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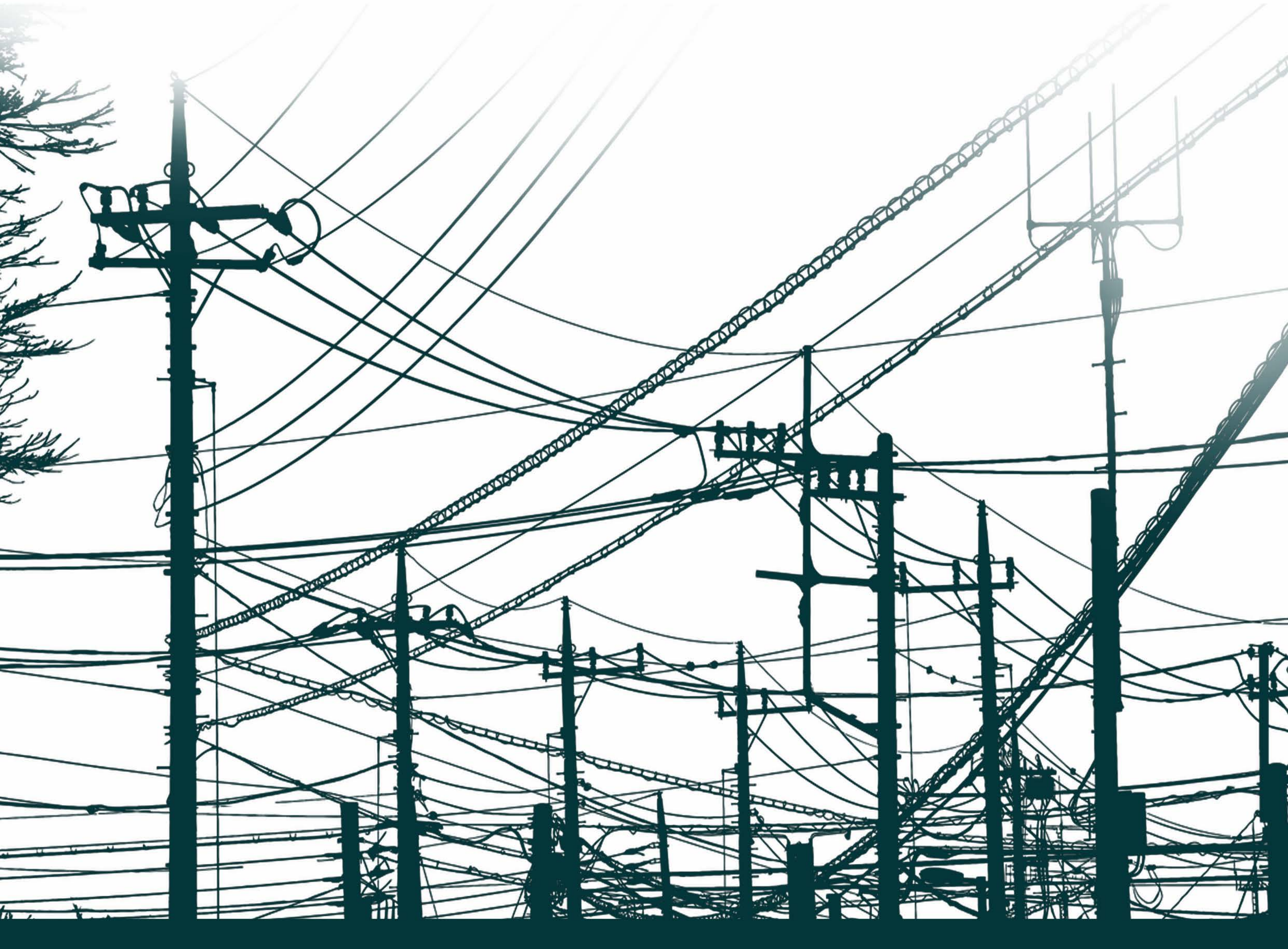
NERC ISSUES ORDER ON THE TRANSITIONAL ACCOUNTING TREATMENT OF TARIFF RELATED LIABILITIES IN THE NESI AS PART OF IMPLEMENTATION OF THE PSRP



THE POWER SECTOR RECOVERY PROGRAM

The Power Sector Recovery Program (PSRP) which was approved by the Federal Executive Council on the 22nd of March 2017 has as its program scope, the de-risking of the power sector for private investment through a comprehensive package of financial, operational, governance, and policy interventions. According to the PSRP, between February 2015 and December 2016, the market shortfall which is the amount owed by the Distribution Companies (DisCos) to the rest of the electricity market is estimated at NGN 476 billion, of which the tariff shortfall (deficits caused by tariffs lower than cost of service delivery) is estimated at NGN 420 billion.

The resultant effect is that the power sector as a whole is not financially viable and more so the Discos are neither attractive to the banks (considering most of them are yet to pay off the loans received from the banks to procure the PHCN assets) nor to private sector investors who should be pumping in much needed funds to improve service delivery, address infrastructure deficit and provide network rehabilitation which would invariably reduce ATC&C losses and address other inefficiencies. The poor financial status of the DisCos has made it impossible for them to make full payments to the Nigerian Bulk Electricity Trading Plc. (NBET) for energy received and to settle the invoices issued by the Market Operator ("MO") under the relevant industry agreements. It is clear that unless the DisCosbecome viable, our power sector will continue its gradual decline to collapse.

In simple terms, the PSRP's financial intervention fundamentally relies on utilizing public funds to subsidize power consumption by Nigerians until end-user tariffs become cost reflective. These funds are to be sourced from the Payment Assurance Facility (PFA) funded by the Central Bank of Nigeria (CBN), guaranteed by the Ministry of Finance and managed by NBET, additional NGN 927 billion through Federal Government budgetary contribution, and a US$1 billion World Bank Performance Based Loan (PBL).

Some of the areas of intervention provided for in the PSRP include commitment to fully-fund projected sector deficits due to tariff shortfall from 2017 until 2021, development of a Financing Plan to fully-fund the shortfall until tariffs attain cost recovery levels and support sector liquidity, clearing of historical deficits due to tariff shortfall as part of the Financing Plan, and clearing of historical Ministries Departments and Agencies of Government (MDA) debts, and the implementation of a payment mechanism for future electricity bills. According to the PSRP, NGN 40 billion (US$ 131.1 million) was included in the 2017 federal budget in order to settle some of the MDA outstanding arrears. CBN is to develop an MDA debt payment system whilst the Nigerian Electricity Regulatory Commission (NERC) is mandated to implement a mechanism for regular payment of future MDA electricity bills. Going forward, the DisCosare charged with the responsibility of metering and collection of tariffs from the MDAs regardless of stiff resistance that may be put up by certain of the MDAs.

NERC's IMPLEMENTATION THROUGH

ISSUANCE OF ORDER ON TREATMENT OF TARIFF RELATED LIABILITIES

As part of the ongoing implementation process, NERC recently issued the Order on the Transitional Accounting Treatment of Tariff Related Liabilities in the Financial Records of Participants in the Nigerian Electricity Supply Industry Order No. NERC/196/2020 dated 28th January 2020 (the "Order"). The Order statesthat it seeks"to resolve the continual accumulation of future tariff related shortfalls during the transition to cost reflective tariffs and to prevent the accrual of new liabilities in the financial records of DisCos" and will remain in effect until tariffs become cost reflective at which time NERC will then require full settlement of market invoices by the DisCos.

The Order provides that

(i) NBET shall continue to invoice DisCos for energy and capacity in accordance with the provisions of their respective vesting contracts and other NERC directives

(ii) The invoices shall dearly indicate the amount immediately payable by the DisCos in accordance with the 2019 Minor Review of MYTO 2015 and Minimum Remittance Order for the year 2020 and the amount due and payable by the Federal Government

from multiple funding sources in the PSRP Financing Plan

(iii) The DisCos shall settle invoices received from NBET in full as adjusted by the applicable tariff shortfall and the 2019 Minor Review of MYTO 2015 and Minimum Remittance Order for the year 2020; and the unpaid portion of the NBET invoice that is not directly attributable to the tariff deficit shall be recovered by NBET through the payment guarantee provided by the DisCos.

THE 2019 MINOR REVIEW OF MYTO 2015

You will recall that the 2016-2018 minor review order of MYTO 2015 conducted last year by NERC also included directives on the Minimum Remittance Order for 2019 which is meant toamongst others, provide a framework for the management of future revenue shortfalls in the industry including providing a minimum market remittance requirement to account for differences between cost reflective tariffs and allowed tariffs in the settlement of invoices issued by NBET and the MO. Tariff shortfalls of each DisCo for the years 2015-2020 was computed by NERC and it was ordered that all accrued liabilities and interests in the DisCos' financial records arising from tariff shortfalls should be transferred off the balance sheet and fully settled under the financing plan of the PSRP. The minimum market remittance threshold for the DisCos (which varies for each DisCo) was determined and the DisCoswere mandated to settle their market invoices in full as adjusted and netted off by the applicable approved tariff shortfall. Each DisCo is also required to maintain adequate and unencumbered letter of credit covering three (3) months based on the minimum payment obligation to NBET and the MO.

THE INADEQUACIES OF THE ORDERON TREATMENT OF TARIFF RELATED LIABILITIES

However, although the MYTO 2015 review order specifically states that all FGN intervention from the Financing Plan of the PSRP for funding tariff shortfall shall be applied through NBET and the MO to ensure 100% settlement of market invoices as issued by Market Participants, the Order only addresses treatment of NBET invoices and payment shortfalls by DisCos to the exclusion of settlement of MO invoices. The reason for this omission is not clear and has not been communicated by NERC. We are left to guess as to the possible reasons which, to our mind may be caused by Federal Government revenue shortfalls. As far as we know, settlement of the arrears of MDA debts by the Federal Government is not completed. We are aware that the funding sources for the Financing Plan under the PSRP is evolving and consequently, so is the ability of the Federal Government to meet its settlement obligations due to possibility of revenue shortfalls. The good news is that there seems to be indications that the World Bank may soon release up to about US$1.5 Billion as first tranche payment of the US$3 Billion power sector intervention loan requested by Nigeria last year. "Soon" being the operative word as we are not yet clear as to the precise date of payment.

CONCLUSION

We do hope that the payment, if and when made will help address some of the uncertainties still plaguing the process of settlement under the Financing Plan of the PSRP in a manner that will hasten arrival at a cost reflective tariff regime necessary to stabilize the power sector.

ABOUT THE AUTHOR

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Aderemi is a Partner in the firm's Energy and Natural Resources Practice Group. With seventeen (17) years of experience in the legal profession, she is well versed in corporate and commercial transactions with particular expertise in energy law and policy.

She has consistently advised both indigenous companies and multinationals, including various government MDAs on legal and regulatory issues and has been involved in the development of legal, regulatory and policy framework documents and transactional documents particularly in the oil and gas, power and mining sectors. She also advises on acquisitions, joint venture arrangements, and project finance and has a background in dispute resolution and extensive training in the areas of International Commercial Arbitration.

Aderemi has been recognized by leading ranking firms such as Chambers and Partners Global and IFLR 1000 for her expertise in the industry. She was highly recommended as a Leading Lawyer in Energy and Natural Resources by Chambers and Partners Global 2015. Clients describe her as "very supportive and proactive", "impressive ...very responsive and output focused. She knows what the end game is from the start and has great subject matter expertise." She was a member of one of the Working Groups that advised on the Doing Business in Nigeria Initiative of the Federal Government.

Prior to joining Tope Adebayo LLP, Aderemi spent a great number of years working at one of the leading Energy Practice law firms and served a brief stint at Oando Plc.

Do you need to get in touch with us, to know how we can help you and your business?
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