Half-empty or half-full glass - partial activation of contracts in the Nigerian Electricity Supply Industry begins

The Nigerian Electricity Regulatory Commission (the "Commission" or "NERC") has commenced the process to end the hitherto so-called "energy-only" or "best endeavour" power supply arrangement associated with most of the on-grid power generation companies ("GenCos") in the Nigerian Electricity Supply Industry ("NESI"). Despite the execution of a fully termed Power Purchase Agreement ("PPA") with energy and capacity payment obligations between some of the on-grid GenCos and the Nigerian Bulk Electricity Trading Plc ("NBET"), the PPAs did not take effect due to inadequate capacity to wheel the generated power to consumers. For other GenCos, no PPAs were signed, and energy was being supplied to the grid and paid for by NBET on a best endeavour basis. In both cases, NBET would pay the GenCos only for the energy that is dispatched. The impact of this was both on the consumers and the investors – for consumers, a significant portion of the generation capacity in the NESI were stranded and could not be delivered; for investors, the investments in the generation companies could not be recovered due to the sub-optimal utilisation of the assets.

To address these, the Commission has resolved to implement a phased activation of the contracted capacity under the PPAs between NBET and each of the GenCos as part of a strategy to ensure increased electric power supply across the value chain. Essentially, the partial activation is designed to, amongst other things, –

(a) enshrine market discipline among the NESI operators through the mechanism of liquidated damages for breach of service level obligations; and

(b) address the liquidity shortfall in the NESI by providing an effective payment security framework to ensure that all NESI market operators or vendors – gas suppliers, GenCos, the Transmission Company of Nigeria ("TCN"), and DisCos – are paid all due invoices in full.

In terms of designs, the Commission adopted the following approach –

(a) provision of liquidated damages payable by contract parties in the event of default in service levels;

(b) capacity activated for each GenCo according to its dependable and tested ability; and allocated to each DisCo according to consumer spread and network capacity;

(c) inclusion of gas suppliers into the NESI payment waterfall to ensure guaranteed payment of gas, and to forestall outage due to gas interruptions for non-payment; and

(d) instituting credible and enforceable payment security arrangement that consists of the existing DisCos' Account Administration and Payment Waterfall Framework and additional intervention funds from the Federal Government of Nigeria.

The key transaction agreements for this programmme are the Partial Activation Agreement between NBET and GenCos, Power Evacuation Agreement between TCN and GenCos, Gas Supply Agreement between GenCos and gas suppliers, and Service Level Agreement between DisCos and TCN (together, the "Agreements").

In summary the key terms of the Agreements are as follows –

(a) GenCos are to generate and make available consistently, the capacity that has been activated (the "Activated Capacity") as well as the corresponding energy and NBET is obligated to pay for both the capacity and energy delivered;

(b) where the Activated Capacity is not made available to NBET due to reasons attributable to a GenCo, the GenCo shall pay liquidated damages to NBET for the shortfall;

(c) where the Activated Capacity is not made available to NBET due to reasons attributable to gas supply to the GenCos' power plant, GenCos shall pay to NBET the liquidated damages of a sum equal to the liquidated damages provided in the GenCos' Gas Supply and Transportation Activation Agreements (if any);

(d) where the Activated Capacity is not made available to NBET due to reasons attributable to any force majeure event affecting either of the parties, TCN, the gas supplier or the gas transporter, payment shall only be made for the actual capacity made available, and no liquidated damages shall be payable by the GenCos during the occurrence of such force majeure event;

(e) TCN has committed to evacuate each GenCos' pre-agreed base load and peak load as approved by the Commission; and

(f) GenCos are required to submit a day-ahead nomination each in accordance with the PPA, Grid Code and Market Rules to the System Operator.

Whilst the System Operator's daily report throughout the first and second quarter of 2022 show that there is over 7,000MW available out of the over 13,000 installed capacity, the Commission seems to have only activated 5,300MW to safely accommodate any unforeseen or potential technical constraint.

The key question arising from this programme is the classic half-full or half-empty question. An optimistic view would be that it is a significant step towards maximising the available resources and capacity in the NESI to reduce the supply deficit. The opposite view would be that the real challenge has not been addressed – mobilising investment in critical distribution and transmission infrastructure to offtake both available generation capacity and enable additional generation capacity in the NESI.

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