



NIGERIAN ELECTRICITY REGULATORY COMMISSION

**CONSULTATION PAPER ON THE REVIEW AND CODIFICATION OF ELIGIBLE
CUSTOMER REGULATIONS (ECR) AND THE GUIDELINES ON THE
COMPETITION TRANSITION CHARGES (CTC)**

MAY, 2023

1 INTRODUCTION

- 1.1 The Nigerian Electricity Regulatory Commission (“NERC” or “the Commission”) is an independent regulatory body created by the Electric Power Sector Reform Act 2004 (“EPSRA” or “the Act”) with a clear mandate to regulate all aspects of the electricity business in Nigeria. Its principal functions, amongst others, include:
- a. To create, promote and preserve efficient industry and market structures and to ensure optimal utilization of resources for the provision of electricity services.
 - b. To ensure that prices charged by licensees are fair to consumers and sufficient to allow the licensees to finance their activities and for reasonable earnings for efficient operations.
 - c. To ensure that regulation is fair and balanced for licensees, consumers, investors, and other stakeholders.
- 1.2 Pursuant to Section 27 of the Act, the Minister of Power (“MoP”) made a declaration in 2017 for a certain class of electricity consumers to be designated as Eligible Customer (“EC”). The declaration by MoP established the threshold of a minimum 2MWh/h consumption by a customer or a group of customers (with technical consideration) over a period of one month. The declaration was followed by a policy direction on the determination of the Competition Transition Charge (“CTC”) in 2018 in accordance with Section 28 of the Act. Further to the first declaration by MoP, the Commission issued the Eligible Customer Regulations (“ECR”) in 2017 and developed the guidelines for the determination of CTC in 2020 as compensation for loss of revenue that may arise in the implementation of transactions under the ECR. While the ECR provided for the eligibility requirements and applications process for the grant of EC status, the CTC guidelines provide the procedure for filing for CTC by the Distribution Companies (“DisCos”).

2 PURPOSE

- 2.1 This document sets out for consultation, proposed amendments to the ECR and the Guidelines on CTC based on the experience so far in processing EC transactions initiated by prospective eligible customers and applications for CTC by DisCos. It is expected that the proposed amendments shall address some of the concerns of stakeholders towards ensuring a seamless application process and expedited decision on applicable CTC.

The consultation paper seeks stakeholders' comments on the under-listed areas with a view to improving the regulatory framework for the implementation of the ECR and simplification of the processes provided in the CTC guidelines.

- a. Verification of available capacity to be contracted with EC by a generating company ("GenCo").
- b. Supplier of last resort requirement as and where applicable.
- c. Confirmation of non-indebtedness by host DisCos.
- d. Simplified process for filing and review of CTC applications.
- e. Sequencing of the execution of market participation agreement by EC.
- f. Expansion of EC transactions for 11kV connections.
- g. Network improvement as a condition precedent for EC transactions.
- h. Consolidation of ECR and CTC guidelines for ease of cross reference.

3 LEGAL AUTHORITY

- 3.1 Sections 96 and 32(3) of the EPSRA provides that *"the Commission may, make regulations prescribing all matters which by this Act are required or permitted to be prescribed or which, in the opinion of the Commission, are necessary or convenient to be prescribed for carrying out or giving effect to this Act"*. The Commission hereby seeks stakeholders' input on the proposed amendments in compliance with section 32(3) of the EPSRA which provides that *"In the discharge of its function, the Commission shall consult, from time to time, and to the extent the Commission considers appropriate, such persons or groups of persons who may or are likely to be affected by the decisions or orders of the Commission including, but not limited to licensees, consumers, potential investors, and other interested parties"*.

4 PROPOSED AMENDMENTS TO THE REGULATIONS

Further to the above, the Commission is inviting the general public to submit comments on the proposed amendments to ECR and CTC guidelines as presented in this section. In finalising the review, the Commission shall review and take into consideration stakeholders' comments on the consultation paper as well as other pertinent inputs which may be provided by the public at stakeholder workshops. Specifically, the Commission sets out for consultation, the following areas of the ECR and the CTC guideline.

4.1 Eligible Customer Regulations (ECR)

i. **Execution of Market Participation Agreement with the Market Operator**

Section 14 of the Market Rules provides that “any person who wishes to trade or participate in the Wholesale Electricity Market, shall apply to the Market Operator (“MO”) for registration as a participant in accordance with this Part of these Rules”. Rule 14.2.1(a-d) further list GenCos and ECs as market participants that require registration with MO. In view of these provisions of the Market Rules, Section 8(1)(d) of ECR mandates a prospective EC seeking a permit (approval of the Commission) to provide evidence of registration with the MO as part of her application.

While market registration is required by all market participants, there has been suggestions for market registration to be made a condition subsequent for EC after the permit has been granted by the Commission. The main reason advanced for this proposal is that the eligibility for market participation is contingent on or determined by being a licence or permit holder. It is further noted that making the market registration a condition subsequent could address the risk where the MO commences recognition of an eligible customer transactions immediately upon the execution of a market participation agreement at a time when approval for the issuance of a permit is yet to be granted by the Commission. The recognition of such EC transactions by MO without regulatory approval granting EC status has created market distortions and, to some extent, litigations.

Thus, the Commission wish to seek stakeholders’ comments on amending the ECR making the grant of the EC status by the Commission as a condition precedent for market participant registration with MO. In this respect, no EC transactions shall be recognised by the MO in the settlement statement unless there is an express approval of the Commission granting eligible customer status to a customer.

ii. **Confirmation of Non-indebtedness to a DisCo**

Section 14 (1c) of the ECR requires that applicants filing for EC status must provide a supporting document confirming that the applicant is not indebted to a DisCo thus certifying that the prospective EC customer exiting the network is not indebted to the utility. However, the experience so far indicates long delays in obtaining such letter confirming a state of non-

indebtedness from the DisCos. The ECR does not currently provide a timeline within which response to such a request shall be provided by the DisCo thus directly frustrating the processing of the application.

In view of the protracted delay in securing a response from the DisCos on the state of indebtedness of the EC applicant, the Commission is proposing to prescribe a maximum of 10 working days from the receipt of such confirmation within which a DisCo shall response to official request for letter of non-indebtedness by a prospective EC. A failure to respond within the timeline of 10 working days shall be treated by the Commission as a state of non-indebtedness by the EC applicant.

iii. Supplier of Last Resort (SLR)

The ECR provides that the DisCo operating in the operational area where an EC is located shall act as the Supplier of Last Resort (“SLR”) to the EC. The SLR Agreement, which is to be executed by the EC and the DisCo, shall be activated as the default supplier in the event of failure by the contracted supplier to deliver the contracted energy and capacity. This concept places the burden of balancing on the EC while a failure to deliver contracted energy is a GenCo risk. However, experience has further shown that EC applicants have experienced difficulties in securing SLR agreement with DisCos thereby causing long delays in concluding the review of applications by the Commission.

A market settlement process where a GenCo has multiple contracts and DisCo as supplier of last resort seems to be complex. EC customer generally take energy from the pool unless in very rare circumstances where there is an isolated direct connection between the contracting parties. In this regard, contracted energy and capacity delivered to an eligible customer should be directly settled between the EC and the GenCo as financial transactions. The MO shall fully account for all transactions by market participants GenCos not meeting their performance obligations deemed to have relied on the Pool for supply. The TEM do not provide for a centrally administered balancing market hence the MO would be unable to procure additional capacity beyond existing PPAs to cover shortages. Contracting GenCos shall proceed to invoice the EC as if it has met its performance obligation while the MO invoices the Contracting GenCo for the imbalance in delivered energy.

The Commission therefore seeks stakeholders' comments on the proposed amendment discussed in the above paragraph and as highlighted below:

- a. Contracted GenCo takes responsibility for performance under the bilateral transactions with an EC.*
- b. Any imbalance in the market shall be accounted for and settled by the MO at the end of the billing cycle at the highest tariff of the generation portfolio in the Pool.*

iv. Phase II of Eligible Customers Implementation

Section 35 of the ECR provides for phased implementation of the provisions of the ECR. The implementation **phase I** seeks to allow a customer or group of end-users whose minimum consumption is 2MWh/h over a period of one month, that is either connected directly to a metered 132/330kV or 33kV or to the generation facility of a GenCo to exit contract for supply by a DisCo and apply for an EC permit. **Phase II** on the other hand seeks to allow a customer or group of end-users whose consumption is more than 2MWh/h over a month, that is connected to a metered 11kV delivery point on the network of a DisCo under a DUOS to apply for an EC permit. Although the conditions precedent for the commencement of **Phase II** has not been met, the prolonged liquidity challenge in the NESI and technical complication that may come with implementation of ECR at 11kV voltage level provides a need for re-consideration of implementation of **Phase II** at the current stage of the industry.

Specifically, some stakeholders have raised concerns that if a customer or group of end-users whose consumption is at least 2MWh/h over a period of one month and connected to a metered 11kV delivery point on the network of the DisCos are allowed to apply for an EC permit, it may open a floodgate for many customers to seek the advantage which will further worsen the overall liquidity challenges in the industry and consequently affects the quality of supply to other customers. There are other concerns around the technical delineation of the network and potential capacity of DisCos to manage the system at this current stage of the industry. A more likely route for transactions at 11kV and below may be the eventual unbundling of the supply at a time when the infrastructure can support multiple third party access to the network with minimal congestion.

In view of the above highlighted challenges, the Commission is proposing to expunge the provision for Phase II from the ECR until such a time the market is considered robust enough for EC transaction at 11kV voltage level.

v. Investment in Networks as Condition for EC Transaction

One of the objectives of the eligible customer policy declaration by the MoP was to “unlock stranded generation capacity”. It was envisaged at the time that eligible customer transactions would bring much needed network investments to address network bottlenecks affecting efficient dispatch of generation plants. However, investment in network is currently not a mandatory requirement for EC application. Thus, while noting that some of the EC transactions so far are based on dedicated lines constructed by manufacturers, the ECR and EC transactions have not unlocked the “stranded” generation capacity across the country.

Investment in network infrastructure as a mandatory requirement for grant of EC permit by the Commission may serve as a way of addressing network bottlenecks and unlock stranded generation capacity. It is posited that such a requirement may spur third party investments in networks, improve dispatch, and hence ensure that supply to eligible customers is not conducted on displacement basis. Some stakeholders have advocated that a mandatory requirement for the grant of EC status should include investments targeted at expanding or improving the relevant infrastructure for the provision of electricity, where necessary. The proposed third party investments and improved energy throughput are expected to have a potential to deliver economies of scale to the system and a reduction of the potential for congestion on the transmission and distribution system.

Further to the above, the Commission is seeking stakeholders’ comments on the proposed inclusion of third-party investment in associated networks, where necessary, as a mandatory requirement for the grant of an EC permit.

4.2. Guideline on Competition Transition Charges

The provisions of section 28 of the EPSRA provides that where an eligible customer transaction will result in decreasing energy prices to such an extent that a distribution licensee would have inadequate revenues to enable payment for its committed expenditure or is unable to earn permitted return on

investment, despite efficient management, the Minister may issue further directives to the Commission on the collection of competition transition charge. The Minister had issued such directives in 2018 following which the existing guidelines on the Competition Transition Charges (“CTC”) were issued providing the procedure to be followed by DisCos in filing for compensation for loss of revenue arising from an exit of an EC. The guideline further provides for several cost/revenue loss components under which the DisCo may file as justification for requesting for CTC. The cost/revenue loss components requiring justification as provided for in the guidelines include cross-subsidies, regulatory asset based (“RAB”), legacy and stranded costs all attributable to servicing the EC.

The Commission has granted approval for a number of EC transactions but no application for CTC has received the Commission’s approval due to the inability of the DisCos to sufficiently justify to the Commission a loss of revenue arising from the exit of the EC. Some of the challenges facing the DisCos have been attributed to the complexity of the procedure and/or absence of a simplified methodology for the determination of CTC in the current guidelines. For instance, it is difficult to make a clear determination of the share of regulatory asset base (“RAB”) being used in serving the EC and which may be yet to be recovered prior exit. Similarly, isolated determination of the legacy cost and making sufficient justification for stranded assets attributable to servicing an EC is an arduous task. It is in this context that the Commission is considering a review of the guidelines thereby making its implementation less complex, noting that an exit of an EC could have a potentially significant impact on the revenue of the DisCo. A DisCo may incur revenue loss in the recovery of the following cost components in the event of an EC exit.

i. Regulatory Assets

DisCos are required to make additional capital investments towards improving service delivery and recover the costs incurred in the future through rates charged to customers. DisCos may also have accumulated substantial “under recovery” of revenues partly arising from past decisions to sculpt end-user tariffs or deferred tariff reviews with the intention of recovering the revenue in the future. A potential EC may therefore have benefitted from the invested assets and/or sculpted or frozen tariffs in the past with an expectation that the same customer shall contribute to the recovery of the deferred revenues by the utility by continuing to be a

customer to the utility. Thus, the exit of such customer from the DisCo's network may result in the inability of the DisCo to recover part of the revenue especially where it is not immediately practical to assign the stranded costs to the other customers. While the current CTC guidelines provide for a claim of revenue loss attributable to regulatory assets, disaggregating DisCos' cost to separately determine what portion of regulatory asset is associated with and payable by a customer exiting the DisCo's network is challenging.

ii. Legacy costs

It is recognised that the sector-wide or DisCos-specific costs may have been created by virtue of the privatisation transaction or other power sector reform initiatives. Such costs (including the repayment of the CBN-NEMSF loan to settle the legacy gas debts and shortfall in revenue requirement arising from updating parameters in the tariff model) were designed to be recovered over a specified period. Thus, the exit of potential ECs may distort the assumptions underpinning the recovery of such cost/revenue and consequently result in lower revenues than projected. In view of the forgoing, the guidelines currently allow DisCos to file a claim for CTC for the purpose of recovering legacy costs attributable to prospective EC. However, determination of the portion of the legacy costs to be allowed to be passed onto the ECs in the determination of the CTC has been very challenging for the DisCos.

iii. Stranded assets and contracted capacity charge

A utility makes investments in network infrastructure for the purpose of providing service to customers with return on and return of capital provided in the rates paid by customers. The exit of potential ECs may result in some assets being stranded where such infrastructure provided to serve specific customers may not be easily used to serve other customers or salvaged for commensurate value within a reasonable timeframe. A challenge faced by the DisCos in filing for CTC is the determination of the appropriate DisCo stranded asset and contracted capacity costs to be passed onto a prospective EC in the determination of the CTC. It is noteworthy that a DisCo may also have entered into a long term PPA with responsibility for capacity charge in an effort to guarantee supply to its customers. Thus, the exit of a major customer may result in the inability of the DisCo to fully

offtake the contracted capacity especially where the load cannot be diverted to other customers or customers of similar standing in terms of load size or collection efficiency, while obligations to pay capacity charge for the total contracted capacity remains.

Whereas the guidelines allow DisCos to file a claim for CTC based on the unamortised values of the stranded assets built to provide service to prospective ECs, it is unclear whether the exiting ECs should be responsible for the total unamortised values of the stranded asset. Similarly, the existing guidelines do not provide for the methodology for the determination of the revenue impact of the unutilised load where the load cannot be diverted to other customers or where the other customers that can benefit from the load are not of similar commercial performance (e.g., lower tariff or collection efficiency) as the exiting customer.

In view of item 4.2.(i-iii) above, the Commission is hereby seeking stakeholders' input on the proposals hereunder for a simplified but equitable methodology for the computation of CTC payable by an EC leaving a DisCo's network.

Methodology 1: Adoption of the distribution cost component of the tariff as CTC

This methodology is proposing that the CTC be determined as the distribution cost component of the end-user tariff. The distribution cost, which is currently estimated to be about 24% of the end-user tariff, is a building block of the following components.

- Operating expenses
- Return on capital
- Return of capital ("Depreciation")
- Taxes

Thus, where a DisCo is able to prove that the decision of a prospective EC to exit its network results in revenue loss attributable to any of the underlisted cost components, CTC claim (to be paid either once or in 12 instalments over a period of one year) shall be computed by multiplying the average distribution cost per kWh of the DisCo with the total energy billed to the potential ECs in the year preceding the exit:

- Long-term PPAs and vesting contracts
- Regulatory assets and revenue shortfalls
- Legacy costs
- Stranded investments
- Stranded operating costs

Methodology 2: Adoption of tariff differential as CTC

This methodology proposes that the CTC shall be determined based on the difference between the actual tariff payable by the potential EC(s) and the approved weighted end-user tariff of the DisCo.

$$CTC/kWh = \text{Actual tariff charged to the potential EC} - \text{Weighted average tariff of the DisCo}$$

Thus, where a DisCo is able to prove that the decision of a prospective EC to exit its network results in revenue loss attributable to any of the underlisted components, a CTC claim (to be paid either once or in 12 instalments over a period of one year) shall be computed by multiplying the difference between the Customer's tariff and the DisCo's weighted average tariff with the total energy billed to the customer in the year preceding the exit:

- Long-term PPAs and vesting contracts
- Regulatory assets and revenue shortfalls
- Legacy costs
- Stranded investments
- Stranded operating costs

Stakeholder's comments are also welcome on the duration over which the DisCo shall benefit from the payment of CTC. Respondents may also propose a different methodology for the consideration of the Commission.

5 CODIFICATION OF ECR AND CTC GUIDELINES

As part of the drive towards efficient implementation of the ECR, the Commission is considering codification of ECR and CTC guidelines into a single document for ease of reference and information retrieval. Stakeholders may wish to comment on the proposed codification of the two regulatory instruments.

6 SUBMISSION OF STAKEHOLDERS' COMMENTS

The Commission has prepared this document to facilitate wide consultation by all stakeholders. The document has highlighted the issues that have been noted since the commencement of the Eligible Customer framework and the implementation of CTC guidelines in the NESI. Accordingly, the Commission shall take into consideration stakeholders' inputs on the proposed amendments. In addition, comments/recommendations on any part of the regulations and the guidelines that are not listed for consultation in this paper are also welcome.

Respondents may propose either a modification or an alternative to the proposals in the documents for further consideration by the Commission. A public hearing on the proposed review will be held after the expiration of the response period on dates to be announced by the Commission. The Commission shall consider and review all comments received from the stakeholders. The final decision on the consultation shall form part of the amended regulations which shall be published in an Official Gazette of the Federal Government with clear effective date in compliance with the various provisions of the Act.

In line with the Business Rules of the Commission, stakeholders' inputs on the proposed amendments are expected to reach the Commission within **21 days** from the date of publication of notice requesting for comments on this consultation paper in the National Dailies.

All comments and further inquiries should be sent for consideration of the Commission via ecr_consultation2023@nerc.gov.ng with copies to:

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