NIGERIAN ELECTRICITY REGULATORY COMMISSION

GUIDELINES ON FILING APPLICATIONS FOR COMPETITION TRANSITION CHARGE BY ELECTRICITY DISTRIBUTION AND TRADING LICENSEES

DOCUMENT NO. NERC/GL/2/2020 July 27, 2020

TABLE OF CONTENTS

1. PURPOSE

The purpose of this document is to provide regulatory guidance to distribution and trading licensees in filing applications to the Nigerian Electricity Regulatory Commission ("NERC" or the "Commission") for the collection of competition transition charge ("CTC"), pursuant to the provisions of section 28 of the Electric Power Sector Reform Act ("EPSRA" or the "Act"). The guidelines were compiled considering the findings of public hearings on the matter conducted by the Commission during the period July 11, 2019 to September 10, 2019.

2. BACKGROUND

The Commission issued the Eligible Customer ("EC") Regulations in November 2017 to govern the supply of electric power to ECs, pursuant to the Ministerial directives issued on 10th May 2017 specifying the type of customers that constitute eligible customers. The directive of the Minister was made pursuant to the provisions of section 27 of EPSRA.

Section 28 of EPSRA and the EC Regulations provides for CTC as one of the charges payable by ECs. Section 28 of EPSRA provides that:

> *"If the Minister determines, following consultation with the President, that a directive under section 27 will result in decreasing electricity prices to such an extent that a trading licensee or a distribution licensee would have inadequate revenue to enable payment for its committed expenditures or is unable to earn permitted rates of return on its assets, despite efficient management, the Minister may issue further directives to the Commission on the collection of a competition transition charges from consumers and Eligible Customers, the distribution of the funds collected to the trading licensee described in section 25 (a) and to the distribution licensees; and the duration of the competition transition charge."*

Section 30 of the Act further provides that the Commission shall hold a public hearing prior to the determination of the amount and arrangements for the collection and distribution of CTC. In compliance with this statutory requirement, public hearings were held by the Commission.

3. COMPETITION TRANSITION CHARGE

The CTC is the additional revenue a Distribution Licensee ("DisCo") is eligible to collect outside its normal tariff as compensation for loss of revenue (to cover its committed prudent expenditure) and/or its inability to earn permitted rates of return on its assets

ISA

arising from the exit of an EC from its network. Specifically, the exit of ECs may lead to stranded costs and loss of revenue arising from the following:

a. Stranded infrastructure by network operators that may not be optimally utilised to serve other customers thus recovery of investments may not be realised within the earlier projected life span of the financed assets.

b. Long term contractual commitments such as Power Purchase Agreement (PPA) and Vesting Contract (VC).

c. Deferred expenses such as the amortisation of loans granted to market participants under the Nigerian Electricity Market Stabilisation Fund ("NEMSF").

d. Cross subsidy to other customer classes currently provided by potential ECs.

e. Overhead transition costs.

4. DETERMINATION OF CTC

The CTC shall be computed based on the stranded costs attributable to the EC's exit of DisCo's network by unbundling the DisCo's costs and determining the actual revenue loss per each cost item. The cost items are listed hereunder:

4.1 LONG-TERM POWER PURCHASE AGREEMENTS & VESTING CONTRACTS

The DisCos had, based on the approval of the Commission, entered into a number of PPAs with generation licensees and/or VC commitments with the Nigeria Bulk Electricity Trading Plc ("NBET") for the purpose of serving customer needs under which the parties have performance obligations. The PPAs and VCs generally provide for "Take or Pay" contractual obligations for the off-take and payment of specified quantity of energy and capacity at contractually agreed prices. A DisCo may be exposed to revenue loss arising from the exit of an EC from a DisCo's network if a sizeable capacity of the DisCos' contracted energy becomes stranded arising from the departure of an EC.
A petition filed for compensation arising from long-term PPAs and VC commitments must be substantiated with a clear basis of the claim and detailed analysis as specified below:

a. Capacities already contracted under all PPAs and VC.

b. Projections of load growth and DisCo's expansion plan providing details on:

   i. Network capabilities on serving current peak demand.

BLA

ii. 5-10 years' expansion program of the DisCo to meet new and under-served load.

c. Risk allocation principle/obligation applied in the various PPAs and VCs.

d. Penalties on availability events where capacities made available by GenCos and/or TCN are not fully utilised by the DisCo.

e. Current and long run annualised optimised capacity delivered to the prospective EC over the last three (3) years.

f. Estimates of available capacity to be stranded in the event of eligibility status due to inability to divert supply to other existing or new customers;

g. Estimates of annualised sum-total of specific penalties on availability payments resulting from stranded capacities on account of eligibility status.

h. Estimates on the transition period required for the DisCo to fully divert the stranded capacities to other customers during the unexpired tenure of the PPA/VC.

i. An application for the charge (in ₦/kWh) to be levied on ECs over the transition period based on annualised total of specific penalties on availability payments resulting from stranded capacities and current/long-run annualised capacity delivered to the prospective eligible customer.

4.2 Regulatory Assets & Revenue Shortfalls

Regulatory assets are a unique feature of regulated entities. In the electricity industry, a regulatory asset is a declaration by a regulatory authority allowing a regulated utility to recover a cost it has incurred in the future by charging higher rates than it would otherwise. In the Nigerian Electricity Supply Industry, the DisCos have accumulated substantial tariff shortfalls partly arising from past decisions to sculpt end-user tariffs and to artificially freeze tariff reviews with the intention of recovering the deferred revenues in the future. A potential EC may have benefitted from sculpted and/or frozen tariffs in the past with an expectation that the same customer shall contribute to realising the deferred revenues for the utility.

The switching of a supplier by a prospective EC may result in the volume of energy offtake being delivered to another customer but of a different tariff class, consequently resulting in a variance in revenue recovery.

A DisCo may file claims for CTC for the purpose of recovering accrued regulatory assets and tariff shortfalls attributable to prospective ECs. In the determination of possible compensation, the Commission shall require DisCos to provide the following analysis in filing a claim:

a. Analysis of cost-reflective tariffs versus allowed tariffs by customer classes over the relevant period.

b. Analysis of current and long run annualised optimised capacity delivered to prospective ECs.

c. Regulatory asset/tariff shortfall recoverable from ECs based on current and long run annualised optimised capacity in kWh/h.

d. Analysis of impact of cross-subsidies and proposal for spreading recovery to other remaining customers.

e. Estimates on relevant transition period representing the timeframe required to fully recover the stranded regulatory assets in line with operating tariff order.

f. Estimates of loss of revenue arising from the sale of energy offtake to a lower tariff class or cross subsidies that may be lost due to the exit of ECs.

g. An application to the Commission for the charge (in ₦/kWh) that may be levied on ECs over the transition period based on annualised sum-total of stranded regulatory assets and tariff shortfall attributable to ECs and current/long-run annualised optimised capacity delivered to prospective ECs.

4.3 LEGACY COSTS

Legacy costs are sector wide or DisCo specific costs that may have been created by virtue of the privatisation transaction or other power sector reform agenda initiatives. Such costs were designed to be recovered over a specified period of time and assumptions relating to volume of energy delivery to various customer categories. Some of these legacy costs include repayment of the Central Bank of Nigeria ("CBN") NEMSF, a NGN213billion loan provided by the CBN to support NESI with additional liquidity to settle legacy gas debts and applicable shortfall in revenue requirement arising from the updating of parameters in the tariff model. Where the introduction of an EC transaction distorts the legacy assumptions that underpin the commitments and consequently resulting in lower revenues than projected, an appropriate compensation to the utility may be necessary.

A DisCo may file claims for CTC for the purpose of recovering legacy costs attributable to prospective ECs. This shall be determined by providing the following analysis and justifications in filing claims:

a. Analysis of cost-reflective tariffs versus allowed tariffs by customer classes over the respective period.

b. Analysis of current and long run annualised optimised capacity delivered to prospective ECs.

c. Unamortised legacy costs recoverable from ECs based on current and long run annualised optimised capacity in kWh/h.

d. Analysis on impact of cross-subsidies and proposal to spread recovery with other remaining customers.

e. Estimates on relevant transition period representing the timeframe required to fully recover the stranded legacy costs in line with operating tariff order.

f. An application to the Commission for the charge (in ₦/kWh) that may be levied on ECs over the transition period based on annualised sum-total of stranded regulatory assets and tariff shortfall attributable to ECs and current/long-run annualised optimised capacity delivered to prospective ECs.

4.4 Unamortised Investments in Networks

A utility makes investments in network infrastructure for the purpose of providing service to consumers with "return on" and "return of" capital provided in the rates paid by customers. The exit of ECs may result in some assets being stranded where such infrastructure provided to serve specific customers may not be easily diverted to serve other customers or salvaged for commensurate value within a reasonable timeframe. A DisCo may be eligible for compensation through CTC based on the unamortised values of the stranded assets.

A DisCo's application seeking compensation for stranded network assets specifically built to provide service to prospective ECs should be supported with the following documentary evidence:

a. Details on network asset including date of commissioning, cost of funds used in procuring the asset, useful life allowed in tariff computation, book value, any other relevant information.

b. Analysis of salvage value and or cost associated with diverting the assets to other existing or new customers.

c. Analysis of unamortised stranded cost of network asset to be recovered from ECs.

d. Where the asset stranded could partially be used for another customer, the need to compute and analyze the cost related to the unused part will need to be provided by the Disco

e. Estimates of relevant transition period representing the timeframe required to fully recover the stranded network infrastructure cost in line with operating tariff order.

f. An application to the Commission for the charge (in ₦/kWh) that may be levied on the EC over the transition period based on sum-total of stranded network infrastructure cost attributable to ECs.

4.5 Overhead Transition Costs

Where the impact of a prospective EC would result in the restructuring of the business of the DisCo, there may be stranded operating costs directly attributable to the decision of the EC to switch suppliers. The costs may include employee related expenses prompted by restructuring, such as the costs of offering early retirement or job training due to disruptive impact of the evolving EC transactions.

A distribution licensee filing for CTC compensation for overhead transition costs arising from an EC transaction or the cumulative effect of ECs switching suppliers should be supported with the following documentary evidence:

a. Basis for cost associated with restructuring of business operations including early retirement expenses where applicable due to impact of ECs.

b. Long-run additional cost of restructuring net of savings from lay-offs not provided in the operating tariff order.

c. Estimates on relevant transition period as indicated by the timeframe required for the DisCo to fully recover the additional overhead restructuring costs associated with EC transactions until the next major tariff review.

d. An application to the Commission for the charge (in ₦/kWh) that may be levied on ECs over the transition period based on the additional overhead restructuring costs attributable to ECs.

5. PROCEDURE FOR APPLYING FOR CTC

A DisCo shall file an application with the Commission for applicable CTC clearly justifying that, despite its efficient management, the utility would be unable to meet its revenue requirement arising from the impact of an EC switching supplier. Such claim by DisCos shall be made within 30days of the receipt of the prospective EC's notice of intention to exit network by the DisCo. The Commission shall accordingly process the application as follows:

a. Commission shall review the claim of the DisCo including further consultations on the matter with relevant stakeholders involved in the EC transaction.

b. Where the DisCo's claim for loss of revenue is satisfactorily justified, the Commission shall approve the charge through an open-book review process and issue an Order for the payment of CTC by the EC.

c. The CTC shall be invoiced by the DisCo on the basis of the actual meter reading or fixed monthly charge derived from the current/long-run annualised capacity (kWh/h) and/or energy consumed by the EC.

d. The CTC payable shall have a sunset and limited to the extent of the recovery of stranded costs, deferred liabilities and loss of revenues.

e. The EC shall post a letter of credit in favour of the DisCo covering three (3) months estimated invoicing of the CTC.

6. PARTIES LIABLE FOR THE PAYMENT OF CTC

EPSRA provides that the burden of stranded cost may be allocated to customers other than the EC for the purpose of collecting CTC. On the basis of the consultations held by the Commission and the cost causation principle of rate design which provides that costs be apportioned to causative agents, the responsibility for the payment of CTC has been placed solely on ECs.

7. THE DURATION OF THE PAYMENT OF CTC

Costs such as the legacy liabilities i.e. the CBN/NEMSF, and the recovery of regulatory assets including historic market/tariff shortfalls representing market liabilities recoverable from all customers inclusive of prospective ECs shall be recovered over the tenor of the liability or deferred asset. Overhead transition costs are deemed short-term expenses and shall be recovered when the tariffs are realigned at the next major review.

The CTC (long or short-termed) may be paid periodically over time or vide a single lump sum payment by the EC with long-term costs off-set over the life of extant contracts in the market and short-term costs realigned at the time of a tariff review by the Commission.

Any CTC paid by ECs arising from cross subsidies between tariff classes shall be capped at the rate of contribution paid by the EC at exit date and shall cease when tariffs are rebalanced at the next major review.

James Momoh

James A. Momoh
Chairman

Dafe C. Akpeneye
Commissioner
Legal, Licensing & Compliance