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POWER SECTOR REVIEW

Kaduna Electricity Distribution Company – A Failing Licensee: Lessons and Recommendations

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The Board of Directors of the Kaduna Electricity Distribution Company (KAEDC) was recently dissolved by the Nigerian Electricity Regulatory Commission (NERC) as a result of compounding issues within the company over the last few years. We have provided an update delineating the affairs of the NERC and the KAEDC over the last few years that has resulted in this dissolution, as well as lessons and recommendations to other DISCOs to avoid the same pitfalls.

KAEDC was taken over by the receivership of African Export-Import Bank (Afreximbank) and local lender, Fidelity Bank in July 2022 but has since struggled to improve its financial performance. In January 2023, the NERC conducted a thorough review of KAEDC for the period of January – December 2022. The assessment confirmed that KAEDC had achieved a combined average of its minimum payment obligation to the Nigerian Bulk Electricity Trading Plc (NBET) and the Market Operator (MO), resulting in an average monthly market shortfall of N4.33 billion. This underperformance signaled severe liquidity challenges which jeopardized KAEDC's commercial viability and contribution as a market participant. However, despite several regulatory initiatives and government interventions, KAEDC's management failed to present a clear pathway towards capital injection, operational efficiency, and sustainability. Over the 12-month period, KAEDC accrued a total liability of N51.93 billion to NBET and the MO, excluding historical outstanding debts of NGN41.9 billion from 2015–2021.

In response to KAEDC's financial and operational struggles, NERC, on 15th May 2023, exercised its powers under section 74 (1) (d) of the Electric Power Sector Reform Act (which the Electricity Act 2023 did not invalidate) to cancel KAEDC's Electricity Distribution License. Subsequently, on 1st January 2024, NERC dissolved the KAEDC board, pursuant to section 75 of the Electricity Act (EA), marking the culmination of issues within the company and the broader Nigerian electricity sector. The dissolution was primarily triggered by a massive debt amounting to N110 billion owed to the Nigerian Electricity Supply Industry (NESI). This debt arose from inadequate revenue collection, high technical losses, and operational inefficiencies.

The dissolution of the board has raised critical concerns about the viability of the privatization model, the financial health of other Distribution Companies (Discos), and the potential impact on electricity supply in Kaduna and neighboring areas. KAEDC is one of eleven Discos established during the 2013 power sector privatization in Nigeria, and one of the five electricity Discos taken over by lenders due to financial difficulties. It is however also important to note that the broader Nigerian electricity sector grapples with chronic challenges including low generation capacity, inadequate infrastructure, and financial constraints.

NERC has now appointed an administrator to manage KAEDC's day-to-day operations until a new core investor is found. The sale of KAEDC to a new investor is seen as the most likely path forward, contingent on addressing underlying debt and operational inefficiencies. The success of KAEDC's future hinges on resolving these challenges and navigating the broader issues facing the Nigerian electricity sector.

ARE THERE LESSONS TO BE LEARNT?

The dissolution of KAEDC's board by NERC serves as a cautionary tale for the Nigerian electricity sector and beyond. Here are some key lessons to be learnt from KAEDC's situation:

1. **The importance of financial responsibility:** KAEDC's downfall stemmed primarily from its massive debt, estimated at N110 billion. This highlights a critical need for Discos to prioritize responsible financial management, including efficient revenue collection, minimizing technical losses, and adhering to investment commitments.

2. **The need for robust investment strategies:** KAEDC's failure to attract new investors exposed the vulnerability of the company's ownership structure. It emphasizes the importance of having diverse and reliable investment sources, along with clear plans for long-term financial sustainability.

3. **Transparency and accountability are essential:** KAEDC's lack of transparency in its financial dealings and operational challenges eroded public trust and confidence. Discos must prioritize open communication with stakeholders and uphold high standards of accountability to maintain public trust and attract potential investors.

4. **Addressing operational inefficiencies is vital:** KAEDC's struggles were partly attributed to operational inefficiencies, including high technical losses and inadequate infrastructure. Discos must invest in upgrading infrastructure, implementing efficient technologies, and improving operational processes to ensure reliable and cost-effective electricity supply.

5. **The need for a holistic approach to sector reform:** KAEDC's case underscores the interconnectedness of challenges within the Nigerian electricity sector. Addressing issues like inadequate generation capacity, transmission bottlenecks, and gas supply constraints is crucial for creating a viable and sustainable electricity market.

RECOMMENDATIONS FOR DISCOS

To avoid similar pitfalls as those of KAEDC, other DISCOs can take proactive measures in several key areas:

1. Financial Management and Governance:

Debt Management: Discos can adopt sustainable debt financing strategies to avoid excessive dependence on short-term loans and high-interest rates. Discos should ensure to also diversify funding sources.

Cost Optimization: Discos should adopt cost-reduction initiatives across all operations, including procurement, maintenance, and staffing, and also invest in technology and automation to improve efficiency and reduce operational expenses.

Revenue Collection and Metering: Discos and their sponsor should invest in improved metering infrastructure, and should endeavor to improve metering efficiency and accuracy to reduce revenue losses from meter tampering and under-billing. Discos should also implement robust revenue collection strategies to ensure timely payments from customers.

Transparent Financial Reporting: Discos should aim to maintain transparent and accurate financial records, and ensure timely audits by independent bodies, while implementing a strong internal control systems to prevent fraud and mismanagement.

Corporate Governance: It is also important for Discos to strengthen their corporate governance practices by adopting international best practices and complying relevant Nigerian laws, by that way creating a transparent and reliable management.

2. Optimization of the Electricity Act:

One of the major innovations of the Electricity Act is the decentralization of the power sector and the creation of state electricity markets. States should optimize this innovation of the Act and create an independent, free, and competitive electricity market with minimal government control, except for regulatory "night watch". This way, states can attract and partner with more private investors who can freely fix realistic market prices and drive investments, albeit subject to regulatory oversight . This approach will create a free market that allows the states regulates their prices and create healthy market competition.

3. Proposed Divestment of Fed. Govt. Interest in DISCOs:

The Federal Government in December 2023 indicated its intent to divest its interest in the Discos across the county. This proposed divestment will be a step in the right direction for the Discos, as it will minimize government interference in the operations of the Discos, thus opening them up to more independent/private investments which will in turn benefit the states.

4. Technical Operations and Maintenance:

Infrastructure Upgrade and Maintenance: Discos should invest in upgrading and modernizing aging infrastructure to improve reliability and reduce the risk of outages. Discos should also endeavor to implement robust maintenance programs to ensure the efficient operation of transformers, substations, and distribution lines.

Grid Modernization: It is important for Discos to invest in smart grid technologies such as automated demand response, distributed generation, and energy storage to improve grid resilience and optimize electricity distribution.

5. Regulatory and Policy Environment:

Compliance with Regulations: Discos should always ensure strict compliance with all applicable regulations and policies governing the electricity sector, and also regularly review and update internal procedures to ensure adherence to evolving regulatory requirements.

CONCLUSION

KAEDC's board demise, while rooted in its own crippling debt and operational inefficiencies, exposes larger systemic issues demanding attention. If these issues are addressed, the Nigerian electricity sector can turn the crossroads into a springboard for a brighter future. Where Discos are able to implement the recommendations aforementioned, they can mitigate the risk of encountering similar hardships with KAEDC and build a more resilient and sustainable business model, while generating substantial revenue

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