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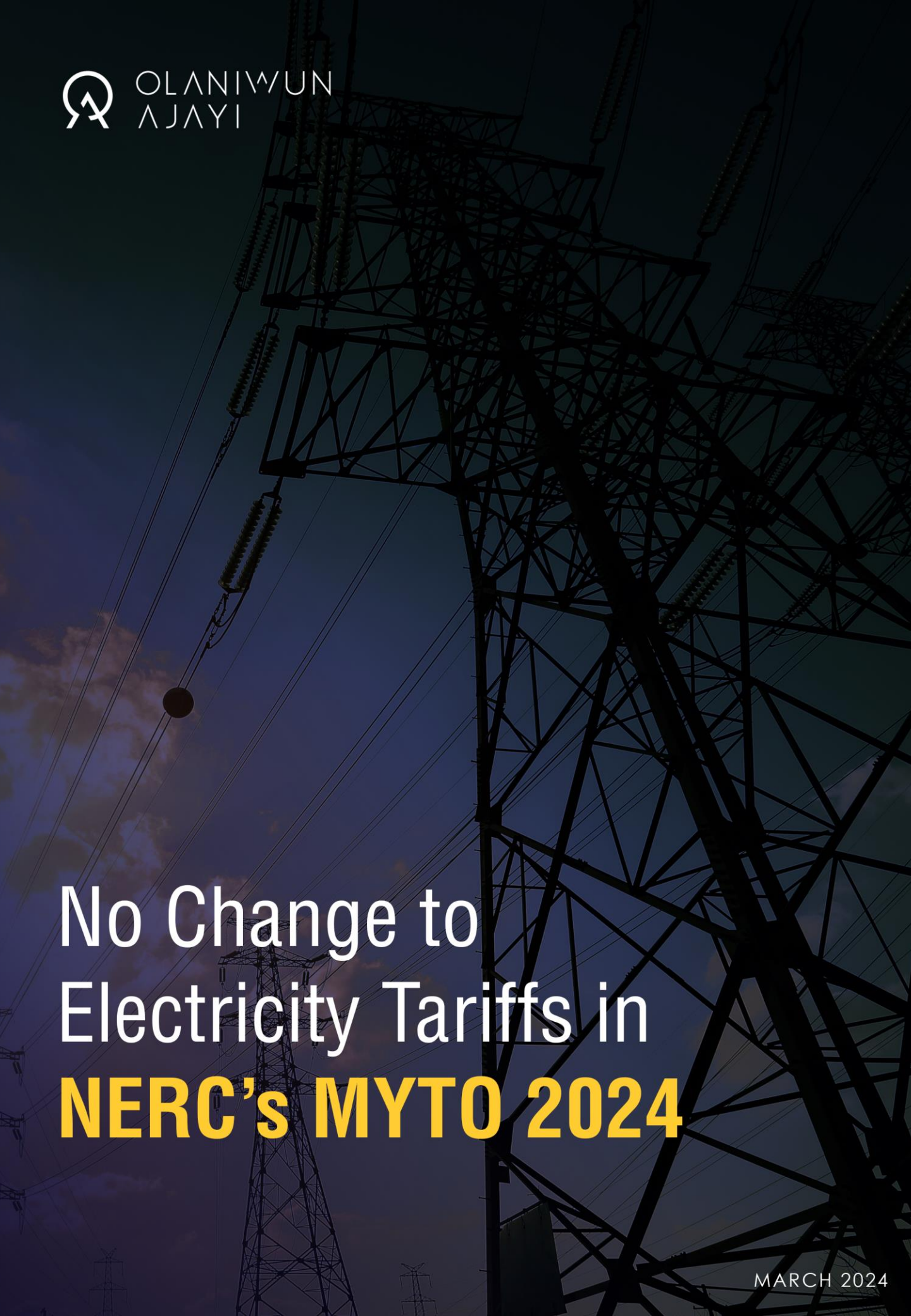

No Change to Electricity Tariffs in NERC's MYTO 2024

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Power Newsletter

INTRODUCTION

In December 2023, the Nigerian Electricity Regulatory Commission (**NERC**) debunked claims that there had been a hike in electricity distribution or end-use tariffs in Nigeria.[1] This followed NERC's issuance of a Multi-Year Tariff Order 2024 (**MYTO** or **the Order**) for each of the 11 (eleven) distribution companies (**DisCos** or **Successor DisCos**) in Nigeria, unbundled from the Power Holding Company of Nigeria and privatized in 2013.[2]

Given the changes to macroeconomic indices, such as the Naira to United States Dollar (USD) exchange rate, the rate of inflation in Nigeria, and other tariff variables, NERC received representations from each DisCo for a review of its tariffs to enable DisCos maintain efficient operations in the market.[3]

A significant aspect of the MYTO review is the increment of end-user tariff and a directive not to charge consumers a certain percentage of the tariff, the difference of which will be paid by the Federal Government of Nigeria (**FGN**) as a form subsidy. It is reported that the FGN will be paying the sum of circa N1.6 trillion in subsidy to DisCos to make up the difference between cost reflective tariffs and the actual tariffs payable by consumers, implying that electricity consumers will continue to pay electricity tariffs at December 2022 rates.[4]

While the above portends somewhat positive gains for consumers, it could have broader distortive effects for competition in the NESI as this may not align with the building block approach to designing end-use tariffs adopted by NERC in 2008. In this newsletter, we delve deep into the tariff regime contained in MYTO design, tracing its historic origins from 2008 until MYTO 2024, and considering each element of the tariff framework. We also identify key elements of the design, such as subsidy, which have implications for the NESI.

BACKGROUND TO THE MYTO 2024

Before the adoption of MYTO in 2008 in Nigeria, a uniform pricing structure was used in which the electricity tariff remained fixed for years despite a continuous increase in the price of natural gas. MYTO was therefore introduced as a solution to the uniform pricing structure utilized in the Nigerian Electricity Supply Industry (**NESI**) post privatization.[5]

1. *Oladehinde Oladipo, "NERC debunks electricity tariffs hike rumours from January 1 "https://businessday.ng/energy/oilandgas/article/nerc-debunks-electricity-tariffs-hike-rumours-from-january-1/*
2. *See: MYTO 2024 for each of the 11 DisCos*
3. *Ibid at para. 4.*
4. *Ibid*
5. *Saheed Layiwola Bello, "Evaluating the Methodology of Setting Electricity Prices in Nigeria" (2013) Fourth Quarter, International Association for Energy Economics, 31*

The MYTO was established by NERC in the exercise of its regulatory power as enshrined in section 76(2) of the repealed Electric Power Sector Reform Act 2005 (**EPSRA**) and substantially reproduced in section 116(2) of the EA to the effect that prices for electricity across the value chain of generation, transmission, distribution, and retailing shall be regulated according to one or more methodologies adopted by NERC and such tariff methodologies shall;

i. allow a utility that operates efficiently to recover the full costs of its business activities, including a reasonable return on the capital invested in the business;
ii. provide incentives for the continued improvement of the technical and economic efficiency with which the services are provided;
iii. provide incentives for the continued improvement of the quality of service of DisCos;
iv. give to consumers economically efficient signals regarding the costs that their consumption imposes on the DisCos' business;
v. avoid undue discrimination between consumers and consumer categories;
vi. phase out or substantially reduce cross subsidies over a time frame as specified by NERC; and
vii. promote co-generation, and generation of electricity from renewable energy sources.

In Nigeria, electricity distribution and retail tariffs are bundled as end-use (distribution) tariffs and in 2008 NERC adopted the building block approach to regulate this tariff. Stacked like blocks used in erecting a building, this approach to tariff regulation incorporates all aspects of the projected costs efficiently incurred by electricity distribution companies and includes these as part of the retail (end-use or distribution) tariff. These costs include the cost of generation, transmission, and distribution, while accounting for depreciation, losses, and forecasts of load.[6]

MYTO for electricity distribution and retail provided for a 15-year tariff path for the NESI with limited minor reviews each year in the light of changes in a limited number of parameters (such as inflation, interest rates, exchange rates and generation capacity) and comprehensive revisions every 5 years, when all the inputs are reviewed in collaboration with relevant stakeholders.[7]

Over the years and beginning from 2008, NERC issued several MYTOs for electricity distribution and retailing. The first MYTO (**MYTO 2008** or **MYTO 1**) was issued in 2008.[8] Between 2008 and 2012, NERC missed several opportunities for annual reviews of MYTO 1 due to undue political interference, market instability and the removal of its first Commissioners. In 2012 MYTO 2 was issued.[9] Sequel to this, MYTO 2.1 was issued in 2015.[10] In 2020, NERC adopted MYTO 2020, and following the directive of the Federal Government to reduce end-use tariffs for consumers, the Revised MYTO 2020 was issued in the same year.[11]

6. https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fpubs.naruc.org%2Fpub.cfm%3Fid%3D53B18C6C-2354-D714-5106-A56AB31E6717&wdOrigin=BROWSELINK
7. https://nerc.gov.ng/index.php/home/myto
8. Ibid
9. Multi -Year Tariff Order for the Determination of the Cost of Electricity Sold by Distribution/Retail Companies for the Period 1 June 2012 to 31 May 2017
10. Multi Year Tariff Order 2.1 for the Period 1st January 2015 to 31st December 2018
11. See: Order/NERC/199/2020- Multi Year Tariff Order 2020. See also: Revised Multi Year Tariff Order 2020

To ensure that consumers are paying appropriate rates for the service provided by DisCos, NERC had approved the implementation of the Service-Based Tariff (**SBT**) starting from 1st September 2020. Additionally, NERC had issued the MYTO 2021 Extraordinary Tariff Order, effective 1 July 2021, which considered the capital expenditure proposals of each DisCo over a 5-year plan, in accordance with their performance improvement plans (**PIP**).[12]

MYTO 2022 reiterates the SBT arrangement and the approved 5-year capital expenditure plans of each DisCo, along with the relevant assumptions used to forecast revenue requirements and applicable tariffs for the period of 2021-2026 which is in accordance with the MYTO Methodology and Regulations on Procedure for Electricity Tariff Reviews in NESI. The approved end-use tariff came into effect on 1st January 2022.[13]

HIGHLIGHTS OF MYTO 2024

A historic appraisal of the MYTO regime was necessary as much of the principles, assumptions, building blocks and macroeconomic variables in MYTO 2024 have been retained since 2008 when MYTO 1 was issued.

Application Filed by DisCos

The Order is issued further to the application of DisCos for an upward review of end-use tariff in Nigeria pursuant to section 116 of the EA. Much like price cap regulation which sets a limit on what utilities can charge consumers, DisCos have filed applications for NERC to approve changes to tariffs based on increased cost of operations as gleaned from changes in macroeconomic conditions in Nigeria, and the need to meet other obligations. In summary, each DisCo's claim was based on:

i. changes to the Nigerian and United States inflation and foreign exchange rates;
ii. the need to reset ATC&C losses, and in connection with this, each DisCo filed an application for a loss trajectory;
iii. the plan to deploy meters to end-users, with the figures also differing amongst DisCos;
iv. commitment to execute capital projects that will enhance DisCos' consumer experience in their franchise areas. In this regard, the projected expenditure filed differed from DisCo to DisCo;
v. the need to revise operating expenditure; and
vi. the plan to exit NBET's Vesting Contract regime and thereby permit each DisCo to procure electricity directly from generation companies (**GenCos**).[14]

12. *See: MYTO 2022*
13. *Ibid*
14. *Ibid. See MYTO 2024 for each of the 11 DisCos in Nigeria.*

NERC's Oder Further to Application Filed by DisCos

Expectedly, NERC did not approve the exact figures filed by each DisCos but has placed a cap on the figures based on its assessment and from available data obtained from secondary sources. In reaching its decision, NERC considered the rate of inflation in Nigeria and the United States premised on data from the National Bureau of Statistics and the United States Bureau of Labor Statistics. Also considered were the Naira to USD exchange rate, contracted energy offtake, gas price and the difference between actual capital expenditure (**CAPEX**) utilization and MYTO CAPEX provisions.[15]

Accordingly, the following building blocks were used to determine the projected revenue requirement of each DisCo from 1st January 2024 to 31st December 2027. These include generation cost, Transmission Company of Nigeria (**TCN**) and administrative cost, system operations cost, market operations cost, ancillary cost, and DisCo cost. With regard to the tariff review variables for the determination of end-use tariff, NERC utilized the following variables for each DisCo;

a) **Loss Target-** which varied from DisCo to DisCo. While each DisCo had filed its perceived loss target, NERC approved a lower threshold. For Eko DisCo for instance, NERC approved a loss target of 14.18%, 20.7%,16.88%, 14.19% and 11.93% for the years 2023,2024,2025,2026 and 2027 respectively.
b) **Nigeria Inflation-** flat rates between 2023 and 2027 were adopted for all DisCos.
c) **US Inflation-** like Nigerian inflation, a flat rate was adopted for all DisCos.
d) **Naira to USD Exchange Rate-** same for all DisCos for all years.
e) **Transmission Loss Factor-** the same for all DisCos.
f) **Energy Delivered to DisCo in GWh-** this varies amongst DisCos.
g) **Energy Delivered to DisCo in MWh/h-** this also varies amongst DisCos.
h) **Generation Cost-** this varies amongst DisCos.
i) **Transmission and Administrative Cost-** this also varies amongst DisCos.

It is important to note that whilst the above variables have been applied by NERC to determine cost reflective end-user tariffs for all DisCos, NERC has approved a lower tariff for end-users in line with the policy directive of the Federal Government of Nigeria (FGN) to subsidize electricity for end-users. In connection with this, the FGN has pledged that it will pay for the difference between the cost reflective tariff and allowed end-use tariff through electricity subsidy. With this policy, the estimated subsidy benefit for customers under Abuja Electricity Distribution Company (AEDC) franchise in 2024, for instance, is approximately NGN 233.26bn (i.e., NGN 19.44bn monthly). Remarkably, the allowed tariffs have been frozen for all customers at the rates payable since December 2022.[16]

15. *See para. 12 MYTO 2024*
16. *See para 22 MYTO 2024.*

OUR THOUGHTS

Whilst MYTO 2024 retains several provisions from previous MYTO regimes, it does introduce key innovations or modifies pre-existing MYTO regimes. This throws up several issues that will require further in-depth consideration in this section.

1. Electricity Subsidy

As seen above, MYTO 2024 provides that further to the policy directive of the FGN, the FGN will be making payment for the difference between cost reflective end-use tariffs and the actual tariffs paid by consumers. It is expected that to achieve this, NBET will issue energy invoices to each DisCo net of the applicable tariff shortfall approved by NERC monthly, while the Market Operator (MO) will issue the full transmission and administrative services invoices to each DisCo at the applicable tariff.[17]

However, this would seem antithetical to the provisions of the EA. While in accordance with section 116(3) of the EA, NERC is to take into account any subsidy provided by the Power Consumer Assistance Fund (PCAF) or from any other source, whether direct or by way of favorable financing terms, or in any other manner, in establishing its tariff methodologies, by virtue of section 117(1) of the EA:-

> *Notwithstanding anything contained in this Act, if the Federal or State Government, as the case may be, desires to grant any subsidy to any consumer or class of consumers in the tariff determined by the Commission under this Act, such subsidy by the Federal or State Government or cross subsidies shall, in order to avoid undue exposure of licensees to speculative revenues, be implemented within the Power Consumer Assistance Fund established under this Act.*

Thus, subsidies granted end-users by the Federal Government should be paid into and applied from the PCAF and not through netting off energy supplied to DisCos by NBET.

Also, an important consideration for the application of subsidy is that it should be specifically targeted at the poor. While Nigeria has a high poverty rate, and the application of subsidy in the electricity sector could assist the poor to cushion the effect of high electricity prices, there is no denying the fact that to avoiding the distorting effects of subsidy on competition in the electricity market, subsidy must be specifically targeted at the poor.

It is noteworthy that the FGN has sustained subsidizing electricity in the electricity sector amid a face-off with the Nigeria Labour Congress (**NLC**) on the impact of the already removed petroleum subsidy.[18] But the point is unmistakable that all forms of energy subsidies, to be properly applied, must be directed at those who need it most. In this regard, the FGN must collaborate with NERC for an effective tariff design which includes subsidies specifically targeted at the poor and relieves the government budget for other capital projects. For instance, the cost of electricity subsidy for the government in 2024 alone is N1.6 trillion.[19]

17. *See para 25 MYTO 2024*
18. *https://www.icirnigeria.org/nerc-approves-electricity-tariff-hike-affirms-n1-6trn-power-subsidy-for-2024/*
19. *Ibid*

ATC& C Losses

ATC&C losses consist of three components:

i. Technical Loss: loss due to the dissipation of thermal (heat) energy resulting from the transportation of electrical current through distribution lines, as well as the decrease in energy during the conversion process in transformers.

ii. Commercial Loss: Losses that occur due to errors in meter readings, incorrect billing, consumption that is not measured by meters, or instances of energy theft.

iii. Collection Loss: unpaid electricity bills.[20]

ATC&C loss provides a consolidated report on the revenues collected by DisCos in comparison to the expected revenue of DisCos, based on energy sold to consumers. This report is crucial in calculating the permitted tariffs of DisCos, which account for the anticipated losses incurred by DisCos in distributing electricity and providing services to end-users.[21]

ATC&C losses have historically been minimized under the MYTO regime in NESI. For instance, none of the 11 Successor DisCos have been able to meet the efficiency loss targets set in successive MYTOs. In the third Quarter of 2023 (Q3/2023), for instance, the ATC&C loss incurred by DisCos in that quarter was 39.45% on the average, comprising - technical and commercial loss (20.91%) and collection loss (23.44%), when in fact the average efficiency loss target set by MYTO for all 11 DisCos was 20.06.[22] This leaves much to be desired.

It is important to note that for the representations made by DisCo to review the mechanics of MYTO 2022, each DisCos flied its proposed individual loss target. However, NERC has approved a lower threshold for each DisCo. While a lower threshold will provide incentives for DisCos to reduce ATC&C losses, the threshold imposed by NERC should be one that can realistically be met by DisCos. To reduce ATC&C losses, DisCos have also filed for capital investments to close the metering gap and scale investments in the electricity distribution networks. Only with time can it be ascertained if the rates approved by NERC will allow these utilities to meet costs, indebtedness to financiers and earn a return of investments.

20. NERC Quarterly Reports, Q3, p. 34
21. NERC Quarterly Reports, Q3, p.5
22. NERC Quarterly Reports, Q3, p.5

Automatic Monthly Adjustments of Tariffs

This is the first time NERC is making an order for automatic monthly adjustments of electricity tariffs in Nigeria.[23] In accordance with the MYTO issued by NERC, minor reviews were expected to be undertaken semi-annually, and major reviews once every five (5) years. [24]

Going forward, DisCos revenue requirements and associated tariffs will be subject to monthly adjustments to allow for changes in inflation rates, Naira/USD exchange rates, and gas-to-power prices. While NERC has not been consistent in its minor reviews of rates in line with macroeconomic trends, the frequent reviews of end-use tariffs will portend benefits and pitfalls, and these include:

Merits of frequent update on end-use tariffs

i. It will enable DisCos to recover their full efficient cost almost immediately without pushing it to a future date.
ii. It may improve the financial viability of DisCos.
iii. It may reduce the incidence of rate shock and guarantee lower cost of electricity services to consumers over the long term due to low impact of finance costs.
iv. It could provide incentives for DisCos on the continued improvement of service delivery to end-users.[25]

Demerits of frequent update on end-use tariffs

i. It may reduce DisCos' incentive to control costs.
ii. It will lead to consumers immediately bearing the full impact of risks associated with macroeconomic changes in the economy.
iii. It is more susceptible to more disputes, and likely to lead to the utilization of more resources on the part of NERC and DisCos.[26]

Minimum Energy Offtake and Transition to Bilateral Contracts

MYTO 2024 acknowledges the revision of the partially contracted capacity of DisCos to guarantee each DisCo's minimum energy offtake starting from 1 January 2024. Accordingly, NERC has ordered DisCos to obtain sufficient bilateral contracts to smoothly transition from NBET's vesting contract regime. Thus, beginning in January 2024, DisCos will not be able to seek compensation for revenue losses caused by generation shortfalls.[27]

The transition to a more competitive market and the powers of NERC to order NBET to novate existing contracts in the NESI are very well recognized in the EA.[28] While there are circa 28 grid-connected operational GenCos and 12 grid-connected DisCos in NESI showing a sufficiently large number of potentially competitive entities[29] recent statistics indicate that only three DisCos are creditworthy to contract directly with GenCos.[30]

23. *See para 23 of MYTO 2024*
24. *https://nerc.gov.ng/index.php/media-library/public-notices/511-notice-of-review-of-the-multi-year-tariff-order-myto-methodology-2017*
25. *NERC, Consultation Paper for the Review of MYTO Methodology May 2017 p. 6-7*
26. *Ibid p. 7*
27. *See MYTO 2024, para. 17*
28. *See section 7 of the Electricity Act 2023.*
29. *NERC, Market Competition Report 2022, at p. 22*
30. *Ibid at p. 53*

Accordingly, it might be pre-mature for NERC to order DisCos that have not reached creditworthiness to enter bilateral contracts with GenCos. The potential for increased competition and the creditworthiness of each DisCo will have to be assessed for NERC to make an order on bilateral contracting. Otherwise, DisCos and GenCos alike will incur indebtedness due to the inability of DisCos to recover funds from the market.

CONCLUSION

The issuance of MYTO by NERC on 28th December 2023 creates a new legal order in the tariff regime for the NESI. By the said Order, NERC has approved an upward review of end-use tariffs in Nigeria. However, Nigerians will not be bearing the brunt of the increase at this time as the FGN will be making up for the difference between the actual tariffs paid by consumers and cost reflective tariffs approved by NERC through electricity subsidy. Importantly, the adoption of MYTO 2024 throws up several issues, some of which have been considered in this newsletter; including the legal validity of not paying subsidies from PCAF, the potential impact of minimizing ATC&C losses, the benefits and drawbacks of reviewing the macroeconomic components in the tariff design once every month, and the likely premature consequence of moving to a bilateral contracting arrangement for DisCos which have not attained creditworthiness.

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