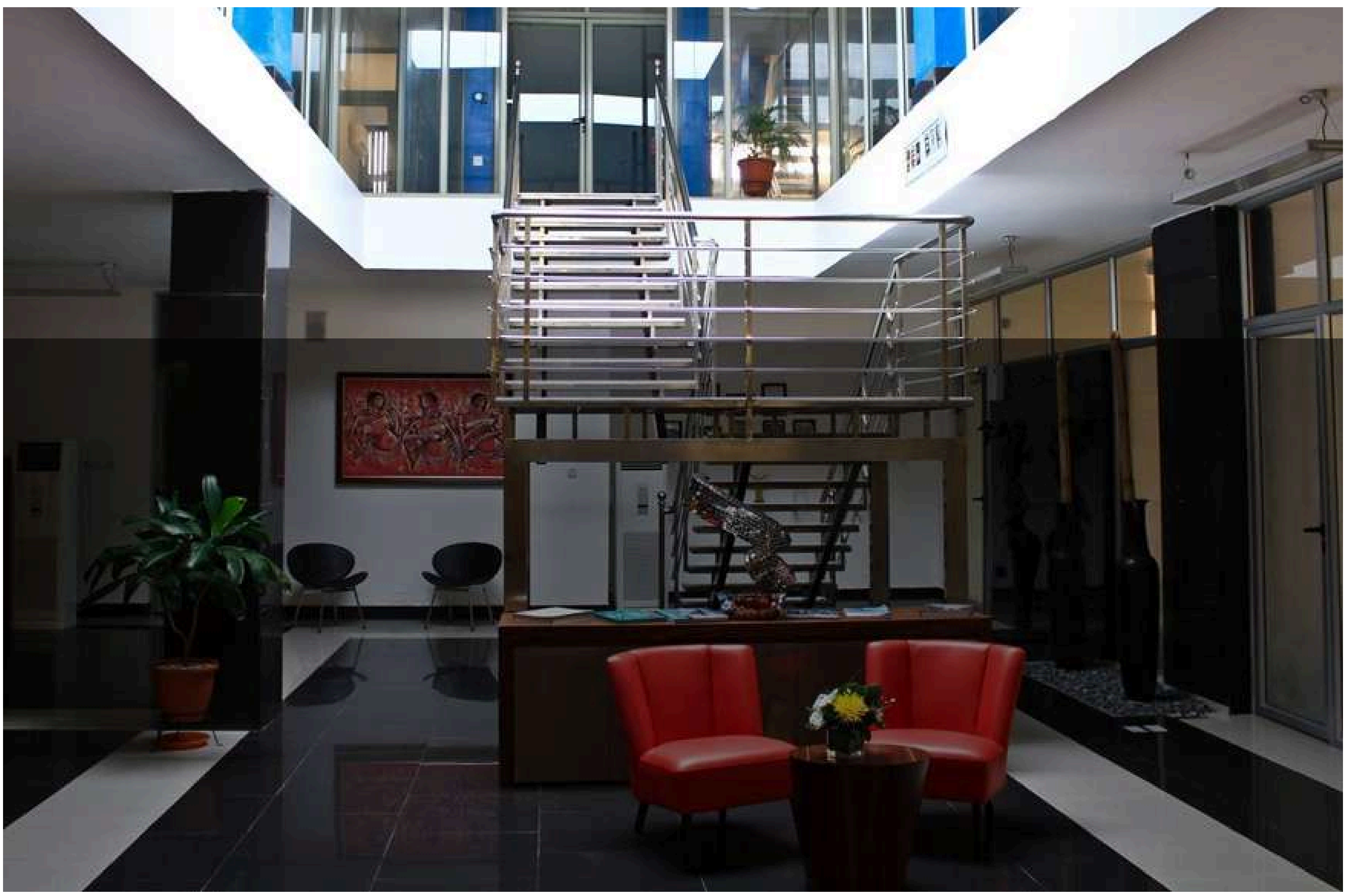
- In view of this transition, GenCos will need to consider robust security arrangements and assurances such as letters of credit and payment guarantees from the DisCos and their investors, as a way of mitigating their risk. However, the ability of these DisCos to replenish these guarantees and the sustainability of these forms of guarantee in the long run is still uncertain at this time. This could also entail NERC making a GenCo's obligations under its PPAs limited to the amounts of power that the DisCos are able to guarantee, so the GenCo can sell power bilaterally to customers that are able to afford it. This however has its limitations such as (a) potential infrastructure gaps to reach such customers, (b) the risk of all the GenCos going after a few credible customers and (c) the fact that certain areas in the country may be at risk of not getting any power supply if the DisCos are unable to afford the bills and/or guarantees.

- Thermal GenCos on the other hand would now be incentivised to make firm gas commitments backed by guarantees and show that they can actually provide the capacities they are contractually committed to. The SO of the Transmission Company of Nigeria ("**TCN**") would also be held to firm and enforceable commitments to deliver power to Discos and eligible customers based on bilateral contracts.

Other implications could be the potential renegotiation of PPAs and security/support documents for privately financed IPPs. There is the question of how these will be managed in the interim if NBET is phased out and whether the government still needs to provide in the interim, some form of subsidy to keep the privately financed and other GenCo PPAs whole.

CONCLUSION

The Order is a key step towards a more competitive electricity market in Nigeria, allowing GenCos to engage directly with DisCos, trading licensees and eligible customers. While this shift reduces government exposure and increases flexibility, it also introduces substantial risks, such as DisCos' solvency and financial reliability. The success of this transition to bilateral trading will depend on the ability of market participants to adapt, secure payments, and ensure stability. With proper oversight, this transition could significantly improve efficiency and service delivery in the power sector.



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