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Nigeria Amends Constitution to Enable Electricity Decentralisation: Key Highlights for Investors and Stakeholders

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Introduction

Recently, the media reported that the President of the Federal Republic of Nigeria **– President Muhammadu Buhari** – assented to sixteen (16) Constitution Alteration Bills presented to him by the National Assembly. One of such Bills is the Fifth Alteration (No. 33) Bill 2022 (the **"Electricity Constitutional Amendment"**). The Electricity Constitutional Amendment effectively alters the Constitution of the Federal Republic of Nigeria 1999 (as amended) (the **"Constitution"**) to empower States within the Federation to make laws with respect to the generation, transmission, and distribution of electricity in areas ***covered*** by the national grid system within the relevant State. Prior to the Electricity Constitutional Amendment, States could only make laws with respect to the generation, transmission, and distribution of electricity in areas ***not covered*** by the national grid system within that State.[1]

The enactment of the Electricity Constitutional Amendment has been commended for providing the necessary fillip for the further liberalisation and decentralisation of the Nigerian Electricity Supply Industry ("**NESI**") so as to promote a competitive and efficient market. While the language of the Electricity Constitutional Amendment is terse and simple, the legal, commercial, and practical implications of that amendment for investors and other stakeholders in the NESI can be far-reaching if the States follow through with the spirit of the constitutional amendment and implement the needed reforms for the electricity sector.

[1] Although prior to the Electricity Constitutional Amendment, States had powers to make laws covering areas that are outside the national grid system, most States did not take advantage of such powers ostensibly on account of certain claims the national grid covered or

In this piece, we provide a simplified analysis of some of the legal, commercial, and practical implications of the Electricity Constitutional Amendment for investors and other stakeholders in the NESI.

Key Highlights and Implications

The enactment of the Electricity Constitutional Amendment throws up several issues that may impact existing investments in the NESI, incentivise new investments in the sector, or even create more hurdles for industry players. To trigger any of these impacts or begin to actualise the intendment of the constitutional amendment within a State of the Federation, the relevant State must first enact its own law, or in the case of States that already have the relevant laws, they may need to amend those laws to align with the principles under the Electricity Constitutional Amendment.

A highlight of some of the key implications is as follows:

State Level Licensing and Regulation

The expanded constitutional provision effectively means that States within the Federation can now license the generation, transmission, and distribution of electricity in all areas within their States, set up commissions and agencies to issue such licences, and make policies and regulations across the entire power sector value chain. This is quite impactful as it not only enables States to create their own electricity markets different from what presently exists, but also demonopolises the current regulatory powers of the Nigerian Electricity Regulatory Commission ("**NERC**").

Amongst other issues that this raises, it is not unlikely that some industry participants who already hold licences, permits or authorisations issued by the NERC for projects that are predominantly within a specific State (e.g., mini-grid operators, distributed energy companies, etc), may consider a migration from the NERC regulatory regime to one that is spearheaded by the States in which they operate – especially if the compliance requirements and the terms and conditions attached to the State licences are less onerous than those in extant NERC regulations and licences.

The risk of overregulation

The concurrent regulation of the power sector by both the Federal Government of Nigeria ("**FGN**") (through the NERC) and the State Governments (through their relevant state electricity regulators) raises a potential risk of overregulation, intrusive compliance requirements, and

had the potential to imminently cover or extend to, most parts of each State and it would have been futile for the States to legislate on the subject.

increased costs due to numerous toll points within the sector. Unless deliberate efforts are made towards creation of the needed synergy between the Federal and State level regulators, investors and industry players may become apprehensive about duplicate and multi-level licensing requirements and charges in the sector. We have seen a manifestation of this risk in some other facets of the Nigerian economy where efforts have been, or are being, made towards regulatory collaboration or resolution in the interest of advancing the relevant sub-sects of the economy.

Conflicts and "covering the field"

While a decentralised or dual approach to electricity regulation is not uncommon in more advanced or comparable markets, conflicts can and do arise in those case. In such cases, unless the regulators at the different tiers adopt the collaborative approach indicated above, the frequent question would be which regulator or applicable law should trump or prevail in a conflict situation. Clearly, if a project involves cross-border or interstate generation, distribution or transmission of electricity, Federal law and regulations will apply and prevail. With respect to intrastate projects where State laws may exist side-by-side with Federal laws and regulations, if there is a conflict between both regimes, there is the likelihood that Federal law would also prevail under the principle of "covering the field".[2] This possibility could complicate the risk analysis for investors who may be unsure about the applicable regime, or whether the regime that applies to them could be invalidated in the event of a regulatory or legislative conflict.

Potential claims under existing contracts

Many existing contracts in the NESI entered into by investors (or their project companies) with the FGN (or its agencies) contain fairly robust "Change in Law" provisions and protections that entitle the private sector counterparties to trigger or activate certain rights or claims under those contracts in the event of a change in law.[3] The definition of change in law under those contracts are such that the implementation or pursuance of the market regime introduced by the Electricity Constitutional Amendment may arguably activate contractual claims especially if the new regime reduces the revenue or returns expected by the investors and their project

[2] The doctrine of covering the field is a constitutional law principle which requires that on matters with respect to which both the Federal and State legislative houses have the constitutional powers to legislate, if there is a conflict or inconsistency between the legislation of a State and that of the Federal legislature, the law enacted by the Federal legislature shall prevail and the State law shall to the extent of its inconsistency be void. Section 4(5) of the Constitution.

[3] See for instance, the various power purchase agreements entered with the Nigerian Bulk Electricity Trading PLC; the Vesting Contracts with the electricity distribution companies, the Performance Agreements with the Bureau of Public Enterprises, etc. that are in force in NESI.

companies from the contracts that are impacted by the implementation of these constitutional changes. Investors may therefore seek detailed counsel on the extent to which their rights under the applicable contracts are, or may be, impacted in this respect.

Impact on electricity tariffs

Non-adoption of cost reflective tariffs has been one of the banes of the NESI, but we expect that the recent constitutional amendments may, in the mid to long term, result in significant changes in the pricing of electricity. Given the devolution of regulatory powers to the States, there is a strong likelihood that States which are desirous of attracting investments into their power sector may (i) in certain cases, float electricity tariffs such that prices are determined by market forces; or (ii) in other cases, continue to regulate tariffs but under an enhanced arrangement that allows for more frequent and realistic reviews that adequately track or adjust for inflation, cost of capital, exchange rate fluctuation and other relevant indices. This would stimulate competition amongst States such that those that are unwilling, or slow to adopt, a flexible approach to tariff setting may lose their share of investments that the reforms may attract.

Emergence of regional Grids

The national grid records incessant partial and total collapses each year despite the funds pumped into the sector. While there have been some reported improvements, the centrally controlled grid remains susceptible to frequent breakdowns. This has heightened the calls by industry stakeholders for the creation of decentralised or regional grids. As States begin to legislate on the generation, transmission, and distribution of electricity within their territory, the States are likely to authorise the emergence or establishment of such regional or isolated grids that run through their States. This would undoubtedly reduce pressure and overreliance on the national grid and result in a decline in system collapses. Grid reinforcement and expansion costs may also reduce considerably as operators focus on smaller grid systems which may be cheaper to maintain and more flexible in terms of operations.

Encroachment on Distribution Franchise Areas

With the implementation of the Electricity Constitutional Amendment, a new set of electricity distribution companies ("**Discos**") that are different from the existing legacy Discos will emerge and, depending on other market dynamics, investors may focus their attention on these new entrants instead of the legacy Discos. The stringent conditions imposed by NERC on, and the perennial opposition of the legacy Discos to, the issuance of independent

electricity distribution licences to interested applicants may also abate. This is because a new set of distribution licences will be issued under a framework that is not controlled by the NERC and the new licensors (the State regulators) are not privy to the arrangements under which the legacy Discos currently file their opposition to the issuance of new distribution licences by NERC. This is an area of potential conflict that the government, regulators, and market players must pay close attention. As more consumers migrate to new energy suppliers under the new regime, the legacy Discos are likely to keep pushing the argument that they have exclusive rights or some form of monopoly on electricity distribution in their franchise or coverage areas, and that the implementation of the constitutional amendments would substantially impair their initial investment assumptions and projections.

Likely spike in certain generation projects

With the weakening of central control, there is likely to be a considerable increase in small to medium scale generation projects (particularly renewables). States may begin to focus (or create a platform for investors to focus) on harnessing the States' energy potentials and utilising resources that are available within their territory to drive industrial and commercial growth. We have already begun to see this inclination in the number of mini-grid and off-grid projects that are under development around the country but expect the trend to continue. In any case, achieving this would depend on numerous factors and initiatives – some of which we will refer to in the concluding part of this piece.

Conclusion

The Electricity Constitutional Amendment has the potential to reshape, restructure and further liberalise the NESI. For a State like Lagos State that has been at the forefront of this liberalisation through its earlier enactment of the **Lagos State Electric Power Sector Reform Law 2018**,[4] and issuance of the **Lagos State Electricity Policy 2021**, the halleluiah drums are already beating to welcome this development.

However, to fully actualise the objectives of the constitutional amendments, States must not only enact their own enabling local laws (or amend existing ones, as the case may be), they must also develop or engage the capacity and resources required to drive these reforms and initiatives efficiently and effectively.

[4] Follow this link https://www.templars-law.com/knowledge-centre/the-leading-light-in-subnational-power-regulation-an-investor-focused-analysis-of-the-lagos-state-electric-power-sector-reform-law-2018/ to see an earlier analysis by TEMPLARS of the Lagos State Electric Power Sector Reforms Law 2018.

Attracting funding and investors into the state electricity markets through appropriate support and incentives will also be key. For this, one hopes that as the States create their own electricity markets, they will take useful lessons from the challenges and mistakes made in the NESI and create the enabling platform to engender investor confidence and unlock investments.

Lastly, the possibility of parallel and conflicting rights and interests of licensees of both the NERC and the States' electricity regulators remains high and must be addressed promptly. A practical solution would be active synergy and collaborative efforts amongst industry players at all levels. The FGN and the State Governments may issue joint regulations, specifying clear roles, functions, and powers of both regulators, including well-defined processes for the joint implementation of their respective roles and functions, to avoid conflicts and overlaps. The Bill for an Act to repeal the Electric Power Sector Reform Act, 2005 and enact a new Electricity Act which is currently going through the law-making process at the National Assembly might be yet another opportunity to begin to address these and other related issues.