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Nigerian Electricity Trading Market

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The Nigerian Electricity Supply Industry (NESI) is a critical pillar of the nation's economic development, facilitating industrial growth and improving standards of living. Over the years, NESI has undergone substantial reforms aimed at enhancing efficiency, increasing private sector participation, and fostering competition. Central to these reforms is the structured progression of the Nigerian Electricity Market (NEM) through distinct developmental stages.

Section 6 of the market rules outlined three market development stages —Pre-transitional, Transitional, and Medium-term Market— designed to steer the NESI away from the monopoly-driven framework towards a fully competitive and effective electricity market. Each stage is supposed to represent a significant step towards establishing an efficient, reliable, and sustainable electricity supply market.

Pre-transitional Stage

The pre-transitional stage officially commenced with the sale of the successor generation and the divestment of 60% majority stake in distribution companies in 2013.

The sector however continued to suffer technical losses due to aging infrastructure and inadequate maintenance, as well as commercial losses from electricity theft and consumer nonpayment, which impacted the overall performance and reliability of electricity supply.

The regulatory framework was also still evolving at this time, causing uncertainty and delays in the implementation of crucial reforms.

The Nigerian Electricity Regulatory Commission (NERC) therefore issued the Interim Market Order to manage revenue shortfalls caused by non-cost-reflective tariffs and high ATC&C losses and prepare the market for the Transitional Electricity Market (TEM) . The order created interim market rules and procedures to oversee the operation of the electricity market during the transition period.

Transitional Stage

The transitional stage commenced on the 1st of February 2015 with the aim of making the Nigeria electricity market more competitive and efficient.

All electricity trading arrangements were carried out through contracts, with the Nigerian Bulk Electricity Trading Plc (NBET) serving as the sole wholesale trader responsible for purchasing electricity in bulk from generating companies and independent power producers (IPPs) and reselling it to distribution companies (DisCos) under vesting contracts.

Vesting contracts ensure that all load participants receive some allocation, regardless of their ability to pay. Analysts have argued that this arrangement weighed more on the social than commercial side and this impacted the efficiency of the electricity market.

As a result, many discos were unable to pay their full invoices. Those who paid were discouraged by those who paid little, especially when no steps were taken against defaulters. This may have contributed to the market's liquidity crisis. NERC therefore introduced the Minimum Remittance Order (MRO) and, later, an escrow account system to ensure market participants' financial commitments are met.

Medium-Term Market

The Medium-Term Market Stage is a watershed moment in the history of Nigeria's electricity market, following a transitional era dominated by the NBET's central role. As the sector steadily shifts further away from its erstwhile monopolistic framework, this stage pushes forward key developments meant to boost market competition, improve flexibility, and support long-term viability.

Section 6.5.2 of the market rules states that "The Medium-Term Market will, among other things, reflect flexibility in the design of bilateral contracting through the implementation of the balancing market where each Participant will be able to buy and sell the difference between metered quantities and contracted quantities at fair and efficient market-determined prices."

A key feature of the Medium-Term Market is the ability of any licensed distributor to enter into bilateral contracts for the purchase and/or sale of energy.

The introduction of bilateral trading changes market dynamics. Gencos and Discos now have the ability to participate directly, allowing for a more competitive environment and driving the next wave of market liberalisation. As the NBET's role begins to wane, private sector investors have the chance to step in and fill the hole by acquiring a trading license, thereby decentralising the electricity trading system.

The Order on Transition to Bilateral Trading in NESI

The Order on the transition to bilateral trading in NESI, which came into effect on the 25th of July 2024, marks a significant shift in Nigeria's approach to electricity market operations. Rooted in the broader context of Nigeria's electricity sector reforms, this order aims to move the market from a centralised, monopolistic structure to a competitive and decentralised system.

Section 19 of the order states "NBET shall forthwith cease to enter into new contracts for the purchase and resale of electricity and ancillary services in NESI. Any contract executed by NBET in violation of this Order shall not be approved by the Commission and shall be treated as an infraction that is subject to regulatory sanction."

The primary goal of the Order is to transition the market to bilateral contracts for energy and capacity between Gencos, trading licensees, and Discos. This shift aims to foster a more competitive market structure by reducing NBET's role and providing opportunity for private investors to participate in the wholesale market as electricity trading licensee.

The Wholesale Electricity Market – Opportunity for Trading Licensees

Transitioning to a bilateral market provides flexibility for energy offtake for Discos, but it also creates multiple contracting situations that can be expensive and hectic.

Gencos have generally dealt with one bulk purchaser, and this has also been the same for the Discos who have by and large restricted their commercial arrangements to one supplier. It may therefore be chaotic to have to enter into a number of contracts with a variety of purchasers and suppliers. Bilateral contracts typically require bank guarantees and creates risk for the parties. Consequently, there may be an argument for private entities to invest in obtaining trading licenses and stepping into the void created by the potential exit of NBET.

Nigeria is looking to significantly grow its generation and transmission capacity with a lot of emphasis placed on increasing the contribution of renewable energy sources to the grid. The more players come into the generation space, the more difficult it may be for the relevant Discos to continue to enter into this multitude of relationships and effectively manage them. It may be easier for an independent party whose sole objective is aggregating energy and selling to where there is a need.

Therefore, it is our opinion that the market currently provides significant opportunities for that sort of entity.

A wholesale electricity market, through the operations of a trading licensee, provides the following benefits:

- aggregate electricity across multiple Gencos and create a more streamlined procurement procedure, allowing Discos to acquire the electricity they need more efficiently.
- simplifies administrative and operational processes, reducing the complexity and costs of handling different contracts and relationships.
- licensed traders have specialised knowledge and experience in the electricity markets, allowing them to negotiate better bargains and handle market risks more efficiently than individual Discos.
- provide access to a wider range of energy sources, including renewables, that may not be directly available through individual Gencos.

Challenges

Navigating the wholesale electricity trading landscape comes with its fair share of complexities. One significant challenge is the unpredictability of market dynamics, where price volatility and fluctuating demand can disrupt trading strategies and profitability. Additionally, trading licensees often grapple with infrastructure deficits, such as inadequate grid capacity or transmission bottlenecks, which can limit their ability to efficiently deliver electricity to end-users.

Regulatory compliance presents another hurdle. NERC enforces stringent standards, and staying aligned with evolving policies can require substantial administrative effort and financial resources. Furthermore, securing trust and collaboration from both Gencos and Discos may be challenging, especially in a market still adjusting to reduced dependence on NBET.

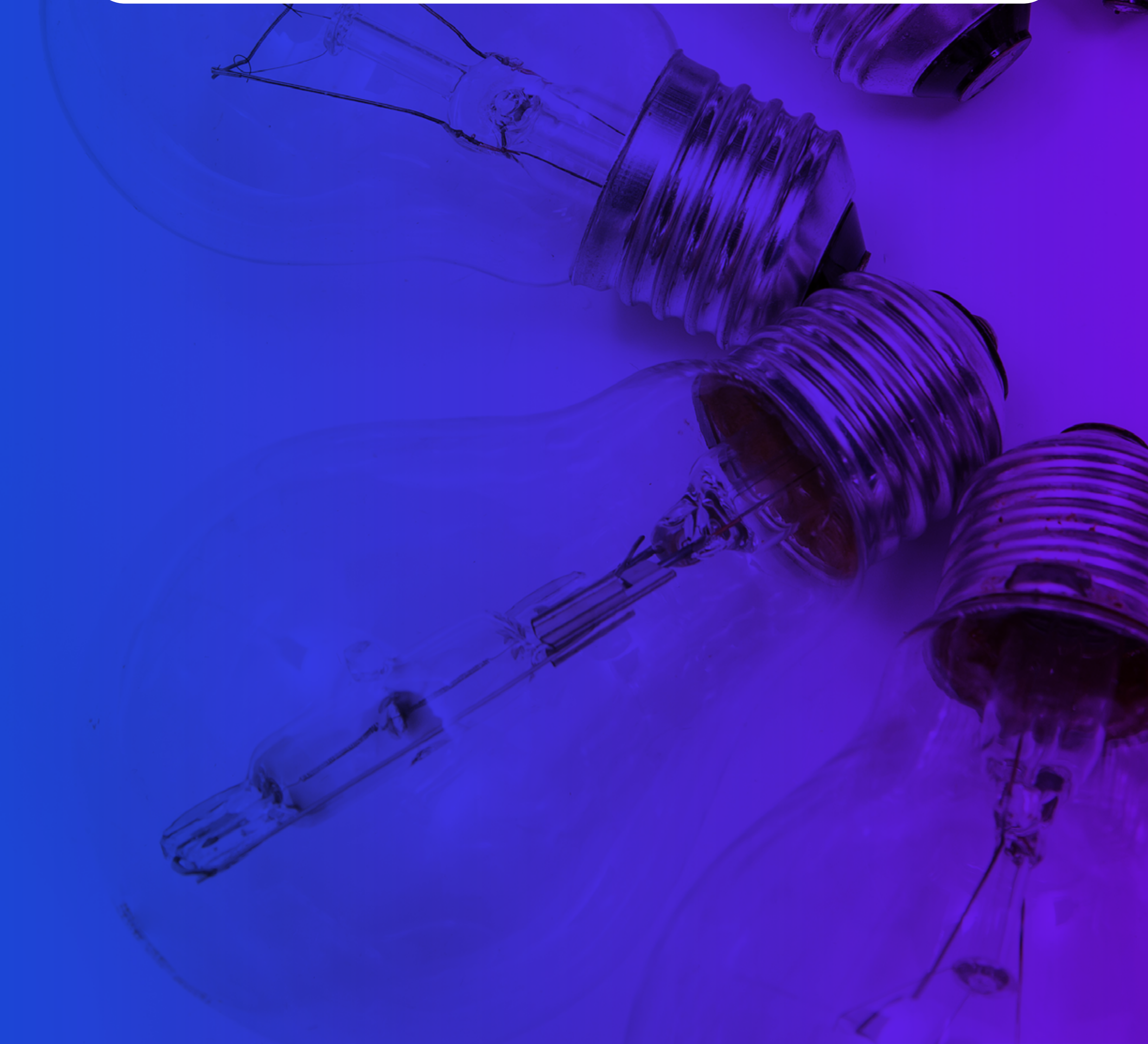
Furthermore, high ATC&C losses caused by technical inefficiencies, commercial losses from unpaid invoices, and energy theft strain the disco's financial resources, reducing their ability to fulfill their financial obligations. Discos' poor collection efficiency may limit their ability to provide a bank guarantee in favor of the trading licensee, exposing the trading licensee to financial risk.

An important aspect to consider is the Discos backward integration. Most Discos are vying for a trading license; some have already obtained it, while others are in the process. These actions by the Discos limit opportunities for new investors in the wholesale market, creating an entry barrier for new investment and knowledge into the sector, as Discos will be bound to only transact with themselves through their new trading licensee subsidiary.

Conclusion

The Nigerian electricity industry is at a crossroads, changing from a highly centralized wholesale market to a dynamic, competitive one that offers opportunities for private sector participation.

To guarantee that the industry benefits from this strategic transition, sector stakeholders must work together to solve existing barriers and create an environment receptive to innovation and investment. The growth and entry of independent traders into the market will enhance market dynamics and it is essential that we enact policies that make this worthwhile for investors even as the opportunity exists.



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