

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

EXECUTIVE SUMMARY

This executive summary mainly states the findings of the review of the Nigeria Electricity Regulation Commission Mini-Grid Regulation 2016 carried out by the firm of Vale Partners (Barristers & Solicitors) undertaken on behalf of Heinrich Böll Foundation (“HBF”). The executive summary highlights the material issues identified by the legal review team. In order to make the exercise foolproof, we have also considered the views of practitioners working with the DISCOs as well as those of our clients who are foreign investors seeking to participate in the development of the sector in Nigeria.

In bullet points, we list in this section the areas of concern and what can be done to address the issues:

- The operators of isolated mini-grids must pay regard to the expansion plans of the Discos and also obtain their written consent stating that they area to be covered will not fall within their five-year expansion plan. The problem with this requirement is that the Discos have not deposited their expansion plan to the Commission and if their commitment to providing prepaid meters to customers can be used to assess their performance, it is doubtful if any Mini-grid developer will have their expansion plan and written consent. Our proposition is that the commission should give them a stipulated time to provide the expansion plan failing which the commission will have to approve the application of the Mini-Grid developer who is seeking to invest in the sector. Furthermore, where consent is withheld unreasonably, the commission should play its role to provide the consent.
- For interconnected mini-grid developments, the need for a Tripartite agreements is welcome; but the regulators are not paying regard to circumstances whereby the Discos are frustrating the negotiations and they are making it impossible to for such agreements to be reached. The Commission must serve as an umpire in such cases and mediate between the parties.
- The inspection and accounting regimes proposed are too cumbersome for small mini-grid investors and can become unnecessary over-regulation. While the intention of the commission is salutary, it should be wary of over-regulation which is not in the best interest of any of the parties.
- The MYTO proposed to be adopted should be incorporated into the regulation or the formula to be adopted for the tariff regime.

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

- The most germane issue is about the expansion of the network of the Discos, from our analysis and after speaking to industry practitioners, we are of the view that the sections will deter investment in the sector. For example, it is obvious that no investor will be favourable to the idea of having his/her investment taken over within five years or more. From experience, it is around the fifth year that any mini-grid can begin to attain the optimal return on investment.
- The provision can also lead to claims against the country for expropriation of assets by foreign investors especially those who have made investment decisions prior to the emergence of the regulation.
- In our opinion, we believe that in order to meet the national renewable energy target, renewable energy projects should be allowed to run side-by-side with the Discos in any particular location where they can be mutually supportive of each other.
- Overall, the regulation should be given more consideration because in its current form, it will not deliver the required energy mix for the country and will also frustrate future investment in the power sector in the country. As a matter of fact, there is no investor that will be willing to invest knowing fully well that the investment can be scrapped or be subjected to hostile take-over within a period of five years or more.

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

SCOPE OF THE REVIEW

The scope of work of the Legal team in the review of the Mini-Grid Regulation 2016 includes the following:

- How the regulation can help to respect the rights of DisCos, the rights of investors and the rights of communities to have power.
- Whether the regulation facilitates the installation of mini-grids in estates, with estates or communities being regarded as driving elements in the pioneer market for mini-grids. The analysis will cover the nature of Distributed Power units.
- How the regulation covers the accountability and transparency of DisCos vis-à-vis their commitments, expansion plans, access to this kind of information which should be public information and whether non-performance by DisCos will translate into market opportunities for mini-grid operators as a matter of rule.
- Whether the tripartite agreements between community, DisCo and mini grid investors are workable; citing current practice in the field.
- Whether the regulation has taken into cognisance the need to align with Renewable Energy Action Plan for the country.
- Whether the Regulation in its current form does not breach the existing Bilateral Investment Treaties that the country has been signatory to and, indeed, other international treaties on foreign direct investment.

This report summarises the findings of the team and should be read in conjunction with the full text of the Regulation to be able to obtain a complete understanding of our findings. However, we are dealing with the review seriatim.

PREFACE THE REGULATION

“The Regulation provides for permit and tariff approval procedures which will ease the administrative burden on the Mini-Grid Operator and ensure the process of obtaining the permit in a timely manner with minimal requirements from NERC. The Distributed Power of the Mini-Grid determines the regulatory procedure to be followed. For Distributed Power of up to 100kW, a permit is optional for the Mini-Grid Operator; while for Distributed Power of over 100kW and installed Generation Capacity of up to 1MW a permit, will be required. Beyond that limit, a full licence is required which is outside of the scope this regulation and is taken care of by other already existing regulation.”

- We are of the opinion that the Regulation does not ease the administrative burden on the Mini-Grid Operators rather it will operationally stifle investment in Mini-Grid projects in Nigeria as the requirements for Permits are quite onerous.

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

Looking at the Preface to the Regulation, the intention is to minimize two risks that Mini-Grid Developers can face namely:

(i) Protection from sudden tariff changes

(ii) Stranded Mini-Grid investments due to coverage of Mini-Grid area by Discos. It seeks in principle to guarantee 'Fair Compensation for Mini-Grid Investors.'

- Unfortunately, there is nothing in the Regulation that supports that intention.

3. Interpretation & 4. Application of the Regulations

The definition of **Mini-Grid** in section 3 is used to include:

“any Isolated or Interconnected Mini-Grid generating between 0kW”. Since by virtue of section 4(1) of the Regulation, the Regulation is applicable to Mini Grids with generation Capacity of 1MW,

- We suggest that the definition of Mini Grids under section 3 should exclude any Isolated or Interconnected Mini-Grid generating between 0kW.

6. Geographical Delineation of Distribution Systems

6 (3) “A Mini-Grid Developer applying for a Mini-Grid Permit shall submit to the Commission an accurate description of the proposed distribution and generation system, including geographical depiction.”

- The Geographical depiction will make the operation of Mini-Grids cumbersome for Mini-Grid Developers and Operators as they would have to be making several applications and request for permits even within a State where there is more than 1 Disco. This can arise in Lagos State, for example. It would have been more convenient if the permit covers basically unserved area or underserved area without Geographical depiction.

6(5) “In case of different Feeders being connected to the same generator, the Commission may define each Feeder a separate Mini-Grid or all feeders together as one Mini-Grid as long as the aggregate power generated and distributed through these feeders does not exceed 1 MW.”

- Will this provision be applicable where the different Feeders connected to the same generator are operated by different Mini-Grid Operators? Where the Feeders are connected by different Mini-Grid operators and the production capacity of each is less than 1MW will this regulation be applicable?

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

- We are of the opinion that the Regulation should not apply where the different Feeders connected to the same generator are operated by different Mini-Grid Operators as such the different Feeders connected to the generator should not be treated as one Mini-Grid.

7. Isolated Mini-Grids larger than 100 kW of Distributed Power and up to 1 MW of Generation Capacity

7 (1) (b) - "confirmation of the Distribution Licencee's expansion plans approved by the Commission through the Commission to ensure that the Mini-Grid activities will not interfere with the expansion plans into the designated Unserved Area;"

- Since it is the responsibility of the Commission to approve the expansion plans, the confirmation of expansion plans should not be the responsibility of Disco but that of the Commission as the Commission being the approving authority ought to have the expansion plans of the areas being covered by each Disco,
- If it must be the responsibility of Discos to confirm the expansion plans as contained in the draft, then there should be an enforcement mechanism by the Commission that would make the Discos submit their expansion plans. The commission is also to maintain an updated deposit of such expansion plans to check unreasonableness on the part of Disco where the confirmation is not forthcoming.
- It is also important to add that industry experts have confirmed to us that none of the DisCos has existing expansion plan anywhere. In essence, this would mean that no one will be able to make progress because there requirement to have the expansion plan will become a bottleneck for Mini-Grid Investors.
- However, if there is no expansion plans (as we have confirmed that none of them has an expansion plan) and the Discos are not up to speed in the submission of their expansion plans what is the way out?

7(1) (c) - "written consent of the Distribution Licencee of the intended area where the operational period of the Mini-Grid Developer will be within the five year expansion plan of the Distribution Licencee;"

The issue here is that a typical Disco might unreasonably withhold the written consent or give unachievable conditions for them to give the written consent. As a result, we are proposing:

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

- It should be included under that provision after Licencee that “such consent not to be unreasonably withheld”
- We suggest that there should be a time line within which the Disco must provide the expansion plans and also provide the written consent. They must not be allowed to ignore the request for written consent without penalty. They should be given a timeframe to provide the written consent or refuse to provide the consent giving reasons for their refusal. The Commission, in the case of refusal should have the final decision on the matter.
- We also suggest that there should be penalty of fine where the Discos fail or neglect to provide the expansion plans. Where a Disco unreasonably withheld its consent, the Commission should have overriding power to grant the consent after a specified timeframe.

9. Interconnected Mini-Grids

9(1) “For an Interconnected Mini-Grid, the Connected Community, the Mini-Grid Developer and the Distribution Licencee have to sign a Tripartite Contract which becomes binding for all parties upon approval by the Commission. The Commission may approve the Tripartite Contract mentioned in S. 6(2) above upon the fulfillment of the following conditions -”

- This provision is based on the assumption that the negotiating the agreement will be easy. From the experience of working in the sector, the experience has been that the Discos will not concede to any project going ahead in any connected communities.
- We suggest that NERC should adopt innovative approach in formulating the conditions so that interconnected communities and the Mini-Grid Developers will not be at the mercy of the Discos. Discos can wield monopoly power unless closely regulated and required to provide non-discriminatory third party access.
- Where agreement becomes impossible to reach as a result of the non-cooperative attitude of Discos what can the way be out?
- Some of the mandatory conditions in the Tripartite Contract as contained in the template in Annex 11 and the other templates offend the principle of **Freedom of Contract**. The freedom to enter into contract got an express approval in the Supreme Court case of *Merchant Bank Nigeria Ltd v. Adalma Tanker* (1990) 5 NWLR (pt. 153) 747 where the court said that the parties are bound by their agreements and the court will not rewrite the contract for the parties. See also **Union Bank of Nig Ltd. & Anor. v.**

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

Nwaokolo (1995) 6 NWLR (pt 400) 127. The principle of freedom of contract was reinforced by Cohen who said:

The view that in an ideally desirable system of law, all obligations would arise only out of the will of the individual contracting freely, rest not only on the will theory of contract but also in the political doctrine that all restraint is evil and the government is best which governs least N.J Dion 1932 46 Harvard Law Review 558.

- The law of contract is the basis of all economic activity in a modern society. The concept is that the terms should be left to be determined by the parties, less regulated by statutes or courts, except to protect the weak and young from exploitation.

9(1) (b) the proposed retail tariff is calculated using the MYTO methodology, agreed by the Mini-Grid Developer, the Distribution Licencee and Connected Community and approved by the Commission;

- MYTO methodology is not defined in the Regulation or Annex 15, for clarity it should be defined.

13. Inspection of accounts for the purpose of adjustment of tariffs and ascertaining depreciated value

(1) Any Person authorised by the Commission shall be entitled to inspect and verify the accounts of a Mini-Grid Permit Holder at any reasonable time and the Mini-Grid Operator shall be under obligation to render all necessary assistance, including provision of required documents to the Person so authorized to inspect the accounts.

- Instead of "at any reasonable time", we are of the opinion that it should be "upon reasonable notice" any reasonable time is nebulous and is capable of causing confusion

19. Interconnection of the Distribution Licencee's Network to an Isolated Mini-Grid operated under a Permit and Re-integration of Interconnected Mini-Grid into a Distribution Licencee's Network

19 (i) Each Mini-Grid Permit Holder shall operate in the geographical area specified in its Permit or Tripartite Contract as applicable

- Comments as in 6(3) above regarding the geographical depiction.

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

Where a Distribution Licencee extends its network to an Isolated Mini-Grid operated under a Permit, two options are available to the Mini-Grid Permit Holder:

(a); or

(b) Transfer all assets the Isolated Mini-Grid Operator does not want to remove from the Mini-Grid system to the Distribution Licencee in return for compensation. Where the Mini-Grid Permit Holder elects to take this transfer option, the compensation mechanics shall be as follows:

This section does not envisage the fact that there could be hostile take-over of assets on the part of the Discos. The idea that the Discos can choose to extend their distribution network within five years or shortly thereafter negates the need to obtain their expansion plan. In our opinion, the reason they provided their expansion plan was to keep Mini-Grid developers in the know of where it would be safe to have their deployment without running foul to the expansion plan of the Discos. As a result:

- We suggest that it is counter-productive to allow the take-over of assets within any period of less than fifteen to twenty years after their Mini-Grid operators have been able to recoup their investment.
- We therefore suggest that Mini-Grid operation should co-exist with Discos without a takeover due to expansion plans of Discos.
- 19(2)(b) of the Regulation is a complete disaster because there is no Mini-Grid Operator that plans to run its deployment for only 5 years. The provision allows for take-off or removal of asset within a period of five years contradicts Section 7 (1) (b) and (c).
- We suggest that the provision should be removed from the Regulation. If the Discos had already given consent for the Mini-Grid Operator with the written consent indicating that they do not intend to have their connection there within five years, it is difficult to understand why they can still come into the area within five years and take over the assets or ask the Discos to remove their assets.
- As a matter of fact, in the case of foreign investors in the Mini-Grid sector, this might potentially lead to international uproar against the country and also breach our international obligations under the Bilateral Investment Treaties (BITs) that the country has signed with other nations. Without exaggerating the consequences, it could lead to cases of expropriation against the country in international investment tribunals. Such

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

unintended outcome does not portray the country in the true light as an investors-friendly nation.

- Industry sources are also perturbed about this provision especially because it is proposing to treat mini-grid operators less favourably compared to other players in the sector who enjoy longer period to recoup their investment.
- The compensation mechanism for de-commissioned Mini-grid asset is unclear under the regulation and it would lead to avalanche of cases in the Nigerian courts, which is not good for the investors or for the country.
- Another downside of this provision is that it is totally in formulated without any consideration for our obligation under the various Renewable Energy Frameworks that Nigeria is part of. As a matter of fact, it is an affront to our National Renewable Energy Action Plan.
- Learning from the experience of other developed countries who have set achievable targets for a sustainable energy mix, the regulation ought to have considered the possibility of providing incentives for the roll-out of more Renewable Energy Mini-Grids that can generate more Megawatts of electricity either to be fed to the national grid or sold directly to the Discos.

20. Determination of Tariffs and Other Charges *Retail Tariffs*

- For Mini-Grid Permit Holders, retail tariffs and other charges are determined using the MYTO methodology included in Annex 15 and approved by the Commission subject to a limitation of
- Comments as in 9(1) (b) above

21. Exclusivity Period and Site Reservation for Project Development Purposes

- Although the provision of section 21 says the community may grant an exclusive right to developers to develop an Isolated Mini-Grid and an Interconnected Mini-Grid project, the requirements in clause 21(2) as well as clause 5.1.1.1 under the duties and obligations of the parties in annex 1B makes installation of mini-grids practically unachievable in estates. It is a tall order to obtain endorsement letter from the State Government.
- The provision on termination in clause 8 of Annex 1B is not helpful also to the Mini-Grids developers.

VALE PARTNERS

**REVIEW OF NIGERIAN ELECTRICITY REGULATORY
COMMISSION REGULATIONS FOR MINI-GRIDS 2016**

It is obvious that the Regulation does not consider these other issues:

- The life span of a typical Mini-Grid might be about 20 years minimum. De-commissioning the asset within five years is counter-productive and it is doubtful if anyone would be willing to invest in the sector based on those terms.
- The regulation did not pay any particular attention to the Renewable Energy Action Plan of the country and the need to have a robust energy mix in the country. The NERC did not regard the fact that for a country of 170 million people, we need diverse power generation sources and that renewable energy coming from either grid connected or off-grid sources will help to achieve the objective of meeting the energy needs of the populace. For example, rather than de-commissioning and scrapping assets that can still generate power for the people and contribute to energy supply in the country, it would be more productive to allow the energy generated to be fed into the national grid at a tariff that can assist the investors to recoup their investment over a longer period. The NERC should design a framework that will make it possible for the Bulk Power Purchaser to buy from the Mini-Grid Developers at a price to be agreed with a view to allowing their to have returns on their investment.

By embracing such change for the better, the confidence of investors in Renewable Energy market will be renewed and sustained.

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