
# Highlights of the NERC Guidelines on Distribution Franchising in the Nigerian Electricity Supply Industry (NESI)

The Nigerian Electricity Regulatory Commission (“**NERC**”) on 2 July 2020 issued the Guidelines on Distribution Franchising in the Nigerian Electricity Supply Industry (NESI) (the **“Guidelines”**). This followed the Consultation Paper on the Development of a Regulatory Framework for Electricity Distribution Franchising in the Nigerian Electricity Supply Industry (NESI) published on 17 April 2019.

The distribution companies (“DisCos”) have inherent powers under their respective licence terms and conditions to cede any part of their functions to third parties subject to the approval of NERC. The Guidelines therefore provide the regulatory framework to achieve this objective. This briefing note provides a highlight of the key provisions of the Guidelines.

1. **The Applicable Distribution Franchise Models**

NERC has identified the following franchising models in the Guidelines:

a) **Metering, billing and collection**

Here, the distribution function of metering, billing and collection will be outsourced to the franchisee. The DisCo will retain ownership and control of operations and distribution in the distribution area, while the function of metering, billing and collection will be outsourced to the franchisee.

b) **Total management of electricity distribution function in a ring-fenced area**

Under this arrangement, the franchisee will be responsible for maintaining the electricity distribution system in the ring-fenced area. It is expected that the franchisee would possess the expertise and the capacity to invest resources into the upgrade and expansion of the distribution system.

c) **Total management of distribution feeders including billing and collection**

Under this arrangement, the franchisee will be responsible for maintaining the distribution feeders including billing and collection in the franchised area system in the ring-fenced area.

d) **Loss reduction and provision of embedded generation**

In addition to the functions mentioned above, this model allows the franchisee access to procure further energy, either through bilateral arrangements over the transmission network (TCN grid), or embedded at local distribution networks level, to meet the electricity deficit (or peak demand deficit) of customers within the allocated area.

Under the Guidelines, NERC has the discretion to consider other innovative franchise models provided by DisCos which is not been included in the list. The latitude given to the DisCos to develop other franchising models is consistent with the existing rights of the DisCos under their respective licences to cede any part of their licence obligations to a third-party subject to the approval of NERC.

**2. Eligibility Considerations**

Prior to proceeding with a franchise arrangement, the DisCos are required to obtain a 'No Objection' from NERC. There is no timeline within which NERC is mandated to give its approval or 'No Objection', but NERC is required not to unreasonably withhold its approval. In considering the application by a DisCo for 'No Objection' to proceed with a franchising arrangement under any of the models or approved innovative model, NERC will consider the following:

a) **Commercial arrangements which include the following considerations:**

**i. Applicable tariff**

The applicable tariff under the franchise agreement is generally to be determined in line with prevailing MYTO. Keeping the tariff in the franchise areas within the MYTO threshold may disincentivize investors who would be looking at getting the franchise in order to charge a premium above MYTO. The ideal scenario would be to allow such ringfenced franchise areas to have a tariff that is not tied to the MYTO benchmark.

**ii. Procurement of additional generation capacity**

The procurement of additional generation capacity for any franchised area through a bilateral contract or embedded generation option shall be in compliance with NERC's prevailing orders, regulations and guidelines. With this provision, it appears that the procurement of any additional generation capacity by a DisCo for the franchise scheme must also comply with the Regulation on the Procurement of Generation Capacity. This regulation, amongst others, requires that such procurement of additional capacity by a DisCo must be subject to a competitive process and the prior approval of NERC.

**iii. Requirement for public consultation**

DisCos are required to hold customer consultation where additional generation capacity will result in a higher tariff. NERC may also conduct public hearings to determine prudence on the part of DisCos in procuring additional capacity. This means that unless there is an express willingness of the consumers in the franchise area to opt for a higher tariff, the franchisee is obligated to maintain the MYTO level tariffs.

b) **Contractual arrangements which include the following considerations:**

**i. Content of a franchise agreement** -

Whilst no template franchise agreement ("**FA**") has been provided by NERC, the Guidelines provide certain mandatory provisions that should be included in the FA. The DisCo is required to provide base data for the franchise area prior to entering into the FA. The FA is to provide for any amount payable by the franchisee, expected capital expenditure, tenor of the FA (which shall not exceed the tenor of the DisCo's license), cancellation terms, remedies for failure of franchisee, technical delineation of franchised area, asset register, trading point, treatment of legacy contracts, reporting obligations, metering arrangement, termination and a dispute resolution mechanism. These provisions are to serve as a guide in drafting the FA.

**ii. Payment security**

As part of the franchise arrangement, the parties are to ensure the securitization of the franchisee's payment obligation in a form acceptable to the DisCo to ensure that the DisCo's obligation to the market is not compromised by virtue of the franchise arrangement.

**iii. Competitive procurement**

DisCos are required to engender as much competition as practicable in planning a franchise arrangement, by adopting an open competitive approach in the engagement of prospective franchisees.

**iv. Prohibited parties**

Parties related to a DisCo as directors and shareholders are expressly barred from entering into a FA with the relevant DisCo.

**3. Revocation of Franchise Arrangement**

The Guidelines provide that NERC may, on its own accord or based on a third-party petition, conduct enquiry into a franchise arrangement. On the basis of any of these, a public hearing could be held by NERC prior to the issuance of an order of revocation. Upon revocation, the DisCo will be required to continue the provision of electricity services previously performed by the franchisee. In addition, all compensations and settlements accrued to a franchisee or a DisCo for unamortized investments shall be made in accordance with the provisions of the FA. The grounds for revocation as provided in the Guidelines are as follows:

i. the franchise arrangement is being operated in a manner that willfully or unreasonably contravenes any provisions of Electric Power Sector Reform Act 2005, licence terms and conditions of the distribution licensee, regulations and orders of NERC, Market Rules and Network Codes;

ii. the franchisee is carrying on business in a form or manner which constitutes an immediate threat to public health and safety; and

iii. any circumstance which renders it necessary in the overriding public interest to suspend the FA.

The Guidelines provide the desired regulatory certainty and may open up the DisCo space for additional investment and upgrade of DisCos' infrastructure by interested third-party investors. The franchise regime is also likely to stimulate investment embedded generation to provide additional generation capacity for the franchise areas.

One of the important points to note is that notwithstanding the involvement of third parties, such entities will operate under the relevant DisCo's electricity distribution licence and the responsibility for compliance with the licence terms and conditions will remain with the licensee. This means that the obligations that flow to the DisCos in consequence of their DisCo licence shall continue to reside with the DisCos.

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