

Supplementary Order to the Multi Year Tariff Order 2024

OALP P&I NEWSLETTER

INTRODUCTION

In January 2024, the Federal electricity sector regulator, the Nigerian Electricity Regulatory Commission (the **Commission** or **NERC**) committed to reviewing electricity tariffs once every month following changes in macroeconomic conditions in the country which impact end-use electricity tariffs in Nigeria vide the Multi-Year Tariff Order 2024 (**MYTO 2024**).¹ In the past few weeks, and indeed since the beginning of the year, there has been several regulatory decisions from NERC signaling increased competition in the retail market. Paramount among these was the complete liberalization of the tariffs paid by Band A customers in the Federal electricity market.²

On 28 March 2024 (effective 3 April 2024) and 3 May 2024 (effective 6 May 2024), NERC followed its commitment towards reviewing end-use tariff due to changes in variables in microeconomic conditions in end-use tariffs by issuing the April 2024 Supplementary Order to the Multi-Year Tariff Order - 2024 (**April 2024 Supplementary Order**). This was followed by the May 2024 Supplementary Order to the Multi-Year Tariff Order - 2024 (**May 2024 Supplementary Order**). Together, (the **Regulatory Orders**).

In this newsletter we review the Regulatory Orders noting

the likely impact in the Nigerian Electricity Supply Industry (**NESI**).

HIGHLIGHTS OF THE SUPPLEMENTARY ORDERS

MYTO 2024 was issued in January, 2024 pursuant to the provisions of the Electricity Act 2023 (or the **EA**), which empowers NERC to adopt tariff methodologies that will allow for cost reflective tariff for electricity.³

In keeping with the MYTO methodology which prescribes major tariff reviews once every five (5) years, the MYTO 2024 also acknowledged that NERC will conduct subsequent minor tariff reviews of tariffs every month.⁴ Accordingly, the goal for issuing the Supplementary Orders is to adjust certain passthrough indices in MYTO 2024 which are outside the control of DisCos such as inflation rates, exchange rates, available generation capacity and gas price for the determination of final end-use tariffs.⁵ The Supplementary Orders also impose other obligations on DisCos in the light of the provisions of the EA.⁶ Below are major highlights of the Supplementary Orders.

Minor Review Indices

With regard to the review of electricity tariff, the Supplementary Orders do not significantly differ from MYTO 2024. Only that by these Supplementary Orders,

1. See Multi-Year Tariff Order 2024 for the eleven (11) distribution companies in Nigeria.

2. See: April 2024 Supplementary Order to the Multi-Year Tariff Order- 2024.

3. See section 34 and 116 of the EA.

4. See Paragraph 23 of MYTO 2024.

5. Paragraph 3 April Supplementary Order 2024

6. Such as renewable purchase obligations on DisCos following the provisions of the EA. These are further discussed below.

NERC has undertaken a minor review of electricity tariffs based on indices provided in MYTO 2024 which have been preserved in the Supplementary Orders, including (a) Nigeria inflation rate; (b) United States inflation rate; (c) foreign exchange (FX) rate; (d) Generation Capacity; and (e) gas prices.⁷



Exchange Rate: Like the MYTO 2024, the Supplementary Orders adopt the Central Bank of Nigeria (CBN)'s USD to Naira exchange rate and imposes 1% premium above the CBN rate as transaction cost. Accordingly, for the April 2024 Supplementary Order N1,463.31/USD\$1 is used and for May 2024 Supplementary Order N1,463.31/USD\$1 is used.

1



Nigerian Inflation Rate: In computing end-user tariffs, the Supplementary Orders use a 31.70% inflation rate in the April 2024 Supplementary Order and 33.20% in the May 2024 Supplementary Order, which is based on the Nigerian Bureau of Statistics' (NBS) report on inflation for the months of February 2024 and March 2024 respectively.

2



US Inflation Rate: Relying on the data obtained from the website of the US Bureau of Labour Statistics for the month of February and March 2024, the US inflation rate in the Supplementary Orders are pegged at 3.20% and 3.50% respectively.

3



Available Generation Capacity: Relying on periodic reports from the System Operator, the Supplementary Orders maintain the January 2024 projection of the average offtake for each DisCo.

4



Wholesale Gas to Power Prices: The April 2024 Supplementary Order utilizes the revised gas-to-power price assumption in MYTO 2024 of US\$2.42/MMBTU and maintains the gas transportation cost assumption of US\$0.80 MMBTU. The May 2024 utilizes the same gas-to-power and gas transportation prices in the April 2024 Supplementary Order.⁸

5

Tariff Hike for Band A users

By the April 2024 Supplementary Order, NERC revised the electricity tariff for Band A customers from circa N60 - N70 per kilowatt-hour to N255/KWh for all DisCos.⁹ A major highlight of the April 2024 Supplementary Order therefore, is that it completely liberalizes the tariff regime for Band A customers in the federal electricity market. However, this figure has been revised downwards to N206.80/KWh in the May 2024 Supplementary Order due to the consequent downward review of the USD to Naira exchange rate. However, the allowed tariffs for Bands B – E customer categories shall remain frozen at the rates payable since December 2022.¹⁰

Service Level Commitments

MYTO 2024 is incentive based. DisCos have committed to providing minimum hours of electricity per day at certain Service Bands. Accordingly, all DisCos are expected to be responsible for providing services according to the commitments outlined in their Service Based Tariff proposals which aim to adjust end-user tariffs based on the level of service received by customer clusters, as determined by the average hours of supply per day over a one-month period.¹¹

Monitoring and Evaluation of Compliance to Service Commitment

A duty is imposed on DisCos to set up and maintain a rapid response team to ensure effective service delivery on the committed minimum hours of supply to each service Band commencing with Band A feeders effective 3rd April 2024. Also, DisCos are to publish on their websites the schedule of approved Band A feeders that have been affected by the rate review. Where a DisCo fails to meet the committed service level to a Band A feeder for seven (7) consecutive days, the feeder shall be automatically downgraded to the recorded level of supply pursuant to the provisions of Section 6 of Order on Migration of Customers and Compensation for Service Failure under Service-Based Tariff Framework (the **Order on Migration and Compensation**).¹²

7. Paragraph 5, Supplementary Order to MYTO 2024.

8. See Clause 5 of the Supplementary Orders.

9. See: MYTO 2024.

10. Paragraph 7, Supplementary Orders.

11. Paragraph 8, Supplementary Orders.

12. Paragraph 9, Supplementary Orders.

Retrospective Adjustment and Upward Migration of Service Bands

The Regulatory Orders stipulate that where a DisCo fails to deliver the committed service levels over one (1) month, the provisions of the Order on Migration of Customers and Compensation will apply. In accordance with Clause 6 of the Order on Migration and Compensation, a customer (prepaid) on the affected feeders shall be compensated with a token for units of energy in KWh to account for the differences between the vended tariff and the applicable tariff for the actual service experienced in the month. For post-paid customers, the resulting bill will be adjusted to reflect the actual quality of services actually delivered to the customers.¹⁴ DisCos are also to continuously ensure upward migration of customers from the lower service Bands to Band A service level in line with the target on improvement in quality of service as provided in the Order on Key Performance Indicators for each DisCos issued from time to time by the Commission.¹⁴

Procurement of Embedded Generation and Imposition of Renewable Purchase Obligation

The Supplementary Orders mandates DisCos to procure a minimum of 10% of their load allocation for 2024 from embedded generation. Fifty percent (50%) or half of this capacity must be sourced from renewable energy sources. DisCos have been given until 1st April 2025 to fulfill this mandate. This initiative demonstrates how the renewable energy resources of Nigeria can be integrated and scaled-up to achieve a sustainable energy mix both on- and off-grid - while meeting growing energy needs to support the country's development. It provides analysis of the energy types and quantities currently utilised in all sectors of the economy, namely residential, commercial, industry, agriculture and transport. It also predicts how energy types and quantities may evolve in terms of energy conservation and energy efficiency up to 2050.¹⁵

Remittance Obligation

By the Supplementary Orders, DisCos have a continued remittance obligation which is subject to a cash water fall in MYTO, even though the Federal Government in principle make up for the difference between cost-reflective tariffs as determined by NERC and actual tariffs paid by consumers. Further to Paragraph 12 of the April 2024 Supplementary Order and Paragraph 13 of the May 2024

- 1 NBET shall issue energy invoices to each DisCo, net of the applicable tariff shortfall approved by NERC monthly, while the MO shall issue the full transmission and administrative services invoices to the DisCos at the applicable tariff.
- 2 DisCos shall make full settlement (100%) of the market invoices issued by the MO and NBET.
- 3 FGN intervention from budgetary appropriation and other sources for funding tariff shortfall shall be applied by NBET to ensure 100% settlement of market invoices as issued by GenCos.
- 4 DisCos shall be liable to relevant penalties/sanctions for failure to meet the payment obligation in any payment cycle under the terms of their respective contracts with bilateral counterparties including NBET and MO.
- 5 DisCos are to maintain adequate payment securitization for energy offtake in line with the earlier directive of NERC and relevant bilateral contracts.
- 6 DisCos are to settle their market invoices under the DisCo Remittance Obligation thresholds and all settlements are subject to regulatory net-offs as may be issued from time to time by NERC.

OUR THOUGHTS

The issuance of the Regulatory Orders throws up several positive gains for the federal electricity market and will no doubt impact the drive towards the creation of state electricity markets as well. Below, we consider the likely impacts of the Regulatory Orders on NESI.

▪ Monthly Reviews of Electricity Tariffs

Between April and May 2024, electricity tariffs have been revised twice vide the April 2024 Regulatory Order and the May 2024 Regulatory Order. The advantage of this is that true, or close to true market prices will be paid by end-users for electricity tariffs. Added to the Federal

14. Section 6, migration of customers and compensation for service failure under the service-based tariff framework.

15. Paragraph 10(c), Supplementary Orders.

16. Paragraph 11, Supplementary Orders.

Government's commitment towards subsidizing consumers in Band B-E, there are positive signals that DisCos may soon begin to recover the true cost of their investments in the sector.

▪ **Liberalization of Band A Distribution Tariffs**

The gradual liberalization of retail tariffs in the federal electricity market through the adoption of market prices for Band A electricity consumers is a positive development for the market. Despite public outcries of tariff hike for all consumers in the federal electricity market, the true position is that only Band A consumers will be required to pay the true market price. To protect these categories of consumers from paying for tariffs which do not reflect the cost of service provided, NERC is putting in place a monitoring and enforcement mechanism that ensures that Band A consumers receive at least 20 hours of electricity per day. Accordingly, DisCos will not only be held liable for service level commitments, but Band A feeders will automatically be downgraded where service level commitments are not met. It is hoped that with effective public outcry, and NERC's monitoring mechanism, DisCos will be held to their service level commitments.

▪ **Imposition of Renewable Purchase Obligations**

At the time DisCo licenses were issued, the license terms and conditions did not impose renewable purchase obligations. Indeed, one of the criticisms of the Electric Power Sector Reform Act 2005 (EPSRA) is that it did not contain a detailed framework for renewable energy in the NESI. Besides the Feed in Tariff for Regulations on Feed-in Tariff for Renewable Energy Sourced Electricity in Nigeria 2015, there was no support scheme for renewable energy in the country.

Since the enactment of the Electricity Act 2023, NERC has been mandated by the provisions of the legislation to impose a specific or general condition on an electricity distribution licensee to comply with such renewable purchase obligations as may be prescribed by NERC under the provisions of the EA to promote generation and consumption of energy from renewable energy sources.¹⁶

The imposition of a renewable purchase obligation on DisCos and its consequent implementation introduces a new regime in the Nigerian energy sector as this would be key to achieving national climate commitments by diversifying energy supply and reducing dependence on fossil fuel. It is envisaged that this initiative would stimulate trade activities in renewable energy trading within the Nigerian energy sector.

▪ **Promotion of Embedded Generation**

The Supplementary Orders mandates DisCos to source 10% of their load allocation for 2024 from embedded generation, and half of this percentage must be sourced from renewable energy sources. This is likely to promote embedded generation in the NESI and in line with the provisions of the EA which mandate that in granting generating licenses, the Commission shall promote embedded generation, hybridized generation, co-generation, and the generation of electricity from renewable sources such as solar energy, wind, small hydro, biomass, and such other renewable sources as defined under the EA or may be developed.¹⁷

We note that the EA does not define the term embedded generation. In accordance with NERC Regulations for Embedded Generation 2012 (**Embedded Generation Regulations**), embedded generation is generation of electricity that is directly connected to and evacuated through a distribution system that is connected to a transmission network operated by a System Operations Licensee.¹⁸ However, DisCos may only be able to source for embedded generation where there are sufficient embedded generation licensees in the market. Given the timeline set by NERC for DisCos to procure electricity from embedded generators, and the timelines for commercial operations of power projects, perceptively, the embedded generation licensees from whom DisCos must procure electricity should already be in or close to commercial operations. Imposing such an obligation in the absence of ready suppliers in the market will clearly impose an onerous obligation on DisCos.

16. Section 72(2)(d) of the EA.

17. Section 80(2) EA.

18. Section 3

CONCLUSION

The gradual liberalization of retail tariffs in the federal electricity market through the adoption of market prices for Band A electricity consumers is a positive development for the market. Despite public outcries of tariff hike for all consumers in the federal electricity market, the true position is that only Band A consumers will be required to pay the true market price. To protect these categories of consumers from paying for tariffs which do not reflect the cost of service provided, NERC is putting in place a monitoring and enforcement mechanism that ensures that Band A consumers receive at least 20 hours of electricity per day. Accordingly, DisCos will not only be held liable for service level commitments, but Band A feeders will automatically be downgraded where service level commitments are not met. It is hoped that with effective public outcry, and NERC's monitoring mechanism, DisCos will be held to their service level commitments.

For More Information, Please Contact : _____



Wolemi Esan
Deputy Managing Partner
wesan@olaniwunajayi.net



Osamede Osasu
Associate
oosasu@olaniwunajayi.net



Ibi Ogunbiyi
Partner
iogunbiyi@olaniwunajayi.net



Chijioke Ucheakonam
Associate
cucheakonam@olaniwunajayi.net



Chinenye Ajayi
Managing Associate &
Team Lead
cajayi@olaniwunajayi.net