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Policy Brief

Privatising Nigeria's Electricity Supply Industry

Will there be light?

January 31, 2013 | Patrick O. Okigbo III and Mmachukwu Oyeka

Nigeria has consistently failed to deliver the electric power required by homes, businesses and support services. Various efforts by the government to improve service delivery resulted in failure. The Federal Government decided to privatise the sector in an effort to increase electricity supply and improve service delivery. This Policy Brief reviews the goals and process of the privatisation exercise to ascertain whether it will deliver the expected electricity at the end of the process.

ISSUE STATEMENT | Will the on-going privatization of the Nigeria Electricity Supply Industry result in increased electricity supply to Nigerians?

BACKGROUND | DARKNESS

For years, Nigeria failed to deliver much needed electricity to its citizens.

Nigeria's *Electric Power Consumption per capita* was 85kWh in 1990 placing it at 124 out of 139 ranked countries. By 2000, it had dropped further to 74kWh placing the country at 130 out of 139 countries. Although Nigeria's electric power consumption per capita increased to 136kWh in 2010, Nigeria still remained at 130 out of 139 countries.[1] As a consequence of insufficient power, Nigerians resorted to self-generation of electricity from diesel and petrol generators with estimates of about 6,000MW (more than twice the average output from the national power grid during 2009).[2]

Issue Statement:
Will privatisation deliver electric power to Nigerians?

Background | Darkness
Acknowledgement of government's inability to manage business enterprises informed the choice of privatisation as a model. However, privatisation has delivered mixed results in other countries.

Privatising NESI | From Darkness to Light
Some of the key privatisation milestones have been met. The process is still challenged.

Risks | Avoiding "Process Failure"
Nigeria cannot afford a failed privatisation process. The process still faces some significant risks of failure. The risks can be mitigated.

Conclusion | Let There Be Light
The privatisation process will deliver the goals IF both the public and private sectors proactively address a few critical factors.

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[1] THE WORLD BANK (2012). *Electric Power Consumption (kWh per capita).* Available at the World Bank website <http://data.worldbank.org/indicator/EG.USE.ELEC.KH.PC> (Accessed December 24, 2012)

[2] PRESIDENTIAL TASK FORCE ON POWER (2010). *Roadmap for Power Sector Reform (A Customer-Driven Sector-wide Plan To Achieve Stable Power Supply).* Available at the website of the Presidential Task Force on Power <www.nigeriapowerreform.org> (Accessed: December 24, 2012)

Successive governments have displayed a lack of competence to manage the power sector.
Between 1999 and 2007, Nigeria spent about US$16 billion on the power sector. Although *Electric Power Consumption per capita* increased from 75kWh (1999) to 138kWh (2007), it was still evident that the government of Nigeria lacked the ability to manage the sector. The continued failure (and high aggregate technical, commercial and collection losses) has been attributed to a combination of factors: public sector inefficiencies, poor planning, poorly trained and unmotivated staff, systemic corruption, etc.

A policy decision was made to privatise the sector.
In appreciation of the need for a complete reform and reengineering of the Nigerian power sector, the Obasanjo administration (1999-2007) while making efforts to improve service delivery realised the need for a full-scale transformation of the electricity supply industry. The *National electric power Policy* of 2001 prescribe a reform of the sector and was the precursor to the *Electric Power Sector Reform Act (2005)*. The EPSRA (2005) provided the legal framework for the formation of companies to take over the functions of *National Electric Power Authority* (NEPA), develop competitive electricity markets, establish the Nigeria Electricity Regulatory Commission, provide the licensing and regulation of generation, transmission, distribution and supply of electricity, enforce performance standards, protect consumer rights and obligations and determine appropriate tariff regimes. In essence, government was ready to relinquish management and control of the sector to private sector investors.

Globally, privatisation has delivered mixed results.
A World Bank review[3] of privatisation of power sectors in a number of African countries acknowledges that privatisation leads to increased electricity supply; however, it may result in the exclusion of some citizens from service delivery. Many residents in rural communities may not have access to the power grid as the new private sector owners may consider them to be unprofitable customers. In most cases, continued government support is required to serve these customer segments. A reverse argument posits that the relinquishing of its funding responsibilities to the private sector (through privatisation) frees up resources for the government to provide support to the less commercially viable customers. In addition, although privatisations typically result in an initial increase in tariffs (to make the sector attractive for private investors) the resultant competition leads to subsequent reductions in prices. Quality and reliability of service will typically improve as the government enforces stipulated service levels.

PRIVATISING NESI | FROM **DARKNESS** TO LIGHT

Availability of electric power is critical to the economic development and national security of any nation. According to the *Roadmap on Power Sector Reform*, Nigeria must deliver 40,000MW on-grid electricity by 2020 to meet its vision of becoming one of the top 20 largest economies in the world by that year. However, this goal requires an annual investment of an estimated US$10 billion from 2010 to 2020. The government has indicated its inability to provide this level of investment; hence the need to privatise the sector and attract private investments.

The private sector will provide investment and management of NESI while the public sector will provide policy and industry regulation.
The government of Nigeria has acknowledged its inability to manage the enterprises in the power sector. As a result, it desires to transfer the management of the sector to private sector

[3] THE WORLD BANK (2006). *Power Sector Reform in Africa: Assessing Impact on Poor People.* Available at The World Bank website <http://data.worldbank.org/indicator/EG.USE.ELEC.KH.PC> (Accessed December 24, 2012)

investors. The overarching goal of the privatisation process is to attract investors with the managerial, technical and financial capabilities to assume ownership and control of Nigeria's electric supply industry. However, the government will remain responsible for developing sector-wide policy (Ministry of Power) and also regulating the sector (Nigeria Electricity Regulatory Commission).

The privatisation process was modelled after global best practices but customised to Nigeria's needs.

The *Bureau of Public Enterprises* –the government agency charged with the responsibility of privatising the sector- considered a number of privatisation models before deciding on the following:

- An outright sale of 100 percent of the generation companies[4] to private investors with the best plan for achieving the stipulated *minimum generation capacity* targets and who can make the required financial investments in the companies.
- A sale of 60 percent of the distribution companies to private investors with the best plans for reducing *Aggregate Technical, Commercial and Collection Losses* (ATC&C).[5] This model, which is patterned after the *New Delhi Model*, is significantly different from the standard approach that requires private companies to bid a price for an equity interest.[6] The Federal Government, State Governments and Staff (of the erstwhile Power Holding Company of Nigeria "PHCN") will own the remaining 40 percent.
- Given the pivotal role of the Transmission Company of Nigeria (TCN) in the electric supply industry, it will not be sold; rather, a company with the proven technical competence will manage it under contract. The government, which will retain ownership of the company, will continue to fund the maintenance and expansion of the grid. On July 30, 2012, Manitoba Hydro International of Canada was awarded a concession to manage the company under an initial three-year management contract.

Despite significant challenges, the privatisation process has been largely transparent and fair.

Over 180 Expressions of Interest were received. The Request for Proposal (RFP) stipulated *quantitative* benchmarks for the technical and commercial evaluation of the bidding companies. These benchmarks, which formed the basis for the evaluation of the bids, ensured the integrity of the process.

The evaluation teams consisted of representatives from Nigeria Electricity Regulatory Commission (NERC), Federal Ministry of Power and CPCS Transcom (the transaction advisers). NEXANT/USAID consultants provided technical support to BPE while the consultants from the DFID-sponsored Nigeria Infrastructure Advisory Facility provided support to the Federal Government. A number of anti-corruption and security agencies acted as observers of the process including: State Secret Service (SSS), Economic and Financial Crimes Commission (EFCC) and Independent Corrupt Practices Commission (ICPC). This rigorous process resulted in five core investors for the GenCos and ten core investors for the DisCos.

The privatisation process has achieved critical milestones and provided clarity on the remaining steps.

The government has successfully established the critical institutions required to drive the privatisation of the power sector. These institutions include the Nigeria Electricity Regulatory

[4] Geregu Generation Company (where only 51 percent of the company was offered for sale) is the exception to the rule. The exclusion of Geregu Generation Company is because it is one of the newest plants in Nigeria.

[5] ATC&C Losses refer to the sum total of technical losses, commercial losses, collection losses and shortage due to non-realization of total billed amount.

[6] Agarwal M. et al (2003) The Delhi Electricity Discom Privatizations: Some Observations and Recommendations for Future Privatizations in India and Elsewhere. A World Bank Publication.

Commission, Nigeria Bulk Electricity Trading Plc, Systems Operator, Market Operator, Nigeria Electricity Liabilities Management Company, National Power Training Institute, concession of TCN to Manitoba Hydro International of Canada, etc. There is clarity even for the steps that are yet to be completed. (See *Appendix: Status of the Privatisation of the Nigeria Electricity Supply Industry*).

In addition, negotiations with the preferred bidders will commence on January 15th, 2013 and should be completed by February 13th, 2013. At the end of the negotiation process, bidders are required to pay an initial 25 percent of the negotiated price. The remaining 75 percent will be paid within the next six (6) months. It is expected that the privatisation process will be completed by August 2013.

RISKS | AVOIDING **"PROCESS FAILURE"**

The success of the privatisation process should result in increased power supply to Nigerian homes and businesses. Although significant progress has been made with the privatisation process, there are still some risks that may derail the process. In addition, efforts must be made to ensure that the current level of power supply is not interrupted as the sector is transitioned to the new owners.

There are significant risks of failure in the privatisation process.

- Policy Inconsistency: Historically, the Nigerian government has developed a reputation for policy inconsistency and a poor track record with reform and policy implementation. The Jonathan administration has not fared much better. However, the fact that it publicly reversed its decision when it controversially "considered" cancelling the TCN management contract with Manitoba Hydro International shows that the administration may actually be committed to the reform process. Free Market policy advocates and similar stakeholders must continue to encourage the government to maintain faith with the privatisation process (which is not easy for any government to achieve).
- Availability of Funds: Although all the preferred bidders provided the required cash backed bank guarantees of 15 percent of the asset sale value on time, some concerns still exist on their ability to pay the balance before the six-month deadline. Some of the concerns stem from previous privatization efforts that occurred in Nigeria. For instance, a number of the preferred bidders for Nigeria Telecommunications Plc (NITEL) were unable to pay when they were invited to do so. It should be noted, however, that the Bankers Committee –a collection of Nigerian banks- has indicated its willingness and ability to provide the required funds. However, the absence of the right framework for "securitisation"[7] may remain a challenge for the funding institutions.
- Universal Service Obligation: PHCN (and its predecessor, NEPA) had an obligation to provide access to electric power to all Nigerians irrespective of their location or their commercial viability. The government is planning to ensure that customers' needs, that may be deemed to not be commercially viable, are provided for via the Consumer Assistance Fund and under the auspices of the Rural Electricity Agency (REA).
- Shared Services: PHCN provided a number of shared services to the successor companies. For example, System Planning, Meter Testing Stations, Workshop Services, Laboratory Services, Storage facilities, Billing Operations, etc. These services are to be provided by the *Electricity Management Services*; however, there should be commercial opportunities for the private sector in this space.

[7] Securitisation is a widely used financial term. However, within the context of the Nigerian power sector, it's meaning is expanded to include a credit risk management arrangement that relies on guarantees provided by the Nigerian government.

- Failure: There is also no clarity as the government's contingency plans in the event that the new investors are unable to deliver the expected power. Will government rescue the company? If yes, what will be the nature of the intervention?

Contingencies have been put in place to ensure power supply during the transition.
Current employees of PHCN will remain with the companies for an initial six months period to ensure a smooth handover. The new owners will use this period to fully understand the assets they have acquired and then decide on the optimal staff level for the companies.

The new owners will be expected to maintain the performance requirements of the Grid Code and other industry key performance indicators. The new owners will be required to sign performance agreements that include these performance criteria.

The Nigeria Electricity Regulatory Commission is expected to exert its oversight responsibilities to ensure that all the companies (and their new owners) meet all the stipulated and agreed targets.

The Bureau of Public Enterprises will execute its post-privatisation monitoring and evaluation to ensure all the companies (and their new owners) meet all the stipulated and agreed targets.

Commitment is required from both the public and private sectors to ensure success of the process.
A failed power privatisation process will be a major challenge for Nigeria because of the ripple effect on other sectors of the economy that may need to attract private investment. As a result, government must continue to reiterate its commitment to the privatisation process. The private sector, on the other hand, must begin to take advantage of the commercial opportunities that will emerge as a result of the privatisation of the sector.

CONCLUSION | **LET THERE BE LIGHT**

2013 is a critical year for the power sector reform. If project owners and agencies in charge of the reform process remain committed to delivering the required milestones all indications are that the privatisation process will deliver the electric power required to meet the goals of Nigeria's Vision 20: 2020. The transition to private sector-led NESI has been largely transparent and executed with integrity. The process must be protected to ensure it is fully implemented. However, if bottlenecks, slippages and reform challenges are allowed to jeopardize the achievements that have been attained thus far, it will take a lot more than private investment to light up Nigeria. Only time will tell.

Appendix: Status of the Privatisation of the Nigeria Electricity Supply Industry

Strengthen NERC: The government was advised to reconstitute and strengthen the Nigeria Electricity Regulatory Commission that was suspended at the time of the launch of the *Roadmap* in August 2010.	**Achieved:** On December 22, 2010, President Goodluck Jonathan reconstituted NERC. The Commission is actively carrying out its role as regulator of the power sector.
Establish Bulk Purchaser: A government-owned company is required to purchase power (in bulk) from GenCos, sell to DisCos and ensure the former receive payment for the power supplied.	**Achieved:** On August 23, 2011, the Board of the *Nigerian Bulk Electricity Trading Plc* (NBET) was inaugurated to carry out bulk trading until NESI develops the systems for bilateral contracting.
Establish appropriate pricing regime: The end-user tariff needs to be cost-reflective to ensure financial viability of the sector throughout the value chain.	**Achieved:** On June 01, 2012, NERC[8] introduced a new cost-reflective tariff regime outlining the different rates for various customer categories.
Contract out management of Transmission Company of Nigeria: The *Roadmap* recommended that a company with the requisite expertise should manage TCN under contract to ensure it does not inhibit investments in generation and distribution.	**Achieved:** On July 30, 2012, Manitoba Hydro International of Canada assumed control of TCN. The management contract is for an initial period of three years after which it is expected that local staff will take over management of the company.
Efficient and motivated workforce: The Labour Unions frustrated previous reform efforts on the grounds that the government has not paid off outstanding arrears of salaries, pensions and other benefits.	**Ongoing:** On December 11, 2012, FGN announced it has provided ₦170 billion to settle the agreed amount for the staff benefits, pensions and gratuity. The agreement was reached after 11 rounds of negotiations that started in May 2010.
Provide FGN Credit Enhancements: The DisCos are not fully credit-worthy entities and as such cannot independently enter into commercial contracts with independent power plants (IPPs) and PHCN generation companies.	**Ongoing:** NBET is in the process of negotiating appropriate power purchase agreements (PPAs) with IPPs and PHCN GenCos. NBET instruments are backed by credit enhancements provided by the Federal Government of Nigeria.
Make NELMCO operational: The Nigerian Electricity Liability Management Company will assume and manage legacy liabilities of the PHCN successor companies. This is to ensure the new investors are not saddled with legacy liabilities.	**Ongoing:** NELMCO has been established and has commenced payment of the legacy liabilities of the companies (mostly staff related). There is still no clarity on the other outstanding commercial liabilities.
Clarify and strengthen licensing regime: There is need to review the duration of the licenses from the current 10 years to a period sufficient to recoup the high fixed cost investments (20-25 years).	**Ongoing:** NERC is still reviewing the licensing duration. It is important to note that there is a provision to review the licenses, on a rolling basis, for five-year increments.
Privatise the GenCos: At the time of the launch of the Roadmap on Power Sector Reform, the plan was to sell a minimum of 51% equity in the PHCN GenCos to core investors.	**Partially Completed:** On September 25th 2012, Government announced the preferred bidders for the outright sale of 100 percent of the GenCos. Only 51 percent of the Geregu Plant was sold. Full payment and transfer of the companies is expected by August 2013.
Privatise the DisCos: The plan was to sell 51 percent of all the Distribution companies to a core investor.	**Partially Completed:** On October 16th 2012, Government announced the preferred bidders for the sale of 60 percent of the DisCos. Full payment and transfer of the companies is expected by August 2013.

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[8] The MYTO II section of the NERC website. Follow the link: http://www.nercng.org/index.php/myto-2