THE LIQUIDITY CHALLENGE IN THE NIGERIAN POWER SECTOR – *DEAL OR NO DEAL?*

More than three years after the Federal Government of Nigeria handed-over the successor companies[1] to private investors, the power sector remains in dire straits. As at the end of December 2016, the revenue shortfall in the Nigerian electricity market had reportedly reached a staggering ₦1 trillion[2], whilst the sector's huge indebtedness to commercial banks, as at the last quarter of 2016, stood at over US$12.52 billion[3]. Most of these debts to the commercial banks now appear in the banks' balance sheets as non-performing loans (**"NPLs"**).

Given that the electric power sector is an unbroken interconnected chain of activities from generation to transmission to distribution to end users at homes, offices and factories, its alarming liquidity challenge certainly qualifies as a nation-wide crisis.

To date, the

1. GenCos claim they are owed about ₦155 billion for electricity supplied;

2. Gas companies assert that they have unpaid receipts of about ₦110 billion[4];

3. DisCos are accusing Government's ministries, departments and agencies (MDAs), including the military, of owing over ₦156 billion[5] and this excluded the several billions of Naira owed by private residential and commercial customers;

4. Central Bank of Nigeria (**"CBN"**), estimates the GenCos' indebtedness to Nigerian banks as being about ₦356 billion[6], as at the end of the first quarter of 2016;

5. Commercial banks remain in discussions with the DisCos with respect to the ₦402 billion credit facilities advanced to their investor-owners for assets' acquisition during the 2013 privatization process;

6. Government failed to reinvest proceeds from the privatization of the successor companies into the nation's power infrastructure; and

7. Government's shrinking oil revenues, precipitated by the twin shocks of low oil prices and disrupted oil production due to militancy in the Delta region, have impacted Government's ability to extend the much needed investments in TCN[7].

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[1] The eighteen successor companies are: six Generation Companies ("GenCos"); eleven Distribution Companies ("DisCos"); and the Transmission Company of Nigeria ("TCN"). Whilst the GenCos and Discos have been privatized with government now holding only a small percentage of equity in them, the TCN still remains a government's wholly-owned public utility

[2] See "Three years after, private sector investors count losses" by Isiwu & Kalejaye; *Sweet Crude Reports* – A Review of the Nigerian Energy Industry, 9 November 2016 – http://sweetcrudereports.com/2016/11/09/three-years-after-power-sector-investors-count-losses/

[3] See "$14.52bn Loans: Banks go after power sector Investors" by Ezekiel Enejeta; Financial Watch, October 3, 2016 – http://www.financialwatchngr.com/2016/10/03/14-52bn-loans-banks-go-power-sector-investors/

[4] See "Darker days ahead as debts mount for Nigeria's electricity firms" by Isaac Anyaogu, BUSINESSDAY, November 14, 2016

[5] Ibid.

[6] See "Fashola's missteps in power sector"; The Punch editorial, December 7, 2016

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Undoubtedly, the above analysis of the state of the Nigerian power sector reveals that multiple factors are responsible for the credit crunch and distress in the sector. In our view, the most critical challenges impacting the sector are:

1. Foreign exchange crisis;
2. Cost of acquiring the privatized assets;
3. Cost-unreflective tariff regime;
4. Huge collection losses; and
5. Lack of affordable long-time funding.

From an x-ray of the current state of the Nigerian power sector, it is clear that same requires urgent and effective intervention. In this article, we would analyze some of the identified challenges which could be deemed responsible for the liquidity imbroglio as well as proffer policy options that could be considered as the panacea for dealing with same. In our considered opinion, the recommendations can revive the ailing power sector, if properly implemented and assure same gets on the path of profitability, bankability and sustainability.

1. <u>Foreign Exchange Crisis</u>

In recent times, the scarcity of funds and the volatility of exchange rates have characterized the Nigerian foreign exchange (**"FX"**) market, and these factors have negatively affected the capacity of private investors who acquired privatized PHCN successor companies, to honour their loan payment obligations to the commercial banks.

Indeed, at the time of negotiating the various terms of the loan agreements executed between the power companies and the banks, the CBN/official exchange rate was ₦197/$1. Since then, the single, market-determined FX rate has been replaced by multiple exchange rates following a seemingly liberalized, autonomous inter-bank market launched by the CBN on June 20, 2016. This has single-handled engendered and strengthened the unofficial ("*parallel*") market and created a wide margin between the FX rates at the inter-bank market and the said parallel market. Essentially, the volume of FX supply at the inter-bank market has continued to fall short of the FX demand, thereby causing illiquidity and volatility in the market.

The necessary implication of this development has been that the foreign currency-denominated loans advanced to the power companies by banks have remained largely non-performing. The *"devalued"* Naira receipts, which accrue to the power companies from end users of electricity, can no longer effectively service the foreign currency denominated loans. Figures emanating from the Federal Ministry of Power indicate that DisCos have been making only 24.9% of their agreed monthly remittances to banks in recent times[8].

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[7] See "Darker days ahead as debts mount for Nigeria's electricity firms", supra.

[8] See "Power: Discos Pay for Paltry 24% of Electricity Allocation", THISDAY, March 4, 2017 – https://www.thisdaylive.com/index.php/2017/03/04/power-discos-pay-for-paltry-24-of-electricity-allocation/

Clearly, this is a great disincentive to foreign investors and lenders who ordinarily would have brought the needed capital into the sector.

Recommendation:

In our considered opinion, a mixed bag of incentives and economic policies; ranging from continuous and periodic injection of intervention funds to the adoption of a truly liberalized FX market[9], will certainly restore the confidence of foreign investors as well as attract the inflow of the much needed foreign investments into Nigeria in general and into the power sector in particular.

Pending the liberalization ("*in the real sense*") of the FX market, the FX rate which is a major macro-economic variable in the NERC tariff regime, must be amended to reflect the current official rate in the approved MYTO. Additionally, electricity companies should be guaranteed privileged access, on a regular basis, to the official FX market.

However, it is comforting to note that the federal executive council (**"FEC"**), in its first meeting in March 2017, had given consideration to the need to inject new stream of intervention fund into the power sector and therefore had (at the meeting) approved a Power Assurance Guarantee for the Nigerian Bulk Electricity Trading Company (**"NBET"**), to the tune of ₦701 billion[10]. The fund is to be disbursed by the CBN as payment assurance guarantee to see that NBET continue to undertake its role of purchasing the power generated by GenCos and in turn, ensure that liquidity is provided for the GenCos to pay their gas suppliers.

2. Cost-unreflective tariff

Another major challenge, causing financial distress in the power sector, is the unrealistic tariff regime for the DisCos, which is not cost-reflective and therefore does not stimulate needed investments that will lead to adequate and stable electricity supply in the market. Whilst the Federal Government has ruled out any electricity tariff hike[11] this remains an option to be considered.

For purpose of emphasis, the Electric Power Sector Reform Act, 2005 (**"EPSRA"**), which is the principal legislation governing the power sector reform in Nigeria, states in **Section 76(2)(a)** that:

> *"(2) Prices for the activities referred to in subsection 1 of this section shall be regulated according to one or more methodologies adopted by the Commission for regulating electricity prices and such tariff methodologies shall:*
>
> *(a) allow a licensee that operates **efficiently** to recover the **full costs** of its business activities, including **a reasonable return on the capital invested** in business".*

[9] where the naira can find its market-determined equilibrium level
[10] "FG moves to boost power with N701bn gas supply guarantee", BUSINESSDAY, March 2, 2017 http://www.businessdayonline.com/fg-moves-boost-power-supply-n701-bn-gas-guarantee/
[11] FG Rules Out Electricity Tariff Hike for Now by Chineme Okafor, ThisDay of January 10, 2017 http://www.thisdaylive.com/index.php/2017/01/10/fg-rules-out-electricity-tariff-hike-for-now/

Recommendation:

The NERC, with the support of the Ministry of Power should create the needed framework, which will enable willing sellers of electricity to sell to willing buyers.

By law, "the Minister may issue a directive to the Commission, specifying the class or classes of end-use customers that, from time to time, shall constitute "*eligible customers…*"[12]

In recognition of this provision of the law, Nigeria's Honourable Minister of Power, Works and Housing, Mr. Babatunde Fashola, SAN, hinted, during an interview he granted in April 2016, that certain groups of *"eligible customers"* in some parts of the country, predominantly Lagos, have expressed their intention to the DisCos with charge over distributing power to their franchise areas, to buy specific megawatts of electricity at tariff rates to be mutually agreed between these groups of customers and the DisCos[13].

Where the above structure is adopted, DisCos will be able to distribute power at cost reflective tariffs on a willing seller/willing buyer basis rather than at the subsisting regime of subsidized uniform rates for all customers which, frankly, are unsustainable and unrealistic.

3. Huge Collection Losses

Collection losses, which occur either in form of technical or non-technical losses, constitute another major cause of revenue shortfall and thus contributes largely to the liquidity challenge which power companies face in Nigeria.

Reportedly, the country currently has an installed electricity generation capacity of 12,522MW, with available capacity of only approximately 4,500MW due to gas supply constraints. Of the available capacity, about 7% are lost across the transmission lines, leaving only about 93% of generated electricity reaching the end-users/consumers (technical losses). However, the DisCos only collect revenue for less than 50% (some estimate this to be below 30%) of the electricity distributed to end-users[14]. This is as a result of consumers' refusal to pay their bills, theft/bypassing of meters, and a huge number of unmetered customers who enjoy free power without being billed for their consumption. The case of the refusal by Government's MDAs and military units to pay their bills, now running into hundreds of millions of Naira, has been one of the biggest challenges (if not the biggest challenge) facing DisCos and this also amounts to setting a bad example for the private consumers of electricity in the country.

[12] Section 27, EPSRA

[13] "Electricity: The price Nigerians must pay"; Vanguard, April 24, 2016 – http://www.vanguardngr.com/2016/04/price-nigerians-must-pay-fashola/

[14] See: "Understanding and overcoming Nigerian gas-to-power challenges" by Bolaji Osunsanya, MD, Oando Gas and Power; PwC's Annual Power and Utilities Roundtable 2016.

Central to the survivability of the whole value chain, is the collection of revenue for power generated and distributed. Thus, when DisCos are able to get consumers to pay their bills for power supplied, the DisCos are in turn able to pay NBET or the GenCos for the electricity supplied. In the same vein, the NBET will have enough cash to fulfill its obligations under the various power purchase agreements (**"PPAs"**) executed with the GenCos; who in turn will be able to pay the gas companies.

Recommendation:

Adequate infrastructure has to be put in place for the metering of all consumers while more incentives should be provided for local manufacturers of electricity meters, to reduce costs of procuring the meters by the DisCos.

Also very important is the quality of customer services rendered by the DisCos. In this connection, we recommend improved and qualitative services to end-users of electricity as well as robust and inclusive community relations initiatives, that will give consumers a stakeholder's impression in the electric power value chain. These efforts will collectively reduce apathy among consumers and improve on the amount of electricity bills that are settled.

To minimize DisCos' huge collection losses resulting from the refusal of Government's MDAs and military units to pay their electricity bills, we advocate the Government issue a policy that will move all MDAs and military units from the post-paid system to the pre-paid meter platform. This will ensure that these Government's parastatals pay for the electricity they consume.

Embedded generation is another solution to the problem of collection losses and this should be encouraged. Under this option, GenCos are able to sell generated electricity directly to the DisCos or eligible customers (once declared), thus by-passing NBET.

4. Lack of affordable long-term funding

As already analyzed above, the strained liquidity situation in the Nigerian electricity market has stunted cash flow; whilst the capital required for medium to long-term investments in the power sector is grossly inadequate. Most players in the sector will be bold to opine that no lender will extend loan capital if they are unsure of the borrower's capacity to remain in operations in the short-term. Certainly, the short-term cash flows must be first ascertained the value chain before new and cheaper capital can be inflowed.

In our considered opinion, continuing efforts must be made to boost cash flow in the sector, address revenue shortfall as well as bridge the funding gap. "Putting together some form of guarantee that can allow the market issue bonds and create markets where cash flows are possible will guarantee the survival of the system"[15]. Without a doubt, the Federal Government's intervention (through the

[15] Ibid.

Central Bank of Nigeria) is also needed in liquidating the toxic assets on the balance sheets of the banks that advanced credit facilities to the power companies during the privatization process.

Lastly, the Federal Government should also consider providing tax holidays or extension of existing tax holidays to power sector investors in a bid to free up the cash flows of such companies while the restrictions placed on equity dilution in privatized power companies should be relaxed, so as to give room for more diversified sources of skills and capital to be attracted to the power sector.

5. CONCLUSIONS

Except thorough policy and regulatory reforms are carried out to address the fundamental issues responsible for the liquidity challenge in the power sector, the negative multiplier effects could spread quickly beyond the already battered manufacturing, banking & loan, and the Micro, Small and Medium Enterprises (MSMEs) segments, to the other sectors of the economy. Hopefully, the Government will sustain its current focus on the power sector challenges with a view to finding lasting solutions, going forward.

The Grey Matter Concept is an initiative of the law firm, Banwo & Ighodalo