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The Potential Implications of the Eligible Customer Scheme in the Electricity Sector

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Overview

Eligible Customer Scheme in the power sector declared by the Minister of Power, Works and Housing is aimed at ensuring that big industrial consumers buy electricity directly from GENCOs. This has implications for electricity consumers and the financial performance of DISCOs. This brief highlights these implications and areas in the Electric Power Sector Reform Act that needs to be looked into in the light of this declaration.

I. Background

1. Access to electricity is still a major challenge in Nigeria despite series of reforms and initiatives since the enactment of the Electric Power Sector Reform (ESPR) Act in 2005. A significant number of Nigerians lack access to electricity and most of those with access do not have reliable and regular supply. In addition to this, electricity consumers have been made for pay higher tariffs despite lack of substantial improvements in power supply.
2. According to the Electric Power Sector Reform (ESPR) Act, the DISCOs are largely responsible for receiving electricity from generation companies (GENCOs) via the Transmission Company of Nigeria (TCN) and delivering same to final consumers. But DISCOs have faced problems of financial liquidity and most of them have been unable to provide the basic infrastructure (such as meters and transformers) required for effective service delivery.
3. However, the Eligible Customer Scheme which was introduced recently, would further put pressure on the financial liquidity of DISCOs and also affect electricity consumers through higher tariffs. The Scheme allows big electricity consumers such

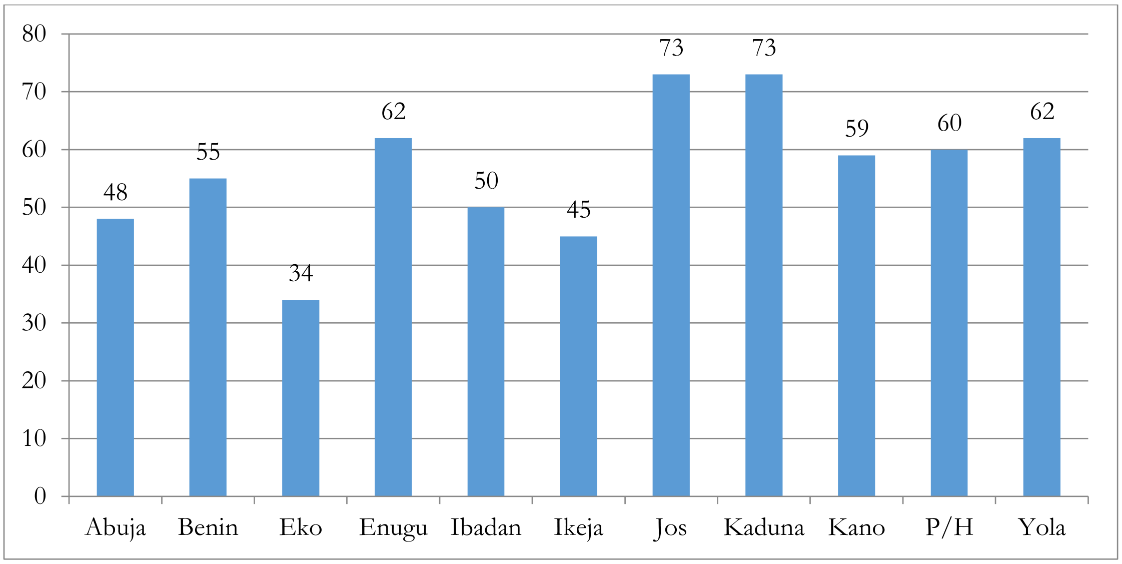
as large industries to be supplied electricity directly by the GENCOs, bypassing the DISCOs. Prior to the Scheme, customers were only permitted to purchase electric power from licensed distribution companies (DISCOs) except for industrial, commercial, and residential customers (off-grid IPPs or captive generators) who generate their own power. But the Eligible Customer Scheme enables some 'eligible customers" to buy power directly from the producers (GENCOs). According to the disclosure of the Minister of Power, Works and Housing, Mr. Babatunde Fashola, at August 2018 edition of the Monthly Power Sector Operators' Meeting, about 5 industrial customers are already benefiting from the Scheme while 26 others have chosen to sign up. It is believed that many more will join the scheme thereafter.

II. Issues

4. The Eligible Customer Scheme is defined in Section 100 of the Electric Power Sector Reforms Act as a customer who is eligible to purchase power from a licensee, other than the distribution companies. This is common in the electricity industry in several countries. The purpose of defining eligible customers in the electricity industry is to facilitate competition in the electricity market by allowing customers to purchase electricity from the supplier of their choice, rather than in a situation where customers only rely on the DISCOs in their region (regional monopoly). Hence, by seeking electricity supply from different GENCOs, customers can select the best deal available to them.

5. While this scheme would enable industrial customers to have access to much needed electricity and evacuate stranded generation capacities, it has implications for the financial performance of the DISCOs and the electricity tariff faced by non-eligible customers. Firstly, large industrial customers account for a substantial proportion of DISCO's revenue collection. Thus, the implementation of the scheme would reduce the revenue available for DISCOs, thereby worsening their financial situation and undermine their ability to provide necessary distribution infrastructure. The liquidity crisis facing the DISCOs is also aggravated by non cost-reflectuve tariffs and high aggregate technical, commercial and collection (ATC&C) losses as shown in Figure 1.

Figure 1: Aggregate Technical Commercial & Commercial (ATC&C) Losses, 2016 (%)



Source: Nigeria Electricity Regulatory Commission (NERC)

6. Secondly, the scheme would lead to increase in electricity tariff for other non-industrial consumers. The scale of electricity tariff across the various DISCOs shows that the tariff paid by industrial customers (average of N45.72/kWh for Class D2) is over ten times that of residential customers (N4/kWh for R1 – lowest ranked customers). DISCOs would therefore need to charge non-industrial customers more in order to recover the loss of revenue from industrial customers if the Eligible Customer Scheme is implemented.
7. Section 27 of the ESPR Act makes provisions to this effect. It states that "*The Minister may issue a directive to the Commission specifying the class or classes of end-user customers that, from time to time, shall constitute eligible customers under this Act*". Section 28, however, provides for a means in case such designation is perceived to have a negative effect of some of the operators. Section 28 states that "*If the Minister determines, following consultation with the President, that a directive given 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 its 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 distribution licensees, and the duration of the competition transition charge".

8. While Section 27 empowers the Minister to declare eligible customers, Section 28 further mandates that DISCOs should be compensated to ensure "*earn permitted rates of return on their assets*". The collection of these competition transition charges would constitute an increase in tariff paid by electricity consumer. Thus, both eligible and non-eligible customers would bear the cost of the Scheme as provide for in the Act. This will undermine current efforts by consumer advocacy groups and the National Assembly to ensure arbitrary increases in electricity tariffs are avoided.
9. The unilateral discretion and powers of the Minister to declare eligible customers according to Section 27 of the Act could lead to abuse and/or uncertainty. The Minister may by declaration change or re-designate such classes of customers at will which could introduce some elements of uncertainty into the system. There is no requirement in the Act for the Minister to consult with stakeholders in the sector before issuing such directives. There is need for benchmark criteria for determining who is qualified as an eligible customer. Such criteria could be the quantity of electricity consumption, the sector of the consumer, availability of distribution infrastructure and other strategic factors.
10. Furthermore, the Scheme would work best in a competitive electricity market characterised by efficiency and market-driven tariffs. GENCOs are currently tied to a power purchase agreement with the Nigerian Bulk Electricity Trading plc (NBET), and can only sell additional capacity to eligible customers. With the current tariff structure, GENCOs may be unwilling to invest in additional capacity. More so, the credit worthiness of the eligible customers to sign long-term power purchase contracts with GENCOs is also an issue to be addressed.

III. Recommendations

11. Section 27 of the Electric Power Sector Reform Act needs to be amended to avoid a situation where the Minister unilaterally makes decisions on the determination of eligible customers. The Minister

should work with stakeholders in the sector before issuing such declarations.

12. Section 28 also needs to be amended to ensure that DISCOs are proportionately compensated due to losses as a result of implementation of Section 27. The section provides for the compensation of DISCOs, but the procedure and methodology for calculating the compensation is not contained in the Act. Inadequate compensation of DISCOs would negatively impact their financial and operational capabilities.

The views expressed in this Research Issue Brief are those of the author(s) and do not necessarily represent the views of the Institute and its Management.

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