

The background features a large, dark green triangular shape on the left side, which contains white circuit board patterns. To the right, there is a silhouette of a high-voltage power transmission tower against a light, hazy sky. The tower is a lattice structure with multiple cross-arms supporting power lines. The overall aesthetic is technical and industrial.

**National Economic Council**

**Ad-Hoc Committee on Ownership  
Review and Analysis of Discos and  
Electricity Sector Reform**

Report Summary and Recommendations  
March 19<sup>th</sup>, 2020

# Executive Summary

## DISCO Ownership and Performance

- Upon review of NCP and NERC documentation, it has been determined that the States' average shareholding in the Discos is 27.3% based on levels of State Govt investment prior to privatisation
- Between 2015 – 18, Discos under-collected on their invoices to the tune of N890 bn while also under-remitting to the market which resulted in a debt of N230 bn<sup>1</sup>
- Between 2015 – 18, Discos underinvested relative to their Performance Agreement targets by N164 bn (67%) and benefited from investments by NDPHC/REA in their networks to the tune of N147 bn
- Board composition across Discos are disproportionately skewed towards private investors while States and LGAs have no representation.

## Reform Revitalization

- The EPSRA established a good framework for driving the reform, through a multi-stage competitive approach, the establishment of an independent regulator, and mechanisms to protect the poor
- The sector has underperformed due to critical challenges incl. non-implementation of cost reflective tariffs, misalignment between the investors and BPE on required investment in Discos, under investment in infrastructure and poor implementation of rules/contracts
- Urgent measures needed to turn the sector around include recapitalization of Discos, firm implementation of industry rules/contracts and the insistence on sound governance principles that improve performance

1. 230 bn includes N48 bn debt owed to the Discos by MDAs

# Scope of Work/Terms of Reference

Scope of Work

<b>Ad-Hoc Committee on Ownership Review and Analysis of DISCOS and Power Reform</b>
<b>To review the status of the ownership structure of the partially-privatised electricity power distribution companies (Discos).</b>
<i><b>Committee Membership:</b> Governors of Kaduna, Adamawa, Anambra, Edo, Kebbi, Lagos, Plateau and BPE, NDPHC, TCN</i>

Terms of Reference

<b>Transactions Review Sub-Committee</b>
<ol style="list-style-type: none"> <li>1. Ownership and Shareholding Analysis</li> <li>2. Review of Collections and Remittance (NERC Open Review Data)</li> <li>3. Review of investment and Capital Expenditure</li> <li>4. Governance structures and processes</li> </ol> <p><i><b>Participants:</b> State House, EDSG, Ministry of Power, Ministry of Finance, NERC, BPE, REA, APGC, ANED, TCN, NBET, NDPHC, KPMG (independent consultants)</i></p>

<b>Reform Revitalization Sub-Committee</b>
<ol style="list-style-type: none"> <li>1. Privatization</li> <li>2. Transactions/Decisions Review</li> <li>3. Commercial and Financial Transactions Review</li> <li>4. Reform Process Review</li> <li>5. Market Design Review</li> </ol> <p><i><b>Participants:</b> BPE, NERC, APGC, ANED, TCN, NBET, NDPHC, PWC (independent consultants)</i></p>

- **Transactions Review Sub-Committee**

- Reform Revitalization Sub-Committee

- Recommendations/Next Steps

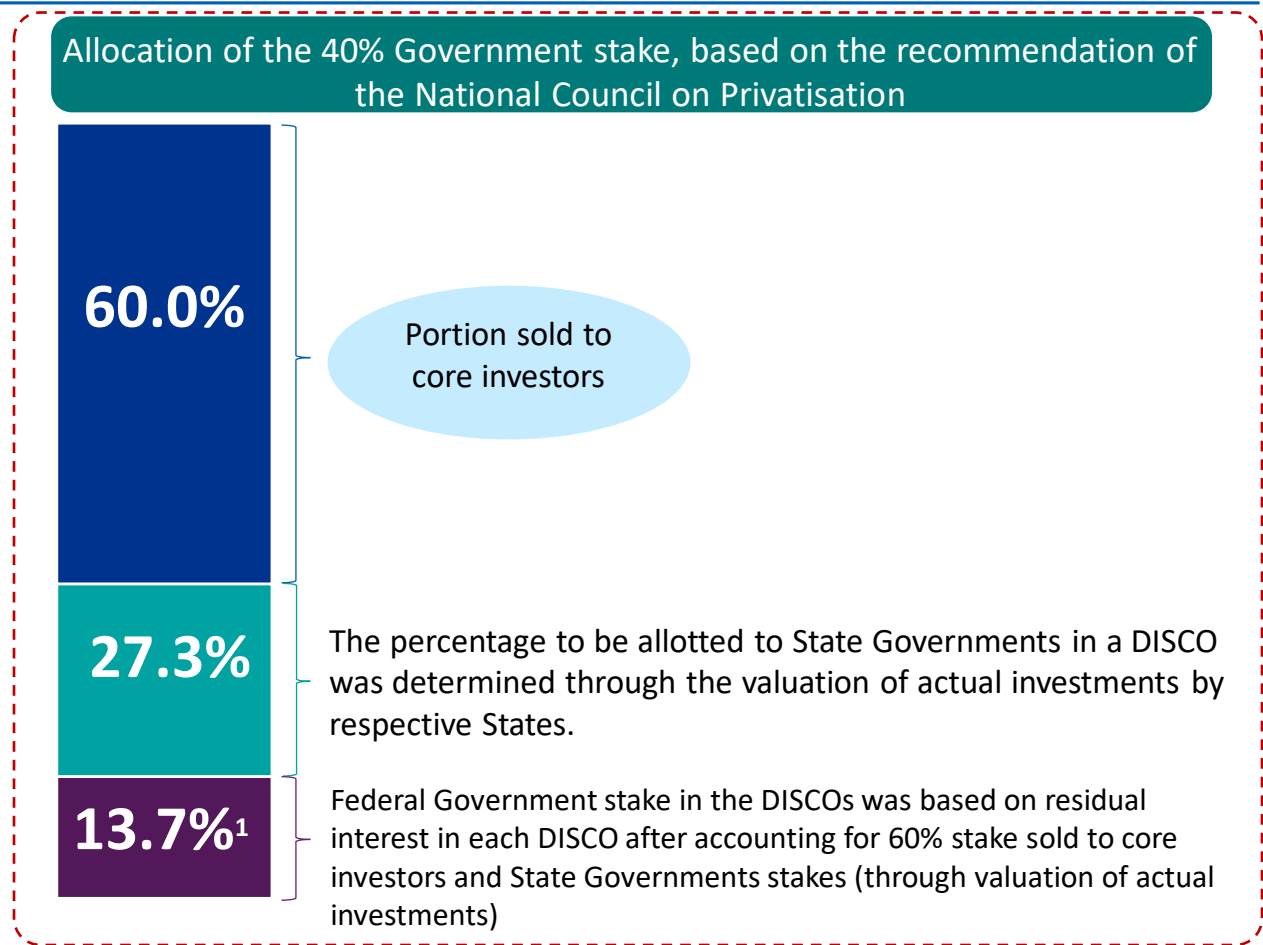
# Review of sale process

## Pre-sale ownership structure



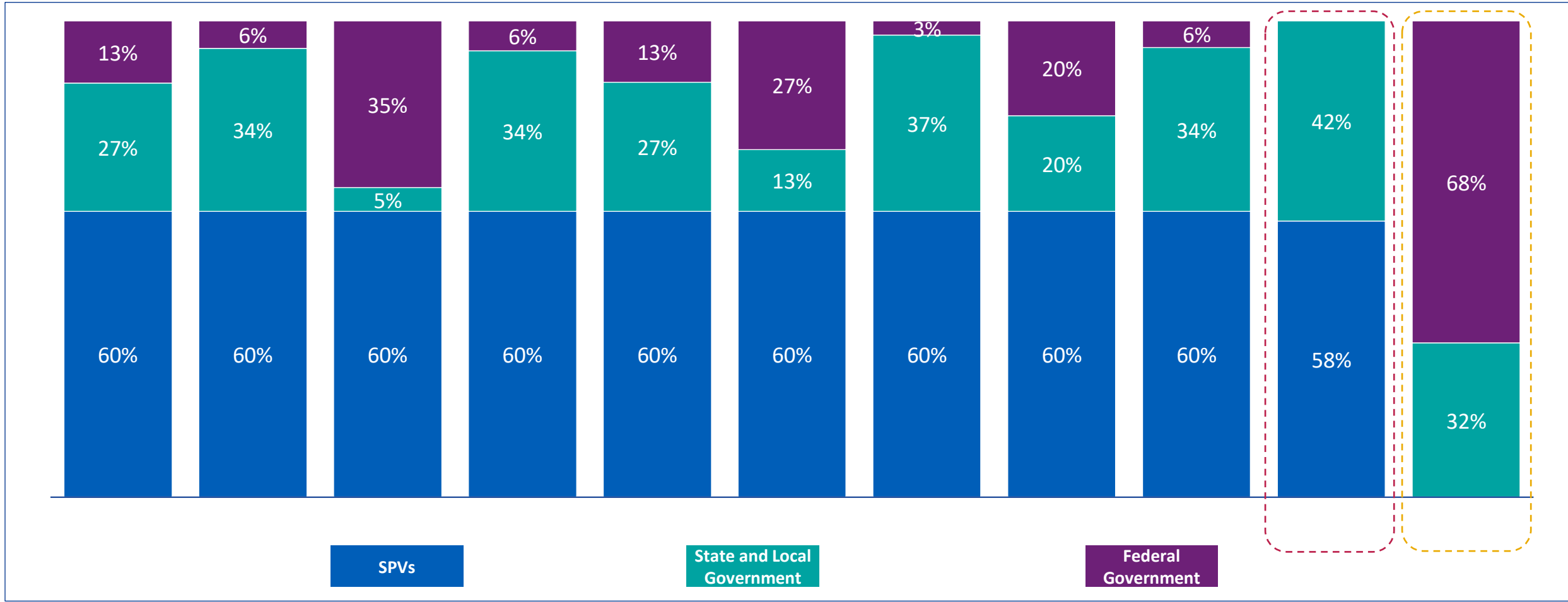
- Presale ownership structure was based on the following representations;
  - Annual appropriations were made from Federal Government's account to the defunct PHCN
  - Employees of the defunct PHCN were Federal Government staff
  - States Government were not compensated for their investments in each Disco
  - The NCP decision to allocate shares proportionate to States contribution to Discos Regulated Asset Base was to compensate the States for their investments (state government equity holdings were not determined at the time of sale)
- Upon sale of 60% equity in each of the Discos, the proceeds were used to compensate former PHCN workers instead of reinvestment in Discos

## Post sale ownership structure



1. Included in the 13.7% is the equity allocated to former employees of PHCN. This translates to the lower of 2% of the total Discos stake and 10% of Federal Government's stake (representing c.1.4%) is to be reserved to former PHCN employees

# Shareholding structure of the 11 DISCOs



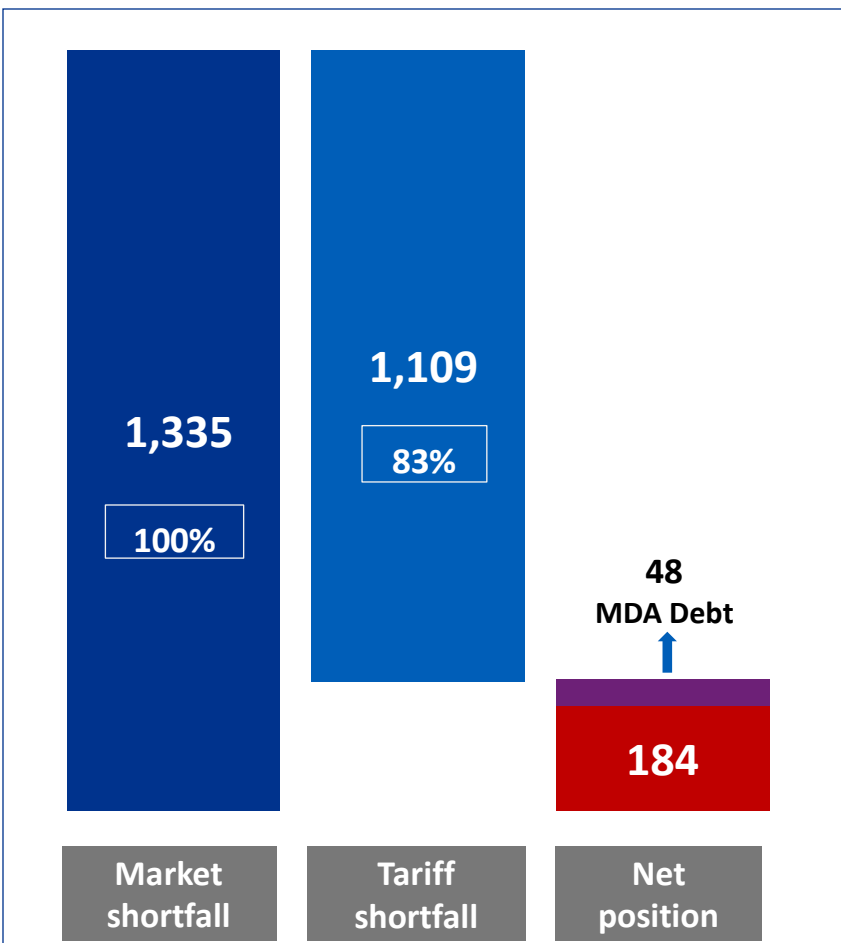
Federal Government stake completely eroded by the State Government and Local Government

Yola DISCO is fully owned by the Government (Federal and State)

# Discos are indebted because of inefficient collection & under-remittance to the market

## Wholesale electricity market (2015 – 18)

### Aggregate net position of discos (₦'bn)

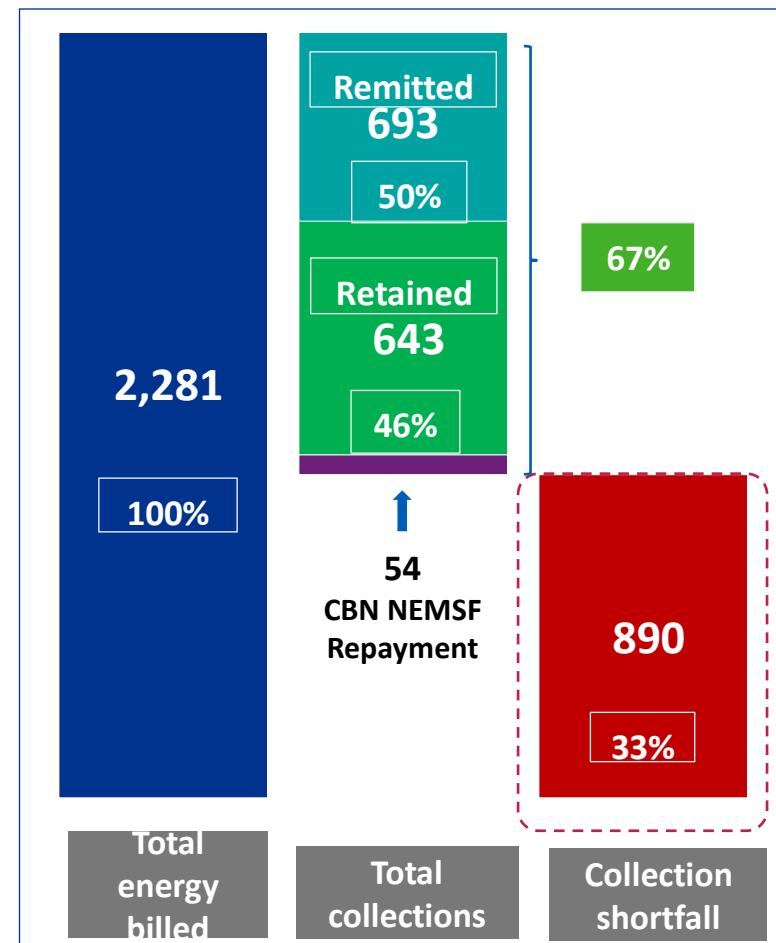


### Notes on the market shortfall and Discos' net indebtedness

- Excluding tariff shortfall (responsibility of FGN), Discos' indebtedness to the electricity market (MO/NBET) amounts to ₦230 billion. This includes ₦48 billion of MDAs' indebtedness to the Discos.
- Discos' indebtedness is driven by two factors
  - Collection shortfall:** On average Discos were only able to collect 67% of their invoices from consumers – losing c. N890 billion in the process
  - Low remittance:** Prior to the release of the NERC minimum remittance order, Discos only paid the market how much they wanted which was generally lower than what was due i.e. discos retained a higher than acceptable share of earnings

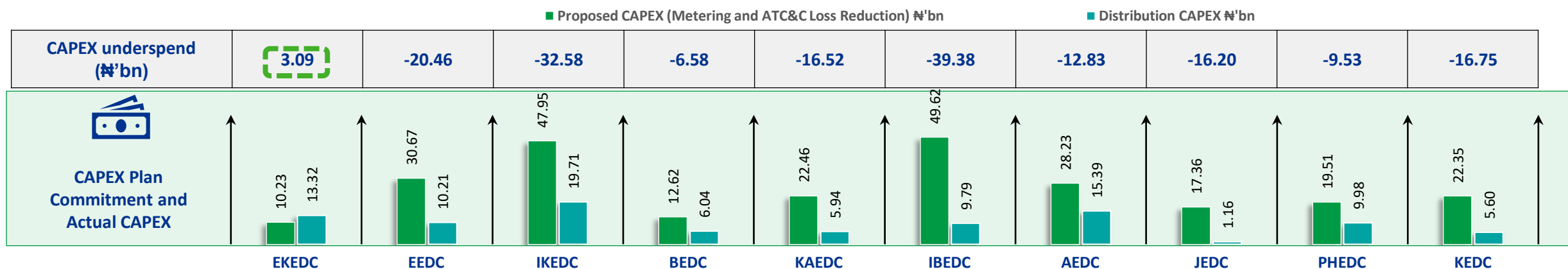
## Retail electricity market (2015 – 18)

### Aggregate billings, collections and remittances (₦'bn)



# Analysis of CAPEX Plans and Target Loss Reductions in the Performance Agreements

Committed capex investment (signed performance agreement) ₦76bn(Metering) + ₦95bn (ATC&C loss reduction) + ₦90bn (Other CAPEX)	<b>₦261 bn</b> <b>100%</b>	Actual investment as at December 2018	<b>₦97 bn</b> <b>37%</b>	Investment underspend as at December 2018	<b>₦164 bn</b> <b>63%</b>
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## Summary of REA & NDPHC CAPEX interventions post acquisition up until 2018 (not yet accounted for as State investments in Discos' asset base)

Contribution Agency	EKEDC ₦' bn	EEDC ₦' bn	IKEDC ₦' bn	BEDC ₦' bn	KAEDC ₦' bn	IBEDC ₦' bn	AEDC ₦' bn	JEDC ₦' bn	PHEDC ₦' bn	KEDC ₦' bn	YEDC ₦' bn	Total ₦' bn
REA	0.08	4.06	0.29	3.18	1.80	3.81	4.27	3.61	2.23	3.98	3.85	31.05
NDPHC	9.03	12.95	15.61	15.09	8.60	9.24	9.12	6.65	15.33	9.62	5.40	116.63
<b>Total per DISCO</b>	<b>9.11</b>	<b>17.01</b>	<b>15.90</b>	<b>18.27</b>	<b>10.40</b>	<b>13.05</b>	<b>13.39</b>	<b>10.26</b>	<b>17.56</b>	<b>13.60</b>	<b>9.15</b>	<b>147.68</b>
<b>Recognised by the DISCO</b>	-	0.14	-	-	-	-	2.69	-	-	-	-	2.83

Source: KPMG analysis from data obtained from the signed performance agreements, audited financial statements of the DisCos, NERC's website & MYTO 2.1

\* The Performance Agreement of YEDC was not provided at the time of this report and is not included in this analysis

\* The 2018 FS of BEDC, KAEDC, IBEDC and JEDC were not provided at the time of this report and were not part of this analysis



## Key issues identified from review of governance practices in Discos

### Description

#### BPE conflict of Interest

- BPE alone represents public sector equity on the board of each Disco, which could compromise its ability to carry out objective Monitoring & Evaluation of each Discos' operations vis-à-vis the Performance Agreement

#### Board representation at Discos

- On average, each Disco has 8 board members of which only 1 represents BPE which is not reflective of the shareholding structure of the Discos
- States/LGAs governments own 27.3% equity in Discos but are not represented
- BPE also does not exercise its veto rights in supervising Disco management

#### Independent Directors

- NERC's requirement for each Disco to have independent directors has not been properly implemented by them

#### Forensic Audit

- Observations from NERC's open book review indicate major governance issues across all Discos, including procurement failures, related party transactions and lack of value-for-money in technical agreements
- Urgent need for technical, financial audits before interventions by WB, Siemens, etc

- Transactions Review Sub-Committee
- **Reform Revitalization Sub-Committee**
- Recommendations/Next Steps

# The Electric Power Sector Reform Act provided a good basis for reform

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## Market structure and evolution

- The market was designed to work through industry regulatory rules and commercial contractual structures
- The Act allowed for the development of a competitive electricity market, through a multi-phased approach, allowing for appropriate progression from one phase to the next

## Regulatory function and capability

- The Act established an independent regulatory commission
- The Act provides for a range of regulatory instruments that drive both technical and economic performance (i.e., licenses, technical codes, MYTO, Market Rules, etc) and ensure exchange of energy for revenue

## Protection of the poor

- The Act created the Rural Electrification Fund and Rural Electrification Agency, for the promotion of rural electrification programmes
- The Act allowed for the creation of the Power Consumer Assistance Fund, to subsidise underprivileged power consumers

# The market has not turned out as planned due to a number of critical issues

1

## Incorrect assumptions

- Some of the critical assumptions that directly affect liquidity in the market and the ability of Discos to make necessary investments e.g. level of metering, aggregated technical, collection and commercial losses, capex allowance were incorrect at the point of privatisation

2

## Lack of adequate due diligence

- The selected bidders did not conduct thorough due diligence on the state of the infrastructure and finances of the successor distribution companies which led to misalignment on what was required to turn Discos around

3

## Tariff shortfall

- NERC has always set tariffs below cost reflectivity, causing a failure to implement regulatory rules and contracts and continuous FG subsidies to the market that compromise the financial position of the Discos and their ability to raise capex funding

4

## Non compliance with contracts

- Across various levels of the value chain, there have been continuous cases of non-compliance with contracts and NERC regulations e.g. vesting contracts, PPAs, procurement rules, without appropriate punishments, further eroding investor confidence in the market

5

## Load rejection by discos

- The absence of a take or pay obligations on Discos for energy supplied combined with direct interference by TCN in Disco's despatch combine to cause repeated load rejection by Discos, which creates financial liability for NBET and also compromises grid safety and reliability

6

## Misaligned infrastructure investments

- Several projects by TCN, REA and other federal agencies have been undertaken without consultation with the Discos causing expensive infrastructure to be built in places where Discos claim they do not have customers needing supply

# Recommendations on the path forward

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## Return to a Contract- and Rules-Based Market\*

- Return to orderly evolution under Market Rules that make contracts effective between Gencos/IPP, TCN, Discos and gas suppliers, backed by payment and performance guarantees
- Implement provisions of the Act that allow for differing tariff methodologies ... ensure that tariffs increase only with improvements in service and encourage Willing-Buyer-Willing-Seller (WB/WS) arrangements

## Recapitalize Distribution Companies

- Recapitalize Discos by shareholders (States/FG, core investors), encourage Gencos to bring in capital and management expertise
- Implement and expand existing infrastructure finance support programs to augment distribution, transmission infrastructure and rural/off-grid programs (TCN - \$1.6B; Siemens - TBD; World Bank DISREP - \$1B; REA / NEP - \$550m)

## Implement Effective Governance

- Government to provide clear policy guidelines to regulators (NERC, CBN) and market participants regarding strategic objectives above
- Return market to regulatory norms with NERC acting to execute its statutory obligation to create and implement efficient market design to ensure quantitative/qualitative improvements
- Ensure that governance of Discos is focused on adherence to regulations, rules and contracts and efficient investment in infrastructure and customer service delivery

- Transactions Review Sub-Committee
- Reform Revitalization Sub-Committee
- **Recommendations/Next Steps**

## Next Steps

- Present Report findings, conclusions and recommendations for NEC approval
- Integrate recommendations into the President's Power Sector Coordination Working Group
- BPE to ensure share allotments recognising State Govt equity in Discos
- Create mechanism through the President's Working Group to implement and monitor tasks and provide feedback
- Conclude Forensic Audits (contracts in place), present findings and recommendations to NEC

# Appendix



# Summary of NERC valuation of state shares (1/2)

S/n	DISCO	Name of SPV	SPV holdings in DISCOs	States holdings*	Total state holdings	Residual FGN holdings	
1	Abuja	KANN Utility Company Limited	60.00%	FCT Niger Kogi Nasarawa	11.20% 8.30% 4.20% 3.20%	26.90%	13.10%
2	Benin	Vigeo Consortium	60.00%	Delta Edo Ondo Ekiti	14.00% 8.40% 6.60% 5.20%	34.20%	5.80%
3	Enugu	Interstates Electrics	60.00%	Enugu Imo Anambra Abia Ebonyi	9.60% 7.40% 6.70% 6.00% 4.00%	33.70%	6.30%
4	Ibadan	Integrated Energy Distribution & Marketing	60.00%	Osun Kwara Ogun Oyo	9.60% 7.30% 6.90% 3.30%	27.10%	12.90%
5	Ikeja	New Electricity Distribution Company Limited	60.00%	Lagos	13.00%	13.00%	27.00%
6	Jos	Aura Energy	60.00%	Bauchi Benue Gombe Plateau	16.50% 10.50% 9.60% 0.40%	37.00%	3.00%

\*Based on NERC's valuation of State Governments contributions between 2005 and 2013 and does not include contributions from 2014 to 2019

# Summary of NERC valuation of state shares (2/2)

S/n	DISCO	Name of SPV	SPV holdings in DISCOs	States holdings*	Total state holdings	Residual FGN holdings	
7	Kano	Sahelian Power SPV Limited	60.00%	Katsina Kano Jigawa	15.00% 11.90% 7.50%	34.40%	5.60%
8	Port Harcourt	4Power consortium	58.00% <sup>1</sup>	Akwa Ibom Rivers Bayelsa Cross River <sup>2</sup>	22.70% 7.20% 6.70% 5.40%	42.00%	0.00%
9	Yola	N/a	0.00%	Taraba Yobe Borno Adamawa	9.30% 8.90% 7.80% 6.40%	32.40%	67.60%
10	Eko	Westpower and Gas Limited	60.00%	Lagos	5.00%	5.00%	35.00%
11	Kaduna	Northwest Power Limited	60.00%	Sokoto Kebbi Zamfara Kaduna	9.20% 4.70% 3.60% 2.60%	20.10%	19.90%

1. Our review of agreed ownership of based on technical proposal submitted (58%) is inconsistent with the internal memorandum from Nigerian Electricity Regulatory Commission (60%).
2. Cross River ownership stake reduced to 5.4% to cap total state holdings to 42%, as against 42.5% presented in the NERC valuation report.