NOTICE OF INTENTION TO CANCEL LICENCES ISSUED PURSUANT TO SECTION 74 OF THE ELECTRIC POWER SECTOR REFORM ACT

TAKE NOTICE that pursuant to section 74 of the Electric Power Sector Reform Act ("EPSRA") and the terms and conditions of electricity distribution licences issued to the distribution licensees ("DisCos") by Nigerian Electricity Regulatory Commission (herein referred to as "NERC" or the "Commission") has reasonable cause to believe that the DisCos listed below have breached the provisions of EPSRA, terms and conditions of their respective distribution licences and the 2016 – 2018 Minor Review of Multi Year Tariff Order ("MYTO") and Minimum Remittance Order for the Year 2019 (hereinafter called the "Order") –

1. Abuja Electricity Distribution Company Plc ("AEDC").
2. Benin Electricity Distribution Company Plc ("BEDC").
3. Enugu Electricity Distribution Company Plc ("EEDC").
4. Ikeja Electric Plc ("IE").
5. Kaduna Electricity Distribution Company Plc ("KAEDCO").
6. Kano Electricity Distribution Company Plc ("KEDCO").
7. Port Harcourt Electricity Distribution Company Plc ("PHEDC")
8. Yola Electricity Distribution Company Plc ("YEDC").

The Commission considers the actions of the aforementioned DisCos as "manifest and flagrant breaches" of EPSRA, terms and conditions of their respective distribution licences and the Order; and therefore requires each of them **SHOW CAUSE in writing within 60 days from the date of receipt of this Notice** as to why their licences should not be cancelled in accordance with section 74 of EPSRA.

STATEMENT OF FACTS

1. The Commission, pursuant to sections 32 and 76 of EPSRA, issued the MYTO – 2015 Tariff Order in December 2015 to address, amongst other objectives, the provision of cost reflective tariffs thus ensuring that prices charged by licensees are fair to consumers, and are sufficient to allow licensees that operate efficiently to recover the full cost of their activities, including a reasonable return on the capital invested in the business.

2. Section 17 of the MYTO – 2015 Order provides for the biannual Minor Review of tariffs taking into consideration changes in exogenous variables outside the control of electricity distribution companies ("DisCos") in line with the requirement of the MYTO Methodology (Amended). These variables are Nigerian and United States inflation rates, Naira/USD foreign exchange rates, gas prices and available generation capacity.

3. The Commission issued the Order to achieve the following –

   A. Overall objectives –

      a. Reflect the impact of changes in the Minor Review variables for the period 2016 – 2018 to determine the cost reflective tariffs for the relevant years; and to ascertain revenue shortfalls in view of the differential between such tariffs and allowed tariffs in the Nigerian Electricity Supply Industry ("NESI").

      b. Determine and recognise the historical (2015 – 2018) tariff deficits pursuant to the objective of resolving the impairment of the financial records of DisCos arising as a consequence of the deficits.

      c. Develop and implement a framework to manage future revenue shortfalls in the industry including a minimum market remittance requirement to account for differences between cost reflective tariffs and allowed tariffs in the settlement of invoices issued by the Nigerian Bulk Electricity Trading Plc ("NBET") and the Market Operator ("MO").

      d. Establish the interim payment arrangements, reaffirm the payment securitisation requirement and flow of funds from DisCos to NBET and the MO.

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e. Steer the market to gradual activation of market contracts in line with the requirements of the Transitional Electricity Market ("TEM").

f. Reaffirm the obligation of core investors in DisCos under the Performance Agreement and Share Purchase Agreements executed with the Bureau of Public Enterprises ("BPE").

B. Minor Review of MYTO – 2015 Tariff Order

a. The Order took into consideration the actual changes in relevant macroeconomic variables and available generation capacity in updating the operating MYTO – 2015 Tariff Order for the period January 1, 2016 to December 31, 2018 in line with the provisions of the MYTO Methodology (Amended). Projections were made for macroeconomic variables for the year 2019 and beyond based on best available information.

b. The relevant data on the following Minor Review variables were obtained from the Central Bank of Nigeria ("CBN"), National Bureau of Statistics ("NBS"), System Operations ("SO") Division of the Transmission Company of Nigeria Plc ("TCN") and NBET for the update of the MYTO – 2015 financial model:

i. Inflation: The actual yearly average inflation rate of 15.6%, 16.5% and 12.1% for the years 2016, 2017 and 2018 respectively were utilised for the review based on the data obtained from the NBS. A projection was made for the year 2019 based on the average of the period January to June 2019.

ii. Exchange Rate: In line with the provisions of the Regulation on Rate Review for NESI, CBN official exchange rates were used in this review. The average NGN/USD exchange rates of ₦255.90, ₦308.80 and ₦309.14 were used for the years 2016, 2017 and 2018 respectively. The MYTO – 2015 provides for a premium of 1% above the CBN rate as transaction cost and this was applied in the current review. The applicable NGN/USD exchange rate for 2019 is computed as ₦306.90 +1% premium = ₦309.97

iii. US rate of inflation: The data on the US rate of inflation was obtained from the website of the US Bureau of Labor Statistics (http://www.bls.gov) for the years under review. The actual average rate of inflation for each year was computed and applied in this review whereas the average official rate of inflation from January to July 2019 was applied for the 2019 projections.

iv. Gas Price: The price of natural gas for the power sector has been regulated since the inception of MYTO in 2008. The Commission has maintained a gas price of US$2.50/MMBTU and gas transportation cost of US$0.80/MMBTU for this review. However, other generating companies had contracted different gas prices outside the regulated rates as provided in their respective individual Gas Sales Agreements ("GSAs").

v. Capital Expenditure Allowance for TCN: The Commission has reviewed the capital expenditure (CAPEX) allowance for TCN to MYTO – 2 level. This is in line with the provisions of the MYTO Methodology which provides for the revision of the financial model due to changes in available generation capacity and associated CAPEX required to evacuate and distribute the revised available capacity.

C. Projected Loss Reduction Targets

The successor DisCos had, in the executed Performance Agreements with the BPE committed to an Aggregate Technical, Commercial and Collection ("ATC & C") loss reduction trajectory over a period of 5 years. The loss reduction trajectory was applied in MYTO 2015 with the first-year loss reduction target imputed at the end of year 2015 following a baseline loss study in the year 2014. However, arising from the uncertainties that shrouded full revenue recovery in the years 2017 – 2018, the Commission, after due consultation with BPE, had agreed on the following:

a. The ATC&C loss reduction trajectory as provided in the Performance Agreement of the DisCos was applied in the tariff computation with effect from 1st January 2015.

b. The Performance Agreement was considered as fully effective in the years 2015 and 2016 and the applicable loss reduction targets were

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applied in line with provisions of MYTO – 2015 Tariff Order of the DisCos.

c. The years 2017 and 2018 are recognised as years of mutual non-performance to account for uncertainties on cost reflective tariffs and revenue recovery. Hence, ATC&C loss improvement targets will not apply in computing tariffs and relevant revenue deficit/surplus in the respective years. In this regard, the provisions for CAPEX for the years of non-performance have been netted-off the revenue requirement of DisCos.

D. Treatment of 2015, 2016, 2017 and 2018 Shortfalls

a. The Commission computed and recognised the tariff shortfalls for the DisCos for the years 2015 - 2018. Under the Power Sector Recovery Plan ("PSRP") approved by the Federal Government, all accrued liabilities in DisCo's financial records arising from tariff shortfalls shall be transferred off the balance sheet and fully settled under the financing plan of the PSRP initiative.

b. All funds retained by the DisCos as represented by excess of market (remittance) shortfalls over tariff shortfall are to be recovered as a full liability of the DisCos, including applicable interest thereon, in line with the provisions of the Supplementary TEM Order, the Market Rules and respective industry contracts with NBET and the MO.

c. All DisCos with excess of tariff shortfall over market shortfall shall be compensated accordingly for the difference.

d. All interest payable by DisCos on unpaid invoices issued by NBET and the MO and attributable to tariff shortfall shall be transferred off the balance sheet of the utilities in line with the Order.

E. MDA Debts

The Order reiterated that the responsibility and initiative for revenue collections from all customers including Ministries, Departments and Agencies ("MDAs") of States and Federal Government rests with the DisCos. Accordingly, this Order made it mandatory for all DisCos to meter all MDAs with appropriate meters of their choice within 60 days from the effective date of this Order. All DisCos reserve the right to disconnect any

MDAs defaulting in the payment for electricity in line with the Regulation on Connection and Disconnection Procedures for Electricity Services.

F. Market Remittance by DisCos

The PSRP provides for a gradual transition to cost-reflective tariffs with safeguards for the less privileged in the society. It is proposed that an intermediate review in end-user tariffs on January 1, 2020 and transition to full cost reflectivity shall be achieved by July 2020. In the interim, the Federal Government, under the PSRP, has committed to fund the revenue gap arising from the difference between cost reflective tariffs determined by the Commission and the actual end-user tariffs. The waterfall of market revenues during the transitional period shall be in line with the following:

a. All DisCos are obligated to settle their market invoices in full as adjusted and netted off by applicable tariff shortfall approved by the Commission.

b. 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.

c. Under this framework, the minimum market remittance threshold for the DisCos was determined after deducting the revenue deficit arising from tariff shortfall from the aggregate NBET and MO market invoices. The DisCos were availed the opportunity to earn their revenue requirement only upon fully meeting the following payment obligations:

   i. Repayment of CBN-NEMS facility.

   ii. 100% settlement of MO's invoice based on the tariffs applied by the MO in determining respective invoices prior to this Order.

   iii. Full settlement of a specified percentage of NBET's monthly invoices being the minimum remittance threshold prescribed in the Order.

d. The DisCos are liable to relevant penalties/sanctions for failure to meet the minimum remittance requirement in any payment cycle in line with the provisions of its respective contracts with NBET, MO and the provisions of the Market Rules and Supplementary TEM Order.

e. The DisCos shall maintain an adequate and unencumbered letter of credit covering three (3) months based on the minimum payment obligations to NBET and the MO.

f. The DisCos shall comply with the minimum remittance thresholds specified in the Order.

G. The commencement date of the Order was 1 July 2019.

PARTICULARS OF NON-COMPLIANCE:

A. The remittances to NBET by the DisCos listed in the table below shows that the under-listed DisCos have failed to meet the expected minimum remittance thresholds for the July 2019 billing cycle as evidenced from the table below:

DisCo	NBET Invoice (NGN)	Remittance (NGN)	Actual Performance	Expected Minimum Remittance
AEDC	7,173,686,088.29	2,152,105,826.49	30%	45%
BEDC	4,368,336,242.22	771,681,330.79	18%	30%
EEDC	4,112,552,587.51	400,000,000.00	10%	42%
IE	7,372,945,102.62	2,949,178.041.04	40%	49%
KAEDCO	3,834,686,472.61	407,774,917.81	11%	18%
KEDCO	3,329,653,653.09	800,000,000.00	24%	33%
PHEDC	3,647,290,100.67	382,965,460.56	10%	21%
YEDC	1,946,338,517.03	194,633,851.71	10%	13%

B. The objective of the Order was to place the DisCos on a path of meeting their contractual/performance obligations to NESI with the recognition of tariff shortfalls arising from revenue under-recovery and the exclusion of 2017 and 2018 as years of mutual mutual non-performance in the performance agreement to enable DisCos comply with condition 2 of their licence terms and conditions which states that *"licensees shall maintain adequate financial, technical and managerial resources and capabilities to allow the licensee carry out the licensed business in accordance with the various regulations, codes, rules, and service standards prescribed by the Commission".*

C. The Commission notes that the failure of the DisCos to comply with expected minimum remittance thresholds in the Order exposes NESI to systemic risk that threatens the sustainability of other parts of the value chain; and the ability to improve service delivery to consumers.

D. The Commission notes further that the DisCos failed to provide the minimum financial securitisation of their payment obligation to NBET i.e. *"an adequate and unencumbered letter of credit covering 3 months based on their minimum payment obligations to NBET and MO"* that would have addressed the compliance failure.

TAKE NOTE that AEDC, BEDC, EEDC, IE, KAEDCO, KEDCO, PHEDC and YEDC are hereby given 60 days from the date of this NOTICE to "SHOW CAUSE" why their licences should not be cancelled in accordance with section 74 of EPSRA.

Dated this 8th day of October 2019

Dafe C. Akpeneye
Commissioner

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