

ALP BUSINESS REVIEW

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INFRASTRUCTURE & ENERGY



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ALP Business Review articles should aim to break new ground on commercial issues and provide an in-depth discussion of current developments and timely issues which are of particular interest to our international readership.

Submissions should be 2,000-4,000 words long, although submissions may be considered if they are below or above this word length. Full guidelines for contributors can be requested from the Content Commissioning Editor of the journal. Details are found on the inside back cover of this journal. All articles are peer-reviewed.

Articles should be sent as a Word document, to the Content Commissioning Editor (john.delano@akindelano.com).

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Contributors should note that submission of articles to ALP Business Review does not guarantee their publication.



AKINDELANO
LEGAL PRACTITIONERS

Editor's Foreword

Infrastructure or Bust: Nowhere Left to Hide.

by John Delano
Akindelano Legal Practitioners

In 2013, the Africa Development Bank (AfDB) estimated that Nigeria's GDP could have grown by an additional two percentage points (vs. 5.4% actually recorded) if we had had greater infrastructure stock. (See page 5.) It is a statement made at the height of the economic boom when oil prices were over \$100 (USD) per barrel. The Nigeria of today is in an entirely different place – it cannot afford not to develop its infrastructure – but now it must do so under the most excruciating stress and strain in an economy where oil prices are less than \$50 per barrel and investor confidence is, at best, lukewarm.

The real trouble with Nigeria is that at the end of every growth cycle, the Nigerian economy comes back to square one – the realization that its infrastructure needs a serious upgrade. It is clear from the articles within that, like it or not, we must now stop playing lip service to infrastructure development or diversity as a critical need, for there is nowhere left to hide. We will not re-emerge from this economic malaise based on the resurgence of oil prices.

It is also clear that Buhari's government must now empower the private sector and create an environment where the working populace can make progress by dint of their own industry and enterprise. Nigeria is not dead – Nigeria is yet to be resuscitated because too many times the Managers of our economy have ignored basic principles – maintaining a substantial foreign currency reserves; actively diversifying the economy and spending on Investing in Infrastructure rather than consumption.

Despite the many challenges, this is not a time for pessimism. Nigeria's government agencies charged with promoting foreign direct investment (Federal Ministry of Trade and Investment and the

NIPC) must galvanise all their resources to accentuate the positives about investing in Nigeria. The government must also have a rethink of its policies, especially with regard to enabling bona fides to transfer funds in and out of Nigeria at a fair rate of exchange.

No major sector of the economy can emerge or thrive without basic infrastructural support. There has been a constant clamour for a return to an agriculture-based economy, and it is a reasonable position to take. But under close analysis, we find that more than half of the produce from agriculture is lost as a result of poor transport links and non-existent storage facilities. Without the establishment of an integrated system of storage as well as road and rail systems in the hinterlands of Nigeria to load up and bring commodities to markets within the country and to ports for export, we will continue to lament the under utilisation of agriculture as a source of foreign exchange and as a provider of employment.

The same is true of mining and, indeed, any industry sector that requires a good transportation network and efficient ports. Be that as it may, the chronic state of the power industry remains the biggest elephant in the room.

Vision 20:2020 was a good plan, but it is almost certainly likely to fail. We will not have an installed capacity of 40,000MW by 2020 because it takes on average five years to build a power plant and (in our jurisdiction) at least three years to negotiate all the contracts and reach financial close. We need to revise the plan, but we need to do so in line with the development of other projects that will drive economic activity and provide the kind of multiplier effect that will make the Nigerian economy the colossal success that it has the potential to be.

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Nigerian Pension Funds and Infrastructure Investment

Opuiyo Oforiokuma,
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“Where the pension fund's focus is on short-term portfolio valuation and recouping costs as fast as possible, the impact of alternative-asset valuations can be a disincentive to invest in infrastructure. The new multi-funds structure proposed by PenCom, however, will enable Nigerian pension funds to segment their portfolios on a risk and liabilities basis.”



for safe and reliable drinking water supplies. Demographically Nigeria is trending towards increased urbanisation as people migrate from the rural areas towards urban centres. Nigeria's infrastructure must cope with increased urban demand and facilitate connectivity with rural areas. Diversifying Nigeria's economy into agriculture also needs supporting infrastructure. Irrigation, storage facilities, electricity to power food processing plants, good roads/bridges, rail, air and sea ports, will all be required to enable Nigeria's local and export markets.

Overview of Nigeria's Infrastructure Situation

The availability of infrastructure such as electricity, transportation, telecoms, water, etc., is a key enabler and driver of economic growth. The African Development Bank has said that a 1% increase in the infrastructure stock of a country translates to a 1% increase in the country's GDP. Infrastructure catalyzes social and economic activity as well as job creation.

Population size, growth, and demographics are key determinants of infrastructure demand. The larger the population, the greater the need for electricity to power homes, businesses, etc.; the greater the need for mass transit systems to transport people and goods; the greater the need

The World Economic Forum 2015 – 2016 Global Competitiveness Report ranks Nigeria's infrastructure 133rd out of 140 countries, behind other West African countries like Cote d'Ivoire (85th), The Gambia (95th), Senegal (109th), Ghana (115th), Benin Republic (130th), and Sierra Leone (132nd). This simple comparison of Nigeria's infrastructure with that of other countries, including those that Nigeria can be said to be in competition with globally, demonstrates how hugely underserved Nigeria's population is where infrastructure is concerned.

Taking electricity as a reference point, the figures show that South Africa's 44,150 MW of installed electricity generation capacity is

US Library of Congress – Country Report on Nigeria Urbanization (<http://countrystudies.us/nigeria/48.htm>)

World Economic Forum 2015-2016 Global Competitiveness Report (<http://reports.weforum.org/global-competitiveness-report-2015-2016/competitiveness-rankings/>)

equivalent to 822MW per one million head of population, whereas Nigeria, by contrast, only has 41MW per one million – 5% of what currently obtains in South Africa. Electricity generation and supply is arguably Nigeria's most critical infrastructure need today, yet the country significantly lags behind South Africa, whom Nigeria surpassed in GDP when Nigeria's 2013 GDP was rebased, and prior to the Naira's devaluation. Applying the South African installed electricity generation capacity ratio to Nigeria indicates that Nigeria needs at least 110,000 MW to properly serve this country today. Nigeria, however, only has around 7,500 MW.

The Nigerian Integrated Infrastructure Master Plan (NIIMP) estimates that a total of \$3 trillion (USD) is required over a 30-year period. The bulk of the NIIMP's estimate is for investment in energy (including electricity), followed by transportation, and then agriculture/water/mining combined. The NIIMP further assumes that nearly half of the financing will come from the private sector, with the remainder coming from public sources such as government borrowing and the Nigerian Sovereign Wealth Fund.

Some infrastructure that is currently owned by government, but which government is unable to properly rehabilitate or maintain, also needs financing. Brownfield assets like Nigeria's existing airports are already built and generating revenue, albeit insufficient to cover their cost and to make a decent return for government. Such assets present opportunities for private investors to participate in. Examples of where this has already happened include electricity privatization in 2013 and concessioning of the seaports around 15 years ago.

The 2016 national budget increased the allocation to capital projects, in contrast with recurrent expenditure that received the lion's share in the past. Capital expenditure in 2016 accounts for N1.59 trillion (26%) of the N6.06 trillion annual budget, with the largest share going to the Ministry of Power, Works & Housing



(N433.4 billion, 27% of the total). Taken together with Transport (N202 billion, 13% of the total), power, works, housing, and transport account for 40% of the budget. The 2016 budget is nearly 50% higher than 2015's, and signals the federal government's plan to use fiscal stimuli to stave off recessionary pressures impacting the economy. Recession has still come, nevertheless, and is now creating serious challenges for the country. The budget assumed a N2.2 trillion deficit; however, with federal government revenues currently 40% – 50% below budget, the actual fiscal deficit for the year will likely be higher.

The Ministry of Finance estimated Nigeria's annual infrastructure need at \$25 billion, i.e., the equivalent of N7.6 trillion at the current interbank foreign exchange (FX) rate, and N6 trillion more than the 2016 capital works budget. The national budget only covers 21% of the Ministry's annual estimate, demonstrating government's inability to finance all of Nigeria's infrastructure needs on its own. Private financing is needed to support government efforts.

The Importance of Long-Term Financing in Infrastructure Development

Infrastructure, by its nature, requires long-term financing (e.g., loans of 10 to 15-year tenors). Economic infrastructure, such as electricity generation plants, major highways, airports, seaports, and railways, are large in size and capital

intensive. The vast majority of Nigeria's infrastructure need (probably as high as 95%) is greenfield, i.e., infrastructure that currently doesn't exist and needs to be developed and built from scratch. Individual greenfield projects can easily cost a couple of hundred million to several billion US dollars to develop and construct, and it can take three to four years of construction before these projects start generating revenue. Where the costs of providing, operating, and maintaining the infrastructure are to be recouped through direct end-user contributions (e.g., tolls on a road, tariffs for electricity), ensuring affordable end-user contributions means it can take several years (seven to ten years) for the cash flows to payback and start earning a return for the investors. Spreading the cost over a longer recovery period helps to reduce the toll/tariff burden on end users, which is one of several reasons why infrastructure project concessions can be anywhere from 15 to 30 years and longer.

If short-term, instead of long-term financing, is used to fund infrastructure projects, there will be a risk that a greenfield project, for example, could become truncated before the construction phase is complete. This could happen owing to a failure to roll over the short-term financing raised at the start, or to raise new financing to fill the gap opened up by the rollover failure, when the tenor of the initial short-term financing expires. Having long-term financing available, which matches the profile of the cash flows involved in an infrastructure project, is a key requisite for investors to gain the confidence to take on long-term infrastructure projects anywhere in the world. Nigeria is no exception.

Infrastructure financing typically requires "patient capital", i.e., equity (share capital) and debt (loans) of a long-term nature. Equity providers take on the larger share of the project and develop the project to a bankable stage when long-term debt can then be introduced. Equity providers also ensure that the project is executed



satisfactorily and that all the financing is serviced and repaid as appropriate. The typical capital has more debt than equity in the mix – as much as 75% to 80% of the total project financing can be comprised of debt. However, debt providers will not provide 100% of the financing – they will want equity investors to have a meaningful amount of "skin in the game". Without equity capital first being in the structure, it is unlikely that debt capital will be obtainable to finance a greenfield infrastructure project. A brownfield project, on the other hand (even if new equity has not been introduced into the capital structure), may be able to attract debt financing when the project has been de-risked after construction/asset delivery and after the cash flows are stable. Such debt capital (e.g., via a bond) can be used to refinance the project and take out the equity investors and lenders that participated in the higher risk early stage of the project.

Data provided by Preqin indicates that public and private pension funds are the largest institutional investors in infrastructure assets worldwide (providing a third of all such investment). Commercial banks rank much lower. In Nigeria, commercial banks are poorly positioned to provide long-term loans owing to regulatory constraints that oblige them to closely match the tenors of their assets and liabilities, which are mostly short term. Pension funds on the other hand, are the largest pool of long-term savings in Nigeria today. By virtue of the long

durations over which they plan to fund liabilities, they are better suited to the comparably long-term investment horizons involved in infrastructure.



Eligible Channels for Pension Fund Investment in infrastructure.

The Pension Commission of Nigeria (PenCom) reported N5.8 trillion of pension assets under management as at 31 July 2016. A large share of those assets (68.4%) were invested in Federal Government of Nigeria (FGN) bonds and treasury bills, with only 0.03% invested in the Infrastructure Funds. PenCom Regulations permit Nigerian pension funds to invest a portion of their portfolios in infrastructure projects through the medium of Infrastructure Bonds and/or Infrastructure Funds. Subject to compliance with stringent and clearly defined criteria, up to 15% can be invested in Infrastructure Bonds while up to 5% can be invested in Infrastructure Funds. In addition, and while not specifically targeted at the infrastructure asset class, the regulations permit Nigerian pension funds to invest up to 25% of their portfolios in ordinary shares of public limited companies that are listed/quoted on a securities exchange registered by the SEC.

Taking all the above into account, and conservatively assuming that 3% of pension fund portfolios are required to cover management fees and other expenses associated with the pension funds' activities, we calculate that Nigerian pension funds can immediately allocate circa N1.1 trillion to infrastructure – N847 billion in

Infrastructure bonds and N282 billion in Infrastructure Funds.

There is, however, a lack of eligible instruments and/or vehicles in the Nigerian market in which the pension funds can invest today. There are no project-specific Infrastructure Bond instruments that, as yet, meet the criteria specified in the PenCom regulations. Such instruments have been used successfully elsewhere in the world to finance infrastructure assets; hence, we believe they will eventually come to Nigeria. Scope exists to use Infrastructure Bonds to finance brownfield assets like airports and railway networks owned and operated by the Federal Government. Infrastructure Bonds can also be used to refinance the Lekki Toll Road and the Lekki-Ikoyi Toll Bridge owned by Lagos State Government, both of which are already cash-generative and have reasonably predictable cash flows. A similar approach may be applicable to the privatised electricity companies when their cash flows eventually stabilise and greater certainty exists about the future of the electricity sector.

As at the time of writing, there was only one Infrastructure Fund in the Nigerian market that meets the criteria specified in the PenCom regulations. The Fund (ARM-Harith Infrastructure Fund) is responsible for the 0.03% of the industry portfolio allocated to this asset class as at 31 July 2016 and is established to invest equity in energy, transport, and utilities infrastructure projects throughout West Africa, especially in Nigeria. The Fund is an equity investor in the \$876 million Azura-Edo IPP currently under construction near Benin City. Other Infrastructure Funds are expected to come into the market in the near term, and they can be structured to provide both equity and debt.

There are currently no listed/quoted infrastructure stocks on the NSE that the pension funds can invest in today. MTN, however, is preparing for an NSE listing in 2017, which, when complete, will be the first telecoms utility company listed in Nigeria.



Challenges Faced by Nigerian Pension Funds When Considering Infrastructure Investments

In addition to the limited availability of infrastructure products/vehicles, Nigerian pension funds have to contend with product risk, political risk, government crowding out, valuation impact, and skill limitations, amongst other challenges. Pension funds prefer low- or no-risk products that generate steady income from the outset. This partly explains why Nigerian pension fund portfolios have a higher concentration of investments in fixed-income instruments like FGN bonds and treasury bills, rather than in equities and alternative assets like infrastructure.

Nigeria's track record is poor where infrastructure projects are concerned, and some experiences of private investors in such projects with government are discouraging. Nigerian pension funds are therefore understandably wary about the political risks and want to have government or equivalent guarantees protecting investments that they make in infrastructure assets. It may not be possible or necessary to provide guarantees in all cases; however, one can sympathise with the relatively high level of risk aversion that the pension funds have towards infrastructure generally, owing to political risk.

Risk-free FGN bonds and treasury bills have, for a long time, been priced to generate high yields. With the most recent increase in the MPR from 12% to 14%, yields are now as high as 20% – 22%. This provides a safe haven for Nigerian pension funds to invest in and results in crowding

out of alternative assets like infrastructure – the latter, while capable of generating higher real returns, are higher risk than FGN bonds and treasury bills. Nigerian pension funds therefore have little or no incentive to consider alternative assets. The Monetary Policy Committee is imminently reviewing the MPR, and there is some pressure for a decrease.

Infrastructure assets, being structured mainly as unlisted investments, are not simple to value or revalue on a daily basis. The returns profile of such investments also typically follows the classic “J curve”; hence, pooling pension fund assets into a single portfolio, as is currently the case in Nigeria, means that the alternative assets dilute the overall portfolio value in the short term, to then reverse in the medium to long term as the alternative assets become cash generative and accretive in value. Where the pension fund's focus is on short-term portfolio valuation and recouping costs as fast as possible, the impact of alternative-asset valuations can be a disincentive to invest in





infrastructure. The new multi-funds structure proposed by PenCom, however, will enable Nigerian pension funds to segment their portfolios on a risk and liabilities basis. Higher risk-alternative assets will be allocated to longer-dated pension liabilities (e.g., for new entrants to the jobs market), while lower-risk assets like cash and government bonds/treasury bills will be allocated to shorter-term pension liabilities (e.g., for those at or close to retirement age). This should help mitigate the pension funds' concerns about valuation implications.

Specialist knowledge, experience, and skills are required for successful infrastructure investment and management. But infrastructure investing is relatively new in Nigeria; hence, a genuine gap in expertise exists today. This is a contributory factor that may further explain the pension funds' current low investment appetite for infrastructure.

Some stakeholders have expressed the view that political and/or regulatory pressure should be applied to compel Nigerian pension funds towards greater participation in infrastructure (the "Compulsion Model"). Our view is that using moral suasion to demonstrate the virtues of investing in such alternative assets (the "Engagement Model") offers a better way

forward. A regulatory approach that combines constructive engagement with incentives, and which helps demonstrate to Pension Fund Administrators (PFAs) that there are tangible economic or fiscal benefits from investing in infrastructure, including where appropriate, the availability of protections such as debt and equity guarantees, would serve Nigeria best.

Key Conclusions

Nigeria is at a competitive disadvantage globally and by reference to peer countries, where infrastructure is concerned. Our infrastructure is inadequate to support the present and future socio-economic needs of the country, including the current imperative to diversify the economy away from oil in the shortest possible time. The availability of long-term financing is a critical ingredient for funding Nigeria's infrastructure needs, and private finance is needed to supplement the constrained financial resources available to government.

Nigerian pension funds can help finance infrastructure here. PenCom regulations ensure that circa N1.1 trillion is immediately available to invest in infrastructure, yet still the pension funds' exposure to infrastructure is insignificant by global comparisons. This, to a large extent, is owing to the very limited availability of investible infrastructure instruments/vehicles that they can invest in, as well as to various other factors, especially risk.

Nigerian pension funds have legitimate concerns about infrastructure investment risk. Unless they can gain confidence about the safety and good management of the investments they make in infrastructure, pension funds will understandably continue to adopt a risk-averse stance towards the asset class. This, unfortunately, will contribute to the continued slow growth of infrastructure development in Nigeria until their concerns are assuaged.

Opuiyo Oforiokuma is Managing Director/ CEO of ARM-Harith Infrastructure Investment Ltd, where he manages the pioneering \$250 million ARM-Harith Infrastructure Fund, a specialist PE fund focused on transport, energy, and utilities projects

throughout West Africa, especially Nigeria. He holds a BSc (Econs) in Accounting and Financial Management from the University of Buckingham and is a member of the Chartered Institute of Management Accountants.



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Closing Nigeria's Infrastructure Gap

Bolaji Balogun
Chief Executive Officer, Chapel Hill Denham

"The transformative potential of infrastructural development for Nigeria cannot be overemphasized."

CHAPEL HILL DENHAM
Management Limited

I have a dream...

I have a dream that one day this great nation, Nigeria, will rise up and live out the true meaning of its promise: "Africa's largest economy". I have a dream that one day, across Nigeria, our sons and daughters will be able to take a train to visit their friends from Lagos to Kano in less than four hours.

I have a dream that even the northeastern region of Nigeria, a region sweltering with the heat of terrorism today will, one day, be transformed into an oasis of freedom, with constant electricity. I have a dream that my children and your children will one day live in a nation where they can drive from Ijebu-Ode to Ogoja and then on to Enugu and then Katsina-Ala for spring break in a few hours.

I am inspired by the famous speech by Martin Luther King, Jr., in Washington, D.C., on August 28, 1963. It took some 45-plus years afterwards to put a black man, Barack Obama, in the White House. My dream is that within 45 months, we can be well on the way to transforming Nigeria's physical and social infrastructure stock.

The transformative potential of infrastructural development for Nigeria cannot be overemphasized. Major infrastructure development projects create hundreds of thousands of low- to mid-skill jobs on a sustained, long-term basis across the entire project value chain, from design and construction to operation, as well as maintenance.

In 2013, the Africa Development Bank (AfDB) estimated that Nigeria's GDP could have grown by an additional two percentage points (vs. 5.4% actually recorded) if we had greater infrastructure

stock. Furthermore, access to infrastructure greatly influences the productivity of private investment and improves a country's competitiveness. Every 1\$ (USD) of investment in infrastructure has an estimated multiplier effect of 6x to 8x on economic activity. Improved infrastructure can also lead to better social outcomes in quality of life, education, health, and life expectancy.

Sustained infrastructural investment will be key to realizing Nigeria's twin economic objectives of diversification and industrialization. Inadequate power and transportation networks currently hamper the agricultural industry by limiting processing capabilities and the efficient movement of produce from farms to domestic and export markets. Inadequate transportation networks—especially rail—are a significant constraint if mining output is to be moved efficiently to ports for export to other markets. It will be impossible to improve our currently thin industrial and manufacturing bases without reliable and efficient power supply. Power generation, back-up, and other self-generation costs impose a significant burden on business, accounting for an estimated 15% – 40% of operating expenses across industries, and a significant portion of capital expenditure for large industrial businesses.

Strong economic growth in all emerging markets has always been premised on a consistent and rapid infrastructure development program. Globally, no country has succeeded in developing its economy, diversifying its economy, and lifting

its people out of poverty without a substantial program of rapid and diversified investment in its infrastructure stock.

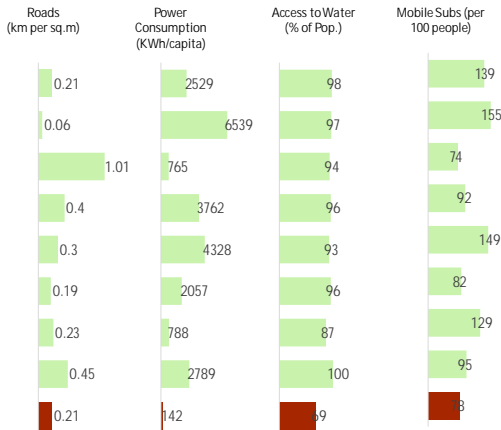


Figure 1: Benchmarking Nigeria's Infrastructure Stock

Infrastructure and Competitiveness in Nigeria
 According to the World Economic Forum's 2016 Global Competitiveness Index, Nigeria ranks higher than just 15 countries worldwide in overall competitiveness. Twelve of those countries are also in Africa. All of these 12 countries are much smaller than Nigeria, with an average GDP of about \$8bn and an average population size of about 13 million. The other three countries are Pakistan, Myanmar, and Haiti, each of which has significant socio-political issues of its own.

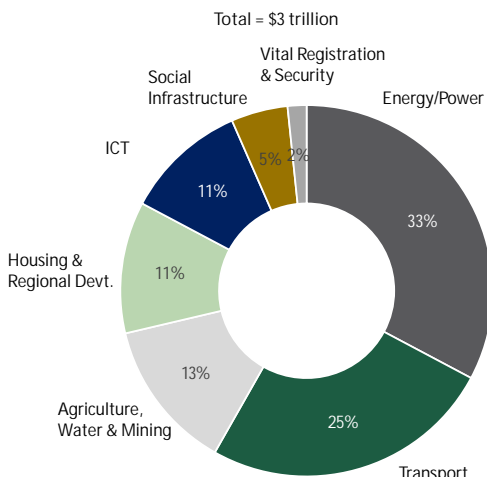


Figure 2: Nigeria's National Integrated Infrastructure Master Plan, 2014-2043



Nigeria's National Integrated Infrastructure Master Plan, as currently contemplated, seeks to double Nigeria's infrastructural stock (as a percentage of GDP) over 30 years, from 35% today to 70%, which represents the benchmark set by institutions such as the World Bank and AfDB for middle-income countries like Nigeria. The associated significant financing requirement is estimated at \$3 trillion and will have to come from a combination of public and private sources.

But when you ask a roomful of enlightened infrastructure financing or investing professionals how many have ever seen this plan, one always finds it shocking how few have. Why is the plan a secret document and how then are potential investors, developers, operators, financiers and Original Equipment Manufacturing (OEM) executives to know the full opportunity set and recognize that Nigeria represents one of the largest infrastructure opportunities globally for any serious infrastructure player?

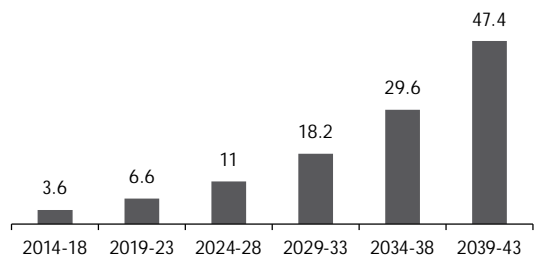


Figure 3: Annual Average Spending Target (N trillions)

Globally, traditional sources of infrastructure funding include:

1. Federal, state and local governments
2. Commercial banks
3. Development Finance Institutions (DFIs)

4. Export credits
5. Debt capital markets (bonds, infrastructure debt funds, etc.)
6. Islamic finance
7. Other forms of equity (developers, operators, utilities, equipment suppliers, etc.)
8. Private equity, infrastructure equity funds
9. Sovereign wealth funds
10. Pension funds

We are not leveraging the private sector enough. It is important that we get past the mistaken perception in some quarters in government that the private sector only acts in its own self-interest. One area where there is a clear coincidence between this enlightened self-interest and the wider and common good is in the provision and improvement of Nigeria's badly dilapidated and sometimes even non-existent infrastructure stock. The private sector suffers most significantly from Nigeria's infrastructure gap and is a ready and willing collaborator in a well-regulated and facilitative environment, to contribute its part. From 1990 to 2012, Nigeria launched 52 public-private partnerships, compared with 1,064 in China and 643 in Brazil.

Fiscal and banking sector constraints in the current environment create an even greater impetus for private capital to bridge the funding gap. It is important that the government and its advisors use the breadth of their available toolkits to provide leverage capacity for public and private sector sources of equity capital, utilizing guarantees, insurance and other similar tools, as illustrated in the table below.

Mechanism	Structure	Form	Leverage Potential
Loan guarantee	Guarantee	Debt	6x-10x
Policy insurance	Guarantee	Debt	>10x
Forex liquidity facility	Direct Financing	Debt	N/A
Equity "pledge" fund	Direct Financing	Equity	up to 10x
Subordinate equity fund	Direct Financing	Equity	2x-5x

Table 1: Public Sector Financing Tools

Source: Nigeria Infrastructure Investment Masterplan.

A typical emerging market project financing structure for a public infrastructure asset can create up to 16x leverage on the government's equity contribution, through a combination of developer and similar equity as well as project debt. By our estimates, a \$48bn project can be funded with as little as \$3bn of government equity.

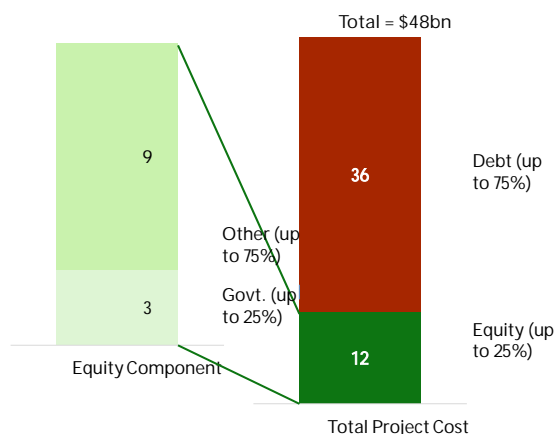


Figure 4: Illustrative Financing Structure (\$ billions)

Infrastructure continues to be a highly attractive asset class for investors looking for low risk, long-term returns, such as pension funds. Infrastructure debt funds in particular are attractive on account of their strong track record of low default rates globally, due largely to the front-loaded debt amortization profile which ensures that the credit quality of an infrastructure project improves over time.

Nigeria's pension funds are currently under-indexed in infrastructure compared in particular to other emerging markets like the countries of Latin America, where infrastructural investment has increased significantly over the past several years. Pension fund Assets Under Management (AUMs) in infrastructure range from 10% – 20% of total AUMs across the region, compared to just 0.04% in Nigeria. The PenCom and Nigeria's pension managers have spent the last year or so building capacity in the asset class and are now well positioned to begin investing more significantly in infrastructure.

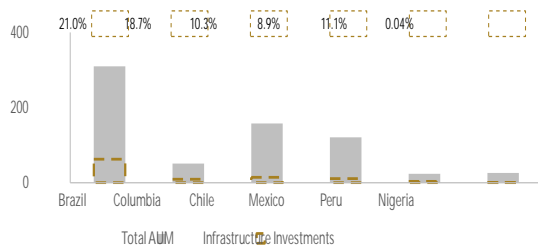


Figure 5: Latin America: Pension Funds Infrastructure Portfolios



Constraints to Infrastructure Investment

Infrastructure is expensive to build in Nigeria. It costs around \$2.6m to build one kilometer of road, compared with \$1.2m in Kenya and \$400,000 in Zimbabwe. There are also structural challenges to the viability of many projects. Key issues include limited financial expertise regarding the instruments and financing tools, non-viability of legal and regulatory frameworks, limited co-ordination between governments at the different levels, insufficient local technical capacity for project design and implementation, amongst others.

At a practical level, most of these problems are not insurmountable, assuming a level of co-ordination between the government and private sector investors to create and deliver bankable projects. We believe that there are eight key co-ordinating actions required of the government to do this:

1. Develop (and transparently share) the government's short- ("quick wins"), medium- and long-term priority transaction pipelines

2. Create an infrastructure project development office, perhaps within the Nigerian Sovereign Investment Authority (NSIA), to act as a hub for project co-ordination, governance/monitoring

3. Create first class concession and tendering processes to attract world-class operators, developers, etc.

4. Channel the government's equity financing through the NSIA, acting as an equity "pledge" fund and use the NSIA to catalyze private sector efforts

5. Ensure viable Public Private Partnership (PPP) legal frameworks are in place, and clarify the role of the Infrastructure Concession Regulatory Commission (ICRC)

6. Position all regulators to be facilitators, working to eliminate bottlenecks and bureaucracy

7. Use financial tools (especially guarantees) to create leverage capacity, thereby catalyzing and stimulating private investment activity

8. Encourage local currency financing of infrastructure projects

Key Priorities

We believe that there are 15 to 20 impactful projects that could have a significant multiplier effect on the Nigerian economy over the next three years. Such projects would:

- Develop directly or indirectly 40,000MW of generation capacity, focusing on renewables – wind, solar, waste, biomass – and hydro, thereby de-risking the economy from gas and fuel oil
- Overlay the existing transmission network to provide evacuation capacity for current installed and near-term generation capacity
- Develop two to three rail projects connecting the major agricultural and mining hubs to major cities, seaports, and airports
- Develop three to four major interstate expressways: Lagos – Ibadan; 2nd Niger Bridge; Abuja – Kano; and Sagamu – Benin – Asaba
- Commit to 4,000km – 5,000km of gas transportation infrastructure, taking gas to major



plants, power plants accompanied by gas storage capacity

- Concession major air and seaports properly

Some 16 years ago, I started the process of assembling the Nigerian investors who ultimately became my partners in one of Nigeria's telecommunications operators. While that particular company has been through a variety of owners and brands, it was the first of Nigeria's Global System for Mobile Communication (GSM) operators to launch its mobile network. It is undisputable that mobile telecommunications has transformed Nigeria.

On March 14, 2001, I told the audience at a Nigerian telecommunications conference in London, "I come from a country, Nigeria, with 460,000 fixed lines. There are 3.5 million Nigerians who have paid NITEL for a telephone line they have not received, and another five million Nigerians are queuing up to pay for application forms for telephone lines that they will never get. I have a dream that, in my life time, well over 25 million Nigerians will own a mobile phone." The audience was shocked by my comments and from their reaction, their disbelief was apparent.

Fifteen-and-a-half years later, it is evident that we all called it wrong, because we sold our

mobile network in 2006 for 6.5x money and many of the people in that room in London never invested in the Nigerian mobile industry. At the end of May, Nigeria had close to 150 million mobile subscribers.

The transformative potential of infrastructure for Nigeria cannot be overemphasized. Nigeria is well behind on delivering on its infrastructure goals and, indeed, on realizing its full economic growth potential. The task, while daunting, is not impossible. It will require significant financial investment and savvy and a concerted partnership effort between the public and private sector, coordinated by the right agencies of the government. We need an unrelenting focus on delivery and creative solutions to maximize the impact of every dollar spent on infrastructure over the next 30 years. These, coupled with the current administration's uncompromising stance on corruption, will help to attract high-caliber, world-class domestic and international private-sector investors, developers, and operators to assist with the development of Nigeria's infrastructure.

I look forward to what promises to be an exciting journey, and I know we all have an opportunity to build the Nigeria of my dreams, but we must start *now*.

Bolaji Balogun is the Chief Executive Officer of Chapel Hill Denham and Chairman of Lafarge Africa Plc. He has more than 27 years of experience in financial services and mobile telecommunications. He spent 11 years within FCMB Group in investment banking and securities trading, leaving the business in January 2001 to become a co-founder and Director of Econet Wireless Nigeria, now Airtel Nigeria. He returned to investment banking when he founded

Chapel Hill in 2005. 'Bolaji is a Director of NAHCO Aviance Plc., Trustfund Pensions Plc, and NASD Plc. He was appointed to the Johannesburg Stock Exchange Africa Advisory Board in September 2009, and from 2010 to 2014 served as Chairman of the Association of Issuing Houses of Nigeria, the investment banking trade group. 'Bolaji holds a BSc in Economics from the London School of Economics.

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Translating Infrastructural Gains to Economic Growth

Dr Ousmane Dore, PhD, MPA

Director, African Development Bank Nigeria Country Office

“Infrastructure boosts growth potential through the provision of essential services such as energy, transport, water, and communication. These vital services are the oil that wheels the engine of a society's productivity.”

Remarks presented at the 5th ALP Seminars

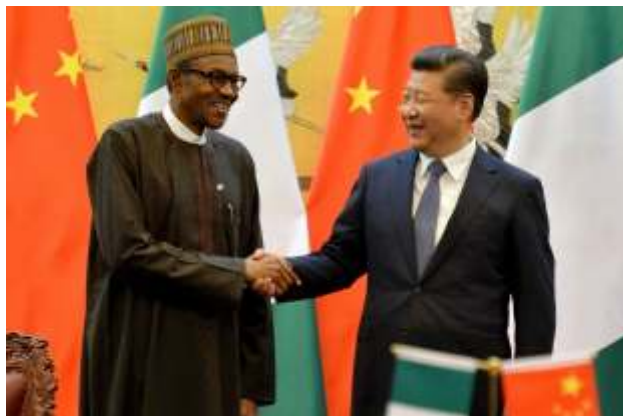
Today's theme – Public Private Partnerships (PPP) and Infrastructural Development: Accelerating the Diversification of Nigeria's Economy – brings to fore a topical issue of discussion for this present government and, indeed, its international partners on the importance of making infrastructure investments that lead to growth. Only through sustainable and inclusive investments can we truly make an impact in the lives of the average Nigerian.

Distinguished guests, we all know that, currently, infrastructure financing in most developing countries cannot be met by government budgets alone. Nigeria, like most developing countries, has been accustomed to delivering infrastructure through budgetary allocations. However, declining revenues from oil exports is making this option less feasible, and this is affecting planned capital investment and improvements in infrastructure. The current administration must deal with the challenges of financing infrastructure improvements and investments given the slump in global oil prices.

Nigeria's real GDP grew by about 2.8% in 2015, much lower than the 6.2% growth in 2014 and the average growth rate of about 7% recorded over the past decade. It is projected to grow (according to the National Bureau of Statistics) by 3.8% in 2016. However recent growth forecast figures released by the International Monetary Fund (IMF) puts it at 2.3%. The

2016 budget of \$6 trillion (USD) benchmarked against an oil price of \$38 per barrel with 30% of its entire budget on capital expenditure (approximately N1.6 trillion – N2 trillion) has led to some measures that the government is putting in place to reverse the slow growth situation, attain fiscal sustainability, fiscal transparency, and structural reforms.

Likewise, according to the African Development Bank's Infrastructure Action Plan report for Nigeria, the priorities for supporting future growth are: meeting the needs for a major expansion of investment in infrastructure; establishing a stable macroeconomic environment with improved coordination between monetary and fiscal policy; reducing the heavy dependence on oil revenues for government revenues and expenditures; increasing investment in building human capacities and skills in the labor force; and



establishing a strong institutional and regulatory framework in support of private sector activities.

As at May 2015, the Ministry of Finance stated that “the lack of funds for capital expenditure means badly needed infrastructure development will be put on hold”. Funding for large projects such as bridges and roads are already facing cutbacks with the government seeking assistance from the Chinese EXIM bank to meet certain crucial and critical projects. This example clearly indicates the vital need for a re-assessment of how the government plans, enacts policies, strengthens reforms, and allocates and manages their capital expenditure budgets; and this is where the African Development Bank (Bank) can provide crucial technical assistance and is committed to working with country/clients to put them on sustained paths to strong economic resilience as they pursue the infrastructure improvements that are vital and imperative. However, before I go into ways the Bank can support, let me first introduce the link between infrastructure and economic growth.

Infrastructure and Economic Growth

Distinguished ladies and gentlemen, we all know the linkages between infrastructure and economic growth. I will not spend so much time in educating an already learned group but will emphasize a few points on why it is important for us to take this seriously:

- Infrastructure plays a key role on economic growth and poverty reduction.
- Infrastructure boosts growth potential through the provision of essential services such as energy, transport, water, and communication. These vital services are the oil that wheels the engine of a society's productivity.
- Infrastructure construction promotes growth and employment creation. The present government is determined to create jobs for youth, and this is one channel of achieving that target.



- Fundamental development impact whereby infrastructure improves people's lives by increasing productivity, reducing transaction costs, promoting economic and social interaction is what infrastructure attains in the medium to long term.

- Making Nigeria one of the most resilient economies would need an improved competitiveness for doing business. According to the Global Competitiveness Index for 2015, for Nigeria, inadequate supply of infrastructure is the largest impediment for doing business in Nigeria. For example, MTN Nigeria spends in excess of \$5.55 million on diesels to power its 6,000 generator plants across the country monthly.

Given these few points, it is still important to show the positive effect of infrastructure on long-term growth. A study by Fidelis O. Nedozi et al. in calculating the relationship between infrastructure and output in Nigeria, found that a 1% increase in infrastructure increases fixed capital stock by 1.37%, while a 1% increase in fixed capital stock increases GDP by 0.06%. Likewise a 1% increase in electricity generation directly increases GDP by 0.2%.

According to the National Bureau of Statistics, over the last decade, Nigeria's infrastructure spending contributed 1.9% (approximately \$4 billion) per annum to GDP. The recommendation

of the Asian Development bank in a KPMG report is that no less than 6% of GDP should be invested in infrastructure. In Nigeria during the last administration, infrastructure spending contributed about 7% – 10% of GDP, which is above the average for Sub Saharan Africa. Overall, we can all agree that infrastructure is a veritable condition for increasing rate of economic growth.

It is evident that the organizers of this annual seminar are aware of the importance of infrastructure in reducing poverty and improving economic growth, hence the importance of making it a yearly discourse using a forum such as this. Worthy of note for us all is that infrastructure development impacts gender as evidenced by the significant impact of rural transport and water access on women's lives and the improved access to education and health and wage-based employment opportunities.



In an article published by the *Journal of Global Economics*, it was stated that the current level of infrastructure deficit in Nigeria has been identified as the major constraint towards achieving the nation's vision of becoming one of the largest 20 economies in 2020. About 70% of the 193,000km of roads in the country are in poor condition, with the AfDB Infrastructure Action Plan estimating \$2.9 billion annually for routine and periodic maintenance. For electricity, 64MW per million is

available compared to 800MW per million in Middle Income groups of African countries. The nation experiences over 320 lost days a year, with over 60% of the population lacking access to electricity, leading to over \$13 billion spent annually to fuel generators. Recently, the country experienced power crises where the country did not produce a single megawatt for three hours. In 2010, only 4% of the population had access to piped water. Access to clean water is skewed in favor of urban dwellers – 74% as against 43% for rural dwellers. About 10 million people in Nigeria do not have access to improved sanitation.

The Global Response

What has been the global response to these infrastructure challenges?

In 2015, a global platform for collaboration among public and private partners that supports high-quality preparation, financial structuring, and risk mitigation for infrastructure projects in Emerging Markets and Developing Economies (EMDEs), called the Global Infrastructure Fund (GIF) managed by the World Bank, was established. This support will focus on complex infrastructure projects with strong potential to achieve financial viability and sustainability and to attract long-term private capital. The objective of the GIF fund is to increase private investment, in particular, long-term finance, in complex EMDE infrastructure projects. The spectrum of GIF's support spans from (a) the creation of enabling environment and project definition and screening analysis, (b) project preparation and investment feasibility, (c) transaction, and (d) financing.

Likewise, a New Development Bank by BRICS countries (Brazil, Russia, India, China, and South Africa) was established to mobilize resources for infrastructure and sustainable development



projects in emerging and developing countries. In addition, in November 2014 the G20 Leaders agreed on a “Global Infrastructure Initiative” to lift quality public and private infrastructure investment, including the establishment of the Global Infrastructure Hub (the GI Hub). The GI Hub works to address data gaps, lower barriers to investment, increase the availability of investment-ready projects, and improve project and policy environments for infrastructure. It plans to raise \$2 trillion for infrastructure funding by 2030, work to improve investment climate, barriers to investment, and help match investor with projects.

Also, the outcome of the Addis Ababa Action Agenda 2015 was the Global Infrastructure Forum, which builds on existing multilateral collaboration mechanisms led by multilateral development banks. This forum has agreed to face particular challenges with respect to attracting private capital towards their infrastructure development, and these include (a) limited investment opportunities, (b) weaknesses in terms of project development, (c) limited capacity and expertise of the public sector and the resulting need for technical assistance, especially in the PPP space, (d) challenging legal and regulatory environments, (e) limited access to long-term

financing through capital markets, and (f) high perception of political risk.

From the African Development Bank (AfDB) side, a ten-year strategy (2013 – 2022) is anchored on five operational pillars of which infrastructure development remains a central foundation. Recently, the strategy has been refocused on five high priorities (known as High-5), namely: to Lighten and Power Africa, Feed

Africa, Industrialize Africa, Integrate Africa, and Improve Standard of Living in Africa.

As the implementing agency for NEPAD, the AfDB has been providing technical and financial assistance in the implementation of the Program for Infrastructure Development in Africa (PIDA) priorities action plan (PAP). In 2012, African heads of states called for innovative solutions to facilitate and accelerate the delivery in Africa. In response, the Bank launched the Africa50 Fund as an investment vehicle estimated to mobilize some \$100 billion (N163 billion) to fast track the continent's industrial development. This initiative, will mobilize funding from within the continent to finance and bridge the infrastructure gaps. Africa50 has already commenced operations headquartered in Morocco and is on track in raising some \$830 million to date in a few months. Africa50 is also expected to invest in African infrastructure projects, while leveraging its innovative Project Finance and Project Development windows.

Public Private Partnerships

In 2014, the Bank approved the operations of four PPP Advisory Hubs to assist countries in policy and legal formulation and other advisory assistance in developing a broad range of requisite skills across

different actors, sectors, and levels of government. The Bank in its operations realized that for effective deal flow vis-à-vis infrastructure development in Africa, it must help governments strengthen their knowledge and capacity to carry out PPPs in order to achieve an impactful role for identifying, procuring, and managing PPPs. Therefore, focusing on the development of capacities, policies, and frameworks within these countries' governments is imperative for the Bank. The PPP hub for West Africa sits in Nigeria at our country office in Abuja.

Another initiative set up by the Bank to facilitate the growth of PPPs in the continent is the African Legal Support Facility (ALSF). The ALSF was established to support African governments in negotiations of complex commercial transactions, providing legal advice and technical assistance, and capacity building. In addition, the facility provides assistance to African countries to strengthen their legal expertise and negotiating capacity in debt management and litigation, natural resources and extractive industries management, and contracting, investment agreements, and related commercial and business transactions. The ALSF also grants and advances funds to African countries for legal advice from top legal counsel in these areas. The ALSF's goal is to ensure fair and balanced negotiations.

In conclusion, as previously stated, the desire for greater stock of infrastructure and through it a reduction in poverty and inequality has

increasingly led governments to seek alternative sources of financing for their infrastructure. The Bank and other development partners who I believe share the same vision will continue to promote efforts in Nigeria to establish frameworks that provide adequate incentives for private partners and safeguards for taxpayers and consumers. The envisaged policy and structural reforms by this government aimed at reducing the country's dependence on oil as a source of government revenue and foreign exchange and putting growth back to a positive trajectory touch various aspects of the economy: Agriculture, Solid Minerals, Energy, Petroleum Industry Governance Bill, Public Finance Management (IPPIS, GIFMIS, TSA), Improved Tax Administration (ITAS, broadening the tax base, and improved compliance).

To align with the government's efforts, the Bank's development agenda for Nigeria is guided by its Country Strategy Paper (CSP). The CSP for Nigeria (2013 – 2017) just finished its midterm review which, following a broad consultation with the new administration and all stakeholders, reaffirmed a country strategy focused on two strategic pillars: Supporting the Development of a Sound Policy Environment and Investing in Critical Infrastructure to Promote the Development of Economic Activities.

Let me conclude by quoting a popular Chinese saying: "to get rich, first build a road."

Dr Ousmane Dore has been the Country Director of the African Development Bank in Nigeria since May 2011. Prior to joining the bank, he worked as senior economist at the International Monetary Fund (IMF) in Washington, D.C., from 1992 to 2007.

During this period, Dr Dore worked in several European and African countries (France, UK, Norway, Iceland, Cote d'Ivoire, Ethiopia) and served as the IMF Country representative in Senegal and mission chief in

Guinea-Bissau from 2003 to 2006. During 2007 – 2008, he was appointed the Minister of Finance, Economy, and Planning in his home country of Guinea, where he contributed largely to the turnaround of the economy and the normalization of the strained financial relations with the donor community.

Dr Dore holds a PhD in Economics from the University of Minnesota (USA), a master's degree in Mineral Economics from the University of Arizona (USA), and a master's degree in Public Administration from Harvard Kennedy School (USA).

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Topic: PPP and Infrastructural Development Accelerating the Diversification of Nigeria's Economy
Featuring: Opuio Oforiokuma, ARM-Harith; Dr Ousmane Dore, ADB; Patrick Mgbenwelu, FBN Qeust; Emmanuel Onwodi, ICRC; Rachel More, RMB; Olusola Lawson, AIIM; Adekalu Balogun, PwC; Dayo Alao, NIAF; Leadway Assurance; Oladale Ajayi-Bembe, ALP



Testimonial

Dear Members of ALP, Thank you very much for your mail. Accept my congratulations on the success of the Seminar. I am similarly pleased that our Mr. Onwodi's contributions were appreciated. I thank you also for your firm's sustained efforts to raise the Nation's institutional capacity for delivering Infrastructure through PPP. - Aminu Diko, *Director General - Infrastructure Concession Regulatory Commission*



Nigerian Power Outlook Circa 2020

George Oluwande, PhD, MBA, C.Eng, FIET
Chief Operating Officer & Deputy Managing Director, Sahara Power Group

“By 2020, it is expected that metering as an issue will be long gone, and this will considerably help to reduce ATC&C losses. Improved metering will also help with collections and hence improve revenues for the Discos.”



Background

It is best to start by providing a review of the Nigerian power sector, starting from privatisation of the Power Holding Company of Nigeria (PHCN) and the sale of its:

Distribution companies (11)

- Ikeja Eko
- Benin Ibadan
- Port Harcourt Jos
- Kano Kaduna
- Yola Enugu
- Abuja

Thermal generation companies (5):

- Egbin Ughelli (Delta)
- Sapele Afam
- Geregu I

And the concessioning of the hydro generation companies (2):

- Kainji (which consist of two hydro plants, Jebba and Kainji)
- Shiroro

The privatisation and concessioning of the generation companies (Gencos) was based on a competitive bidding with the highest bidders winning, except for Egbin which had been a transaction started in 2007 and was based on a “willing seller, willing buyer” approach. Depending on the perceived state of the assets, the equity stake sold in the thermal power companies differs, as follows:

- Geregu I (51% Equity Sale)
- Egbin (70% Equity Sale)

- Ughelli, Sapele and Afam (100% Equity Sale)

However, the privatisation of the distribution companies was more novel in that the winning bids were not based on the highest monetary bids but on the bids that had the most realistic highest loss reduction offer over five years for each of the distribution companies (Discos). For the Discos, only a 60% equity stake was sold, with the government retaining the remaining 40%.

There were performance agreements signed with the Bureau of Public Enterprise (BPE) by the winning bidders to deliver either specific aggregated technical, commercial and collection (ATC&C) losses in the case of the Discos, whilst those for the Gencos were based on either expanding or rehabilitating the respective power companies and providing more generation capacities over specific timelines.

A key point to note is that BPE expected that the new owners, having proved their financial capabilities, would be bringing new money for investment to the sector. It was not envisaged that investments would be dependent on the income



of the companies.

In addition to the privatisation of the Discos and Gencos, a management contract was awarded to Manitoba, a Canadian firm, to manage the Transmission Company of Nigeria (TCN) on behalf of the Federal Government.

This was the background to the handover of the power assets on November 1, 2013. (The Kaduna Disco and Afam Genco were not part of the handover to new owners, as their privatisation had not been concluded owing to the fact that these had to be rebid.)

State Privatisation

At handover of the companies, a recognised limitation was the inability to have carried out shadow operations/running of the companies for up to six months prior to this. The original schedule for the privatisation timeline had envisaged a transition period of about six months prior to handover, during which there would have been shadow management of the companies by the new owners.

The non-cooperation of the trade unions forestalled this and meant that the new owners at takeover were not fully conversant with the companies that were being handed over and their assets. This failure had its first fallout in that within weeks of the handover in November, the electricity regulator, the Nigerian Electricity Regulatory Commission (NERC) had to intervene and set up what became known as the interim rules for the market, as it dawned on all that cash flows in the value chain were inadequate to support the sector.

Interim rules

The interim rules were to apply from handover to the start of the Transitional Electricity Market (TEM) of the Nigerian Electricity Supply Industry (NESI). The rules applied to all the electricity produced and delivered to the Discos, as well as associated services during the interim period. The payment rules applied by the Market Operator responsible for payments were:

1. Gencos – Energy charge (100%); Capacity charge (45%). In the case of Gencos that have effective power purchase agreements (PPAs)

during the Interim Period, the Nigerian Bulk Electricity Trader (NBET) was to make up for any difference between the amount received from market funds and the amount due according to the relevant PPA.

2. TSP – 70% of its expected multi-year tariff order (MYTO) 2 revenue.

3. The Regulator (NERC) – 70% of its expected MYTO 2 revenue.

4. Market Operator (MO) – 60% of its expected MYTO 2 revenue.

5. System Operator (SO) – 60% of its expected MYTO 2 revenue.

6. NBET – 20% of its expected MYTO 2 revenue.

Discos were to make payments that were equal to or greater than the Baseline Remittance for invoices related to the Interim Period as stipulated below:

Disco	Baseline Remittance (as a percentage of the MO's invoice)
Abuja	53.5
Benin	37.88
Eko	97.65
Enugu	41.24
Ibadan	65.37
Ikeja	87.55
Jos	20.7
Kaduna	33.16
Kano	62.97
Port Harcourt	47.45
Yola	0

Baseline Remittance meant the average of the four highest monthly payments made to the MO by a Disco under Federal Government ownership between July 2012 – June 2013 calculated as a percentage of the invoiced amount for the relevant month, which shall be the minimum monthly payment to the MO by a Disco during the Interim Period. (Source of table, definitions, and allocation: NERC, "Rules for the Interim Period Between Completion of the Privatisation and the Start of the Transitional Electricity Market 2013".)

Liabilities accrued during the interim period were the responsibility of the Discos to repay to the MO during TEM. These funds were to be used by the MO to pay outstanding revenue due to Gencos, service providers, etc.

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Discos

With the advent of interim rules, all the performance agreements and business plans of the various companies had to be suspended as there were shortfalls all round, with the thermal power companies facing an average of about 30% reduction in their income. The consequence of this was that 100% of payments for gas supplied was not feasible.

For the Discos, on the basis of baseline studies that they were required to carry out, the results showed that the ATC&C losses were between 40% – 60%. Given that the assumptions were that at handover these losses would be between 25% – 30%, it meant that the sector faced a challenging financial environment.

To reduce distribution losses, a key component is the provision of meters to consumers, as this will help to reduce the ATC&C losses by an average of about 60% for the Discos. The Ikeja Disco, for example, had only about 30% of its customers metered, with others having estimated billings. This was representative of all Discos.

However, the introduction of interim rules provided a ready-made excuse for investors and debt-funding to become difficult to obtain. Estimated billings, fixed charges, and the non-rollout of metering plans were seen as major issues by NERC, and this led to a series of pronouncements from the regulator that were not helpful, including giving customers the impression that fixed charges should not be paid.

An initiative called Credited Advance Payment for Metering Implementation (CAPMI) was being pushed by the regulator as a means of ameliorating the metering issue, but the experience of some Discos was that the private installers of the meters were also helping customers post-installation to bypass the meters, thereby exacerbating the losses. So CAPMI was not well taken up by the Discos.

Gas Supply

Gas supply was inadequate to service the thermal power plants with Egbin, for example, having gas available to generate on average about 400MW despite having about 1080MW available capacity daily.



National Integrated Power Project (NIPP)

The NIPP is a three-tier government power infrastructure project to add about 4,800MW of generation, 8,700MVA of transmission capacity (consisting of lines, substations, etc.), and 3,540MVA of injection capacity to distribution as well as lines and distribution transformers.

Following on from the privatisation of PHCN, the NIPP plants were the next in line to be privatised, on an 80:20 equity ratio with the government retaining the minority stake. (These transactions have stalled.)

The additions to the transmission and distribution networks were expected to be valued and transferred to the Transmission Company of Nigeria (TCN) and the respective Discos. Discussions were expected to determine the basis of the transfer of these assets to TCN and the Discos. But the more relevant point is that the NIPP was expected to help reduce the transmission and distribution network bottlenecks, which would impact on availability of power across the country.

Current State Circa 2015

By the end of 2014, the shortfall that had accrued across the value chain to stakeholders to meet their obligations in terms of payments for wholesale electricity had reached over N120

billion and was increasing at a rate of about N12 billion per month. Power plants such as Egbin by end of 2014 were being owed about N26 billion in non-payment and were, in turn, owing the Nigerian Gas Company (NGC) and its gas suppliers over N8 billion in arrears for gas supplied.

Central Bank Intervention Fund

Debt was piling up, and there was also the legacy debt to gas suppliers (i.e., Shell, Chevron) from pre-privatisation to the tune of about N30 billion to contend with. It was clear something had to be done, as the solution devised by NERC under interim rules for the shortfalls to be made the responsibility of the Discos, whilst correct, was not likely to be implementable given the illiquidity of the market.

Given the importance of power to the economic development of Nigeria and realizing the consequences that a failure of the power sector would have on the economy, in particular the banking sector, the provider of acquisition loans, the Central Bank of Nigeria (CBN), decided to weigh in. The proffered solution was to provide an intervention fund of about N213 billion to cover the interim rules shortfall, as well as all outstanding legacy debts.

But the intervention came with some conditions precedent (CPS) to disbursement.



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These were:

1. A cost-reflective tariff to be put in place by the regulator NERC;
2. Gas Supply Agreements (GSAs) to be effected;
3. Gas Transmission Agreements to be effected;
4. Vesting contracts between the Discos and the NBET to be signed; and
5. PPAs to become effective.

Incidentally, 2 – 5 above were also the necessary conditions for TEM to be declared

By December 2014, NERC came out with a revised set of tariffs for the industry that was meant to be cost-reflective. The key points of the new tariff were that:

- The tariff for maximum demand customers went up by an average of about 60% across the Discos; and
- The increases for residential “R2” customers (the bulk of retail customers in the Discos) was to be frozen for six months until July 2015.

From the Discos perspective, this was not satisfactory as for most of them, the R2 category of customers form the bulk of their income, and a freezing of their tariff increases was tantamount to not having any change in income and negated the cost-reflective requirement

In addition, the Manufacturers Association of Nigeria (MAN), to which most of the Maximum Demand customers belong, protested in February, following the implementation of the new tariff, and made it clear that continued implementation of the new tariff would result in factory shutdowns as well as sackings of employees. MAN also called on its members not to pay the new tariff, but to continue with the old one.

For Gencos, the revised tariff had two elements to it – a revised gas price of \$2.50/therm (USD), an increase from the previous \$1.50, and a proposed increase in gas transportation tariff from \$0.30 to \$0.80. Missing from the review of the wholesale tariff, however, was the foreign exchange transition, as the Naira had been devalued from N155/\$1 to N198/\$1 – a 27% devaluation.

Given that spares, gas supply, and technical services provision are all dollar-denominated, this was a major issue for Gencos. In addition, making the GSAs effective required the thermal power companies to open letters of credit (L/Cs) in the amount equivalent to four months' worth of gas supply. In Nigeria, the provision of such L/Cs by Nigerian banks tend to be either cash- or asset-backed, making it onerous for the Gencos to fulfill.

Notice of Force Majeure Intentions from Discos
Rather than stand by its convictions on the revised tariff, NERC capitulated under political pressure as well as the recognition of unrealistic assumptions and, once again, revised the tariff in March 2015. This time NERC decided that collection losses were wholly the fault of the Discos and thus should not be factored into the tariff pricing.

Contrary to international practice of recognising ATC&C losses, the regulator decided on AT&C (aggregated technical and commercial) losses only, and in one sweep ended up reversing the increases that were to result in the cost reflective tariff. For the Discos, this was the proverbial last straw and resulted in most giving notices of intentions to invoke force majeure (FM). This, in turn, led to CBN freezing the disbursement of the intervention fund, having only paid out in instalments about 30%.

TEM?

In the meantime, TEM was declared by NERC – though to most stakeholders, it was difficult to assume this given that most of the CPs for TEM currently were still to be satisfied or met. So far, only eight out of eleven Discos had provided the security required as a CP in vesting contracts with NBET. (As with the Gencos and GSAs, Discos had to put in place three months income worth of L/Cs as part of the requirements.)

Though most GSAs had the CPs completed, they were yet to be effected in view of the dire finances of the sector. The GTAs were yet to be finalized, as NERC had yet to approve the revised \$0.80 tariff, without which the Gencos would have to bear the brunt of the increase and not be allowed to pass on within the wholesale tariff.

The only significant change that had taken place with the “TEM” (as declared by NERC) was that NBET was now responsible for contracting wholesale power from Gencos and selling on to the Discos. However, given the shortfalls from the Discos, NBET was not keen to finalise on PPAs as, by most estimates, once PPAs became effective in the current situation, NBET would likely run out of funds within eight months.

So as the sector moved towards the end of 2015, the debt burden worsened with Egbin, for example, now being owed more than N40 billion. Improvement in gas supply and record-breaking generation levels partly accounted for the significant increase in debt for the Gencos, which Egbin typifies. Since about May 2015, there had been a noticeable increase in gas being made available for power generation. Egbin since June had been generating an average of more than 1,000MW on a daily basis, compared to the previous 400MW – 500MW daily.

The increased availability of gas supply meant that in August, a new national generation peak of 4,811MW was reached. In fact between August and October, the average generation daily was around 4,200MW compared to 3,500MW, which was the norm. Though there had been an increase in gas availability in the country due to an increase in gas processing operations, a significant element in the increase of supply can be attributed to more of the available gas being dedicated to power generation as opposed to other end users of gas.

Load Rejection Phenomenon

A surprising fallout of the increase in power availability was that some Discos were rejecting load. Initially this was because of the need to adhere to the fixed-load allocation to different Discos of the daily generation and the imbalance excess penalties imposed on those that exceeded their allocations. For some Discos, the excess power was fostered on them by the System Operator to help maintain system stability, and to these Discos, having penalties imposed on them for rendering a service on top of not being able to recover fully the cost of the power because of collection losses and power pilferage was not fair.

This resulted in the first cases of load rejection by such Discos. However, since August 2015, imbalance penalties had been cancelled and were no longer imposed by NERC. But this was replaced by a new phenomenon where some Discos were rejecting load because of their ATC&C losses, as they found that additional power provided to them was resulting in more financial loss since the income was less than the cost of the power distributed.

Load rejection meant that generation had been constrained to an average of about 4,500MW even though available power was in excess of 5,000MW.

Revised MYTO – 10 Years Tariff Plans

By the end of 2015, it was expected that there would be a new MYTO in place as approved by NERC. A significant part of this would be Discos-led, as each had to prepare a 10-year tariffs proposal which was expected to be cost-reflective, make provisions for previous shortfalls and debts, including the CBN intervention fund as well as capital investments. The Gencos expected the wholesale tariffs to have been reviewed taking into consideration, foreign exchange realities, inflation and new gas prices.

Future Circa 2020

There are three main bottlenecks to improving the power supply in Nigeria:

1. Inadequate gas supply – Currently there is over 7,000MW of generating capacity available, taking completed NIPP power plants into consideration. Some of these (i.e., Alaoji, Calabar), have insufficient gas to generate. Between them there is over 600MW of plant that is idle due to unavailability of gas.
2. Insufficient transmission capacity – Lip service has been paid to date by the government and the National Assembly to providing sufficient funding to TCN. In 2014, TCN requested a budget of N187 billion Naira and only N1 billion was approved, of which only about N157 million got disbursed.
3. Limited distribution investment – there is an urgent need for all Discos to concentrate on getting the fundamentals right. At a basic level

customer enumeration and technical audits need to be accelerated and completed, as these will enable improved knowledge of the network system, its state, as well the true number of customers. This will enable informed decisions to be made on metering schemes, overloaded transformers and re-conducting of lines/cables as well as load demand forecasting.

Underpinning the solutions to the bottlenecks is funding. It is expected that innovative means of capital investments will be devised, including bonds, support from multi-lateral agencies (i.e., AfDB, World Bank, OEM-led finance, transmission PPP, etc.).

Metering

By 2020, it is expected that metering as an issue will be long gone, and this will considerably help to reduce ATC&C losses. Improved metering will also help with collections and hence improve revenues for the Discos.

Value Chain Shortfalls

With the 10 years of financial instruments (i.e., bonds, promissory notes, and new money) going into the sector and the Discos in particular, it is expected that the shortfall and illiquidity in the power value chain will have disappeared.

Available Generation Capacity

It is predicted that the available generation capacity in the country will be about 15,000MW. All the NIPP plants will be completed and fully operational. Egbin will have embarked on the doubling of its capacity; Afam, Kainji, Sapele and Ughelli will have fulfilled their performance pledges to increase capacity through rehabilitation and new units; Azura (an IPP) as well as the Total power project will also be completed. Ongoing projects will also include the Zungeru Hydro Power plant.

Renewables

There is a role for renewables to play, in particular solar plants as well mini-hydros. However, the key to the development and implementation of such projects will be commercial viability. The pricing of the electricity produced will have to be competitively priced, as the intermittency of generation will make it difficult to charge a premium tariff to end-users. Solar projects, in particular, will have to be more in the realm of embedded generation serving out-reaches and the hinterlands.

Availability of Gas

With the completion of the ELPs II gas pipeline, the East-West interconnector, and the privately funded Dangote subsea pipeline to Lagos, there should be adequate gas infrastructure to service the power plants and enable gas to be supplied. The move to deregulated pricing for gas means that there will be an incentive for greater gas fields exploration and development.

Bilateral Contracts

With the genuine takeoff of TEM, there will also be more opportunities for bilateral contracts between generators and Discos or large end users.

West African Power Pool (WAPP)

WAPP is currently not getting the attention it deserves in Nigeria, but it is envisaged that by 2020 especially with increased possibility of bilateral contracts, there will be opportunities for Nigerian utilities to become more involved either through selling or buying power from neighbouring countries.

In conclusion, by 2020, the Nigerian Electricity Supply Industry (NESI) should have come of age.

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Revisiting the Subsidy Debate in Nigeria's Transitional Electricity Market

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“The daunting question begging to be answered is: How can Nigeria ensure the realisation of the goals of liberalisation, including the expansion of the industry to the extent of attainment of universal coverage in a market characterised by the dominance of poor consumers, without the retention of subsidy at some level of the market?”

INTRODUCTION

As the Federal Government of Nigeria begins the process of gradual removal of subsidy in the petroleum industry of the country, focus is now shifting to the electricity supply industry (ESI) and the embedded subsidy in the pricing of the commodity.

Advocates for the removal of subsidy in the ESI posit the view that the same ills identified in the retention of subsidy in the petroleum sector – distortion of the market, dependency culture, and corruption – equally exist in the subsidised ESI. This position is irrespective of the structure of the industry although one significant fact has emerged: Reversal of the ongoing liberalisation process is unrealistic and could be economically costly. Moreover, even though competitive electricity markets are still relatively recent, there is clear empirical evidence that well-designed competitive markets do work and can bring economic benefits.

The daunting question begging to be answered is: How can Nigeria ensure the realisation of the goals of liberalisation, including the expansion of the industry to the extent of attainment of universal coverage in a market characterised by the dominance of poor consumers, without the retention of subsidy at some level of the market?

This article, using the qualitative doctrinal and empirical methods of legal research,

examining both primary and secondary data, seeks to explore the different aspects of this question. It particularly examined the extent to which the “blanket subsidy” policy in operation in the ESI in Nigeria could be maintained in the transitional market considering the position of the extant law in the country and the opposition to so doing by international developmental partners.

Nigeria's Electricity Policy

The electricity policy of Nigeria as contained in the National Energy Policy 2003 provides that “the nation shall make steady and reliable electric power available at all times, at economic rates, for economic, industrial, and social activities of the country”. In so doing, it shall continue to engage intensively in the development of electric power with a view to making reliable electricity available to 75% of the population by the year 2020. It shall also promote private sector participation in the electricity subsector, while ensuring broad-based participation of Nigerians.

One of the strategies for the implementation of this policy is the establishment of “a reduced tariff regime for very low-income and especially handicapped electricity consumers and a mechanism for funding the subsidy”. To achieve this, a number of measures were adopted:

A regulated end-user tariff that existed in the period of the vastly criticised monolith, the National Electric Power Authority (NEPA), was

1. Manuel Baritaud, *Securing Power during the Transition: Generation Investment and Operation Issues in Electricity Markets with Low-Carbon Policies*, OECD/IEA, 2012, P. 9
2. Energy Commission of Nigeria (2003), “National Energy Policy”, April 2003, Pp.36

3. Energy Commission of Nigeria (2003), “National Energy Policy”, April 2003, Pp.36-38
4. The Presidency Federal Republic of Nigeria, *Roadmap for Power Sector Reform 2010*, p. 5
5. *Ibid*, p. 5-6

retained. In doing so, however, the Nigerian Electricity Regulatory Commission (NERC/the Commission) was authorised to replace the national uniform tariff with a new cost-reflective ceiling on end-user tariffs. The replacement was made over a period of time commencing in 2007 and reviewed periodically. Still, in order to protect against “rate shock” and to ensure that low-income consumers are provided with the “lifeline” tariff, a much greater price differentiation was made. Also, an inclining block tariff, whereby the rate paid for electricity varies with a given level of consumption, was introduced.

NERC developed the Multi-Year Tariff Order (MYTO) in 2007, which allows for the full pass-through of allowable costs at the distribution level. It provides a 15-year tariff path for the electricity industry, with limited minor reviews each year in the light of changes in inflation, exchange rate, and gas prices; and major reviews every five years. The Government of Nigeria approved the implementation of the MYTO and agreed to provide N177.950 billion over a three-year period to finance the Electricity Equalisation Fund.

The tariff regime requires government support to meet the shortfalls between the required revenue and the collected revenue, which translated to N64.840 billion in the first year, N77.310 billion in the second year, and N35.800 billion through a tariff equalisation fund.

The government subsidy was planned to phase out over a pre-determined transition period, now set at 2012. In 2009, the then Administrator of NERC, Imamudeen Talba, explained that the Federal Government of Nigeria, in three years (from 2009 to 2012), would spend about N177 billion as a subsidy to consumers of electricity. The amount would come from savings accruable from the N5.20 tariff increase to be paid

by consumers during the period. He professed that from 2012, Nigerians would pay the full tariff.

In 2012, the Commission completed a major tariff review where it established separate tariff regimes for each of the three measure areas of the industry – generation, transmission and distribution. (See Table 1 for the Energy and Fixed Charges for the Kaduna Distribution Company under MYTO 2.1 2012 – 2015.) In 2015, MYTO was further reviewed to cover the period from April 2015 to December 2018. (See Table 2 for the Energy and Fixed Charges for the Kaduna Distribution Company under the Amended MYTO 2.1 2015 – 2018.)

Over the years, Nigeria's electricity consumers have generally been shielded from payment of the actual price of electricity. Retail electricity prices have not traditionally kept pace with inflation. Billings for electricity were based, largely, on estimates as against actual consumption from accurate meter readings.

The retail electricity tariff consists mainly of two elements:

1. Energy charge (for variable cost recovery); and
2. Fixed charge (for capital cost recovery).

Electricity consumers are, generally, divided into six categories:

1. Residential;
2. Commercial;
3. Industrial;
4. Street lighting;
5. Customers on special tariff; and
6. International customers.

Because of the differential tariff structure for commercial and residential customers, residential customers have a lower tariff level.

6. See the Nigerian Electricity Regulatory Commission's Notice of proposed Establishment of a Methodology for a Multi Year Tariff Order 2007, Federal Republic of Nigeria Official Gazette, Volume 94 of 27th April 2007, B125-133

7. The Presidency Federal Republic of Nigeria, Roadmap for Power Sector Reform 2010, p. 22

8. Prasad V.S.N. Tallapragada, (2009), Nigeria's Electricity Sector- Electricity and Gas Pricing Barriers, International Association for Energy Economics Newsletter, First Quarter, P. 31

9. Speaking at an awareness campaign tagged 'Power Consumer Assembly' in Katsina, Katsina State, Nigeria in August

TABLE 1: Energy Charge N/KWH and Fixed Charge N/Month,
Kaduna Distribution Company, 2012-2015

Tariff Code	Charge Type	2012	2013	2014	2015
Residential R1	Energy	4.00	4.00	4.00	4.00
	Fixed	-	-	-	-
Residential R2	Energy	12.69	13.96	15.36	16.90
	Fixed	500	800	1,280	2,048
Residential R3	Energy	23.33	25.66	28.23	31.05
	Fixed	25,018	40,029	64,046	102,474
Residential R4	Energy	23.33	25.66	28.23	31.05
	Fixed	156,356	250,170	400,271	640,434
Commercial C1	Energy	16.00	17.60	19.36	21.30
	Fixed	500	800	1,280	2,048
Commercial C2	Energy	21.68	23.85	26.24	28.86
	Fixed	22,680	36,288	58,061	92,897
Commercial C3	Energy	21.68	23.85	26.24	28.86
	Fixed	141,748	226,797	362,875	580,600
Industrial 1	Energy	17.50	19.24	21.17	23.29
	Fixed	1,000	1,600	2,560	4,096
Industrial D2	Energy	22.73	25.00	27.50	30.25
	Fixed	139,466	223,146	357,033	571,253
Industrial D3	Energy	22.73	25.00	27.50	30.25
	Fixed	141,748	226,797	362,875	580,600
Special 1	Energy	16.75	18.42	20.26	22.29
	Fixed	500	800	1,280	2,048
Special 2	Energy	16.75	18.42	20.26	22.29
	Fixed	46,728	74,766	119,625	191,400
Special 3	Energy	16.75	18.42	20.26	22.29
	Fixed	62,500	100,000	160,000	256,000
Street Lighting	Energy	14.19	15.61	17.17	18.89
S1	Fixed	500	800	1,280	2,048

Source: NERC, Summary of MYTO 2 Retail Tariffs developed under the Multi-Year Tariff Order (MYTO) for the Determination of the Cost of Electricity Generation for the Period 1st June 2012 to 31st May 2017, file:///C:/Users/Admin/Downloads/MYTO2_Retail_Tariffs.pdf, P. 13-14

TABLE 2: Energy Charge N/KWH and Fixed Charge N/Month,
Kaduna Distribution Company, 2015-2018

Tariff Code	Charge Type	2015	2016	2017	2018
Residential R1	Energy	4.00	4.00	4.00	4.00
	Fixed	-	-	-	-
Residential R2	Energy	20.66	20.33	23.13	22.24
	Fixed	00	960	152	1,382
Residential R3	Energy	34.30	33.75	38.39	36.92
	Fixed	40,029	48,035	57,641	69,170
Residential R4	Energy	34.30	33.75	38.39	36.92
	Fixed	250,170	300,204	360,244	432,293
Commercial C1	Energy	23.52	23.15	26.33	25.32
	Fixed	00	96	1,152	1,382
Commercial C2	Energy	31.88	31.37	35.68	34.32
	Fixed	36,288	43,546	52,255	62,706
Commercial C3	Energy	31.88	31.37	35.68	34.32
	Fixed	226,797	272,156	326,587	391,905
Industrial 1	Energy	25.72	25.31	28.79	27.69
	Fixed	1,600	1,920	2,304	2,765
Industrial D2	Energy	33.42	32.88	37.41	35.97
	Fixed	55,787	66,944	80,333	96,399
Industrial D3	Energy	33.42	32.88	37.41	35.97
	Fixed	226,797	272,156	326,587	391,905
Special 1	Energy	24.62	24.23	27.56	26.51
	Fixed	800	960	1,152	1,382
Special 2	Energy	24.62	24.23	27.56	26.51
	Fixed	74,766	89,719	107,662	129,195
Special 3	Energy	24.62	24.23	27.56	26.51
	Fixed	100,000	120,000	144,000	172,800
Street Lighting	Energy	20.86	20.53	23.35	22.46
S1	Fixed	800	960	1,152	1,382

Source: NERC, Amended MYTO 2.1 for the Period 1st April 2015 to December 2018, P. 30-31



On December 21, 2015, NERC announced the removal of fixed charges for all classes of consumers rendering that aspect of MYTO redundant. It outlined a new tariff regime, which requires consumers to pay only for the energy consumed. The new tariff regime however comes with an increase in the energy charge.

A Power Consumers Assistance Fund (PCAF) was established by the Commission, pursuant to Section 83 of Electric Power Sector Reform Act 2005 (EPSR Act, 2005), to subsidise underprivileged consumers as designated by the Minister. According to the Act, PCAF draws its funding from contributions from consumers and eligible customers and subsidies from the Federal Government.

A careful review of the legal requirement for a contributory fund for the payment of subsidies

(Section 83(3) of EPSR Act) and the individual States' right to make energy policies that affect them will reveal a serious procedural inadequacy. Section 4 (7) of the Constitution of the Federal Republic of Nigeria 1999 (as amended) which provides that "the House of Assembly of a State shall have power to make laws for the peace, order and good government of the State or any part thereof" with respect to certain matters including:

(a) Any matter not included in the Exclusive Legislative List set out in Part I of the Second Schedule to this Constitution.

(b) Any matter included in the Concurrent Legislative List set out in the first column of Part II of the Second Schedule to this Constitution to the extent prescribed in the second column opposite thereto.

Item 14 of the Concurrent Legislative List provides that "a House of Assembly may make laws for the

2009; see http://www.energy.gov.ng/index.php?option=com_content&task=view&id=54&Itemid=58 - last visited on 20th December 2015

10. See the Multi Year Tariff Order 2 of 2012

11. See NERC: Amended Multi Year Tariff Order (MYTO) – 2.1 for the Period April 1st, 2015 To December 2018, Order No. NERC/REG/3/2015

12. Report of Investigation into the Huge Sums of Money Spent on Power Generation, Transmission and Distribution between June 1999 and May 2007 without Commensurate Result; House of Representatives, National Assembly, Abuja, Nigeria, May 2008, p.96

13. Augustine Okezie and Opeoluwani Akintayo, NERC unveils New Tariff Regime, Removes Fixed Charges, 22

State with respect to – (a) electricity and the establishment in that State of electric power stations; (b) the generation, transmission and distribution of electricity to areas not covered by a national grid system within that State; and (c) the establishment within that State of any authority for the promotion and management of electric power stations established by the State.”

Without the resolution of this procedural inadequacy in the design of the contributory fund, there is the likelihood of challenges in its execution.

Subsidy in Nigeria's ESI – A Conundrum

The apparent shielding of consumers from the true market value of electricity had been in existence for as long as the industry existed. The shielding had been, mostly, in the form of regulated prices combined with the use of differentials between charges payable by consumers and cost of production. Such policy has been attributed to the peculiarities of the country, poverty, and a large rural population.

As of 2008, of the more than 150 million people who compose the population of Nigeria, 70% live below poverty line. This depth of poverty remains unchanged – stagnated and, in some instances over the years, has even become worse. For example, the 2010 Global Monitoring Report of UNESCO reveals that 92% of the Nigerian population lives on less than \$2 (USD) a day, while about 71% of the population lives below \$1 a day.

The 2015/2016 Global Monitoring Report produced jointly by the World Bank and International Monetary Fund (IMF), which applied the reclassified poverty line of living on \$1.90 or less a day, finds that poverty is becoming increasingly concentrated in Sub-Saharan Africa, where its depth and breadth remain an overriding challenge. According to IndexMundi, in the year

2015, 70% of Nigerians live below the poverty line. The EPSR Act 2005, by design, envisaged a mechanism through which the electricity needs of the rural population will be satisfied. This is through the establishment of the REA (Section 88), which provides electricity to the rural population through isolated and mini-grid system, while the pricing of the product would be regulated and government would subsidise the rate through the Electricity Equalisation Fund.

Several studies by the World Bank and the IMF have argued against the use of subsidy in the promotion of social welfare. They argue that subsidy encourages the culture of dependency and facilitates corruption in the industries where it applies.

They further argue that rather than curing poverty, what subsidy does is subsidise poverty and discentivise the subsidised from seeking for better opportunities to overcome their dependency on the subsidy. This presupposes the “refusal” by the subsidised to take advantage of the “available” economic opportunities in order to uplift their standard of living. This is a highly debatable position, especially as it applies to the situation in Nigeria. In the absence of accumulated data in proof of such “dependency culture” by the subsidised, which is linked to the existence of subsidy, it will be difficult to conclude on the issue.

There is no universally acceptable definition of the word “subsidy”. Various scholars define the word in accordance with the tenets of their areas of interest. For example, the economist Mark Jamison defines subsidy as the difference between the incremental cost of service and the capacity-to-pay of users. The Organisation for Economic Co-operation and Development (OECD) opines that subsidy is the result of a government action “that confers an advantage on consumers or producers, in order to supplement their income

December 2015, <http://dailytimes.com.ng/nerc-unveils-new-tariff-regime-removes-fixed-charges/>

14. Ibid

15. Toba Suleiman (2008), Ibid

16. UNESCO (2010), supra, p.307. Living 'below poverty line' is currently estimated at living on less than US\$1.25 a day, at 2005 exchange rates. The OECD defines poverty as living in a household with a household disposable income of less than

half the median for the whole population. See UNESCO (2010), *ibid*, p.165.

17. Global Monitoring Report 2015/2016, Development Goals in an Era of Demographic Change, p.1

18. Index Mundi, Country Comparison of Population below Poverty Line, <http://www.indexmundi.com/g/r.aspx?v=69> – last visited on 20th December 2015

19. IMF Position Paper (2010), “Petroleum Product

or reduce their costs". Barry Naughten, et al, consider subsidy as being akin to market distortions, irrespective of whether they are in the form of explicit or implicit subsidies of inputs into electricity supply or otherwise.

In Nigeria, a Power Consumers Assistance Fund (PCAF) is established by the Commission pursuant to Section 83 of EPSR Act, 2005, to subsidise underprivileged consumers as designated by the Minister of Power. The Federal Government provides subsidy in the price of electricity in order to maintain a viable tariff for

the industry. The tariff takes the form of per unit payment, which reduces each year in order to allow the gradual introduction of viable industry tariff. Table 3 shows the average cost of supply, the Federal Government subsidy, and effective average tariff in Naira per KWH for the period 2008 to 2012.

With the identified level of poverty in Nigeria, the requirement of payment of competitive price for electricity by all, especially at the inception of market opening before price stabilisation, appears to be untenable. This will require the maintenance

Table 3: Average Cost of Supply, FG Subsidy, and Effective Average Tariff (N/KWH)

Year Starting 1 July	2008	2009	2010	2011	2012
Estimated cost of Supply	11.20	10.64	9.49	10.00	10.00
Less Subsidy	5.20	3.64	0.99	0	0
NERC Determined Tariff	6.00	7.00	8.50	10.00	10.00

Source: NERC, Multi-Year Tariff Order (MYTO) for the Determination of Charges and Tariffs for Electricity Generation, Transmission and Retail Tariffs for the Period 1 July 2008 to 30 June 2013 Order No. NERC/GL0159, p.30



of subsidy in competitive market to ensure universal coverage of the service or the imposition of universal service obligation. Alternatively, there could be retention of a public service supplier (supplier of last resort), at least for the transition period of market opening.

However, the determination of persons eligible for the public service supply may pose administrative difficulties to the authorities, running the

Subsidies: Costly, Inequitable, and Rising", February 25, 2010, SPN/10/05 (authored by David Coady, Robert Gillingham, Rolando Ossowski, John Piotrowski, Shamsuddin Tareq, and Justin Tyson). Electronic copy of the paper can be found at <http://www.imf.org/external/pubs/ft/spn/2010/spn1005.pdf>. See also IEA, OPEC, OECD, World Bank Joint Report (2010) "Analysis of the Scope of Energy Subsidies and Suggestions for the G-20 Initiative", submission to the G-20 Summit Meeting

Toronto (Canada), 26-27 June 2010, 16 June 2010. Electronic copy is available at <http://www.oecd.org/dataoecd/55/5/45575666.pdf> – last visited on 20th December 2015

20. See, for example, Mark A. Jamison & Sanford V. Berg (2008), *supra*

21. OECD (2005), "Environmentally Harmful Subsidies: Challenges for Reform", p.16

22. See Barry Naughten et al (1997), "Modelling 'Supports' to

risk of “errors of exclusion” or “errors of inclusion”. Neither blanket subsidy, as exemplified by the MYTO, nor subsidy based on level of consumption as advocated by the Roadmap for Power Sector Reform 2010 is suitable for Nigeria. A possible alternative is subsidy based on income, which equally has its attendant difficulties of application.

Apart from subsidy based on income, another form of subsidy suitable for Nigerian situation is subsidy based on input, such as subsidy for personal installation of solar generator programme. This could encourage the start of new small and medium industries, boost demand, and decrease initial costs for new energy facilities. This is particularly attractive to Nigeria, which is characterised by numerous settlements widely located at long distance with each other.

This has worked with a tremendous success record in Japan. Standard specifications for such installations should form part of the licence agreement of the licensee. This could be promoted through the establishment of a Community Energy Centre. The Centre could coordinate the optimisation of distributed electricity system and determination of the terms of agreement between electric utilities and self generators. Equally poignant is the provision of incentives to IPPs utilising renewable energy sources for generation of electricity.

The retention of subsidy in the pricing mechanism for the ESI in Nigeria suggests the prioritisation of “social justice” over economic prudence, which is a convergence of political expediency with social justice.

The argument that subsidy subsidises corruption in some societies is not without basis. Decades have passed and billions of dollars provided by donor agencies for the provision of social services in developing countries with little progress made in that regard. The consideration of

the effectiveness of decades of subsidies in developing countries is beyond the scope of this article; however, it is acknowledged that several studies have noted the dismay of donors with regard to the ineffectiveness of such grants and subsidies.

(See for example, the position paper titled “Petroleum Product Subsidies: Costly, Inequitable, and Rising” issued in February 2010, by the IMF, written by David Coady, Robert Gillingham, Rolando Ossowski, John Piotrowski, Shamsuddin Tareq, and Justin Tyson. See also the IEA, OPEC, OECD, World Bank Joint Report: “Analysis of the Scope of Energy Subsidies and Suggestions for the G-20 Initiative,” a submission to the G-20 Summit Meeting in Toronto, 26–27 June 2010.)

In one of OECD's reports titled “Environmentally Harmful Subsidies: Challenges for Reform,” the organisation argues that maintaining the competitiveness of an industry through subsidisation may very well be an uphill struggle in defending the industry against ever more efficient competitors. The organisation is not completely averse to the provision of subsidies that “support the use of energy saving devices or the development of renewable energy”. On its part, IEA acknowledges that: “Judicious use of energy subsidies can help address market failures or respond to social and distributional objectives, especially where social welfare mechanisms for directly providing income support to the poor do not exist. Subsidies can also be critical for ensuring access to modern energy services, including electricity, for the poorest.”

However, they maintain that “subsidies to consumptions, by lowering end-use prices, can encourage increased energy use and reduce incentives to conserve energy efficiently”.

the Electricity Sector in Australia’ in *Reforming Energy and Transport Subsidies: Environmental and Economic Implication*, Pp.107-113

23. NERC, Multi-Year Tariff Order (MYTO) for the Determination of Charges and Tariffs for Electricity Generation, Transmission and Retail Tariffs for the Period 1 July 2008 to 30 June 2013 Order No. NERC/GL0159, p.30

24. See pages 5-6 of Roadmap for Power Sector Reform in

Nigeria, 2010

25. See Balkisu Saidu (2010), *supra*

26. February 25, 2010, SPN/10/05; electronic copy of the paper can be found at <http://www.imf.org/external/pubs/ft/spn/2010/spn1005.pdf> - last visited on 20th December 2015

27. Electronic copy is available at <http://www.oecd.org/dataoecd/55/5/45575666.pdf> - last visited on 20th December 2015

There are also arguments that subsidies, especially those driven by political considerations, can hinder the ability of new and emerging industries to compete fairly in the market place. For example, Doug Koplow examines the federal subsidies in the energy sector in the US, which is conservatively estimated at \$40 billion and \$69 billion per year in 2003 with an addition of \$85 billion over a 10-year period pursuant to the Energy Policy Act of 2005, and concludes that apart from hindering the ability of new and emerging industries to compete fairly in the market place, subsidies “can impede the attainment of social and environmental goals”.

It is worthy of note that more than 50% of the subsidy in the US is in favour of conventional energy, specifically the oil and gas sectors. Koplow suggests three ways to reform the design and provision of subsidy in the energy sector; ways that could also help in the improvement of design and provision of subsidy in the ESI in Nigeria, namely:

1. Subsidy Contestability: He opines that this will force multiple recipients of subsidy to compete for access to subsidy programmes. He envisages a situation whereby various options will be developed for achieving a particular policy objective; these options will be featured against one another and the most efficient option will be chosen and funded.
2. Increased transparency on subsidy amounts and beneficiaries from within the government. This includes improved transparency of legislative activities, improved transparency of tax expenditures, especially accurate evaluation of prospective legislation that will determine the tax benefits accruable to certain activities.
3. Increased transparency from outside of the government. This involves the active participation of NGOs and the general public requiring them to

be proactive rather than reactive in ensuring that subsidy beneficiaries are actually those eligible based on their circumstances and not just because of some crafty legislative device.

Considerations Going Forward

Changes in policies usually bring the issue of subsidy to the forefront; however, not all changes require the provision of subsidy. Changes within an industry that touch directly on the economic standing of the citizens who ultimately require the service of the related industry will surely raise questions as to the ability of the affected citizens to adapt within the parameters of the introduced changes.

While many forms of subsidies, financial and otherwise, exist in the ESI in Nigeria, the requisite data needed to quantify their value is lacking. The only data available is that which relates to the subsidy on pricing of electricity.

In advocating for the provision of subsidy it is always necessary to identify the underlying basis for such advocacy or the problem that warrants such advocacy and to determine whether the provision of such subsidy will translate into a long-term resolution of the underlying problem. This is so because if the subsidy merely treats the symptom(s) rather than solve the problem, it will result in the perpetuation of the status quo and will extend the continuation of the “dependency culture” indefinitely as envisaged by the World Bank and IMF. Ideal subsidy is usually time-limited, removable once the underlying problem is resolved.

The notion that subsidy breeds a culture of dependency does not appear to be supported by evidence accumulated, especially as it relates to Nigeria. In Nigeria, there are very limited available economic opportunities for entrepreneurship, which is attributable, in part, to the lack of

28. OECD (2005), *supra*, p.71

29. OECD (2005), *ibid*, p.9

30. IEA, OPEC, OECD, World Bank Joint Report (2010), *supra*, p.

31. *Ibid*

32. OECD Sustainable Development Studies (2007), “Subsidy Reform and Sustainable Development Political Economy Aspects”, Pp.93-94

33. *Ibid*

34. See generally *ibid*, especially Pp.99-106

35. For a more detailed discuss on the design of subsidy in the ESI in Nigeria see Balkisu Saidu (2010), “Committing to Legal and Regulatory Reform: An Analysis of Legal and Regulatory Framework of the Electricity Supply Industry (ESI) in Nigeria”, in Energy, Environment & Economic Growth, Proceedings of the 2010 NAAE Conference, Pp.60-106

sufficient and secure electricity supply in the country, creating a vicious cycle.

It is further submitted that the provision of subsidy in the ESI aimed towards the attainment of universal coverage and creation of robust and efficient ESI will lead to the expansion of the economic sphere and create opportunities for the improvement of the standard of living of the people.

Once a robust electricity market is established and competition ensues; once Nigerians, irrespective of geographical location, have access to secure electricity and the economic activities in the country thrive, there will be no need for the provision of the subsidy as the population, from improved economic activities, will be capable of paying the market price for the product.

Moreover, the market forces will ensure that prices for the product remain competitive and possibly low. This will result in the creation of a virtuous cycle.

Conclusion

Subsidy is an issue that stimulates a lot of debate. That is because subsidy embodies multiple pros and cons. Depending on the usage, it could result in positive outcomes. It could equally result in negative unintended outcomes. Indeed, lower prices can be achieved (without necessarily the use of price caps) through competitive pressure to reduce costs and prices to marginal cost. It is suggested by competition ideologues that

consumers should not be shielded from the true cost of electricity because it is only then that they will manage their use of electricity through change of pattern and usage. Their reasoning being that behavioural change (towards efficiency) in the use of electricity is not only beneficial to the consumers in terms of lower bills but also to the system in terms of improved efficiency and increased reserve which translate into system reliability.

The stated merit of this proposition is valid to the extent that the "true cost of electricity" is limited to the cost and "reasonable" profit; and the best way to ensure that is through effective regulation. Simultaneous pressure for both efficiency and price restraint is needed. Efficiency does not necessarily entail lower prices. Efficiency is the reduction of wastefulness which may lead to price reduction or not.

Where price is brought to the barest minimum in an inefficient sector, the consumer would not feel the impact. Therefore, any subsidy that is based on level of consumption may lead to inefficiency and may not be ideal for the situation in Nigeria. With the December 2015 removal of fixed charges for all classes of consumers and the clamour for the removal of all forms of subsidy in the industry, it remains to be seen what viable incentives would be designed by the policymakers to retain the interest of investors in Nigeria's transitional electricity market.

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Low Oil Prices as a Strategic Advantage!

OIL AND GAS PRACTICE WHITEPAPER

Richard Atoshi Danladi LLB, BL

“In spite of the prolonged free fall of oil prices, it is not all doom and gloom.”



It is no longer news that oil prices just keep falling and crashing into things on their way down. Over production of the commodity has seen the price of oil plummet over the past two years, from its 2014 high of \$112 (USD) a barrel to a sub \$30 nadir in February this year. A steady recovery since then has left prices hovering around \$45 – \$50. The US Energy Information Administration estimates that in 2014 the increase

in the global supply of petroleum and other liquid fuels was almost twice the increase in consumption. That, of course, was a recipe for lower prices and shrinking profits that presented, and still presents, a troubling outlook for big oil companies that invested billions of dollars in oil exploration when prices were high and the not-so-big ones as well. Suddenly, these companies are left in the lurch with the abrupt and prolonged

decline in prices. For Nigeria and Nigerian producers, these are interesting times, indeed, because the major commodity, petroleum, which Nigeria's revenues mainly hang on to, is being threatened. It is under intense attack from a global oversupply of oil, the drastic improvement in shale gas technology in America, the continuous efforts of the US to achieve oil independence, and recent geo-political tensions with major oil producers. Though the global drop in oil prices has analysts, stakeholders, the government, industry players, and just about everyone else mulling over the shrinking profitability of the oil industry, we believe that in spite of the prolonged free fall of oil prices, it is not all doom and gloom.

We see a bright light at the end of the tunnel as there are still business and investment opportunities to be tapped and explored from the situation if one looks a little bit further and acts smarter. We concede that oversupply and lower prices represent a real challenge to the industry, but that does not mean the future is completely dismal. It just means that operators and industry players need to be prepared and to adopt strategies that take advantage of the new reality. They just need to think about the opportunities differently.

This article examines global trends in oil prices, considers key factors influencing international crude oil prices, and highlights the positive outcomes and opportunities to be explored in the oil and gas industry in spite of the global plunge in oil price. It further conceptualises and lays out a strategy for taking advantage of the fall in oil price in order to make profits. We believe that operators resilient enough to weather the challenge posed by lower oil prices will come out stronger than when they entered the period of price decline. While others may be pessimistic, we are aggressively optimistic. We are watching developments in the industry, analyzing changes from the perspective of how they will impact

stakeholders and looking for ways in which we can best help stakeholders anticipate and manage these dynamics.



Global Trends in Oil Prices

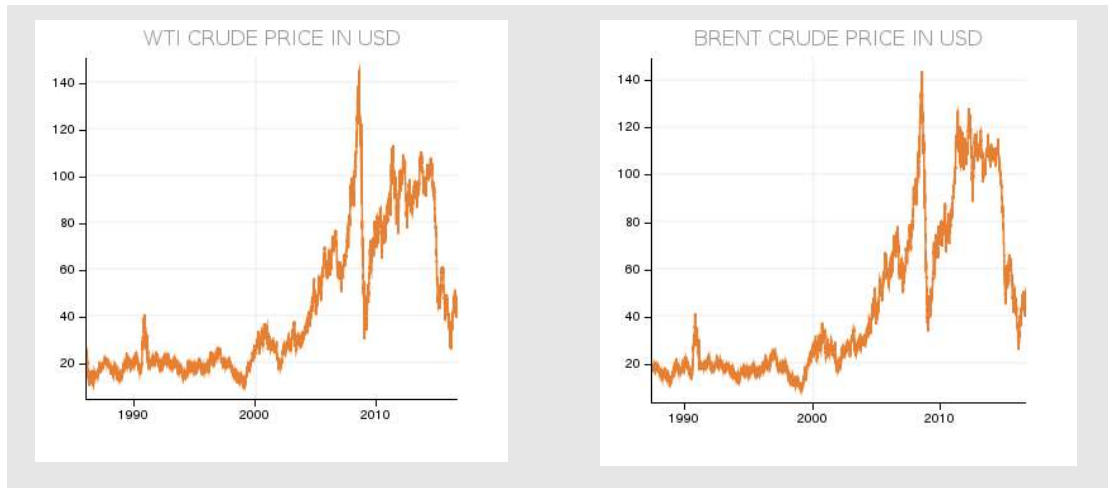
This is hardly the first time the price of oil has experienced a free fall. It always recovers or rebounds. Over the years, oil price movement has been an important driver of the global economic outlook with its booms and busts. The last two decades have witnessed a dramatic trend in the global oil market. During the first half of the 1990s oil prices witnessed a stable decline (until 1996), after which a somewhat volatile trend was experienced until 2000. After easing in 2000 and 2001, global oil prices rose consistently till the end of 2008 through 2009, after which the upward trend resumed from 2010 until the downhill slide from June 2014 till today.

Analysis based on the OPEC Reference Basket price, Nigeria's Bonny Light, UK Brent, and the US West Texas Indicator (WTI) shows that the global price of oil dropped from between \$22 per barrel and over \$24 per barrel in 1990, to between \$15 and more than \$18 in 1995. The price trend recovered in 1996 to between \$20 for the OPEC Reference Basket and \$22 for the US WTI, but the recovery was short-lived. The downward trend resumed at the end of 1996 to as low as \$12.30 per barrel for the OPEC Reference Basket in 1998 as illustrated in the figure below. The years 1999 to 2001 were volatile for the global oil market with price moving sharply from \$12.30 and \$14.40 (US

WTI) in 1998 up to \$27.60 and \$30.40 in 2000. There was a sharp plunge again in 2001 before a resumption of a consistent rise to as much as \$94.50 for the OPEC Reference Basket and \$100.60 for Nigerian Bonny Light in 2008. The world oil price experienced a sharp decline again

in 2009 to as low as \$61.10 per barrel for the OPEC Reference Basket before another big climb until the recent free fall to about \$ 49 per barrel. So, as can be seen from the data above, oil price fluctuations have been a trend for many years. All hope is not lost. Prices will rebound.

As at 06-Sep-2016, the current Brent crude oil price was 47.43 dollars per barrel



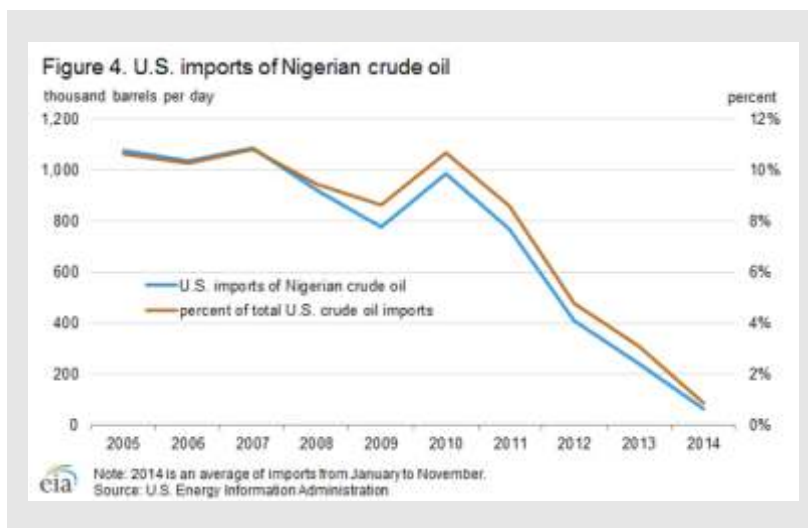
Key Factors Influencing International Crude Oil Prices

Global output of crude oil and demand for oil to drive growth and the needs of a growing world population will continue to drive the world price of oil. We have seen this played out with the ability of

the US to extract oil from shale rock formations by hydraulic fracturing or “fracking”, leading to less demand for imported crude in that country. Formerly, the US was the world's largest consumer of crude oil and petroleum products. Currently, that position is different, and the demand shift is

now towards the Asian markets as a result of growth in developing countries such as China and India.

World oil prices are influenced by a number of factors, many of which have mainly short-term impact. Others, such as expectations about world oil demand and OPEC production decisions, affect prices in the longer term. Supply and demand in the world oil market are balanced through





Taking Advantage of the Oil Price Crash

The price of crude oil has fallen drastically in the international market, and this has affected producers and exporters negatively. The volatile aspect of the petroleum business is largely out of the control of industry players and leaders alike. Like almost everyone else, they are seemingly helpless. So in view of the current plunge in price, should oil companies just despair, count their losses, and accept their fate? Of course not! Instead, oil and gas companies (producers and service companies alike)

responses to price movements, and the factors underlying expectations for supply and demand are both numerous and complex. The ground in the oil patch has shifted dramatically. The forecast for the industry is extremely different today from how it looked just a couple of years ago when the fundamentals of the oil industry were controlled by cartels, such as OPEC. Traditional structural discipline has been replaced by a systemic imbalance marked by vastly increased supply and receding demand growth. Global economic weakness, tougher fuel economy regulations, more viable forms of alternative energy, and the development of extraordinarily efficient engines on equipment as varied as cars, earthmovers, and power plants have all combined to dramatically curtail the need for oil. Meanwhile, robust new reserves in numerous regions around the world are glutting the market.

The key factors determining long-term expectations for oil supply, demand, and prices can be summarised in four broad categories: the economics of non-OPEC conventional liquids supply; OPEC investment and production decisions; the economics of unconventional liquids supply; and the dynamics of world oil market.

whose future is still a puzzle should design a strategy for survival and ask themselves a few simple questions, not entirely divorced from the cost of oil:

- Are we prepared to thrive in a business environment that is oversupplied?
- If we are prepared to thrive in a business environment that is oversupplied, what are the key issues affecting risks, and how can we mitigate them?
- Where do we go to lock in demand? Is it the Asian markets?
- With demand shifting towards the Asian markets, do we have an Asian market strategy?
- Do we have the right technology to meet the challenges of the industry, especially in view of the current price crash?
- Have we analysed our contract provisions with a view to maximizing profits?
- Should we slim down by shedding unprofitable units and cutting back on investments that are not entirely necessary?
- Do we need to improve the efficiency of our operation(s) or adjust our portfolio?
- If yes, then how do we go about this?

We believe that if these questions are adequately and fearlessly addressed and the attendant

changes implemented, then companies, especially upstream oil and gas companies, should be able to forge a pathway for success, no matter how uncertain the prices for their products.

Strategies for Survival in these Hard Times

So how can operators beat the threat of the oil price fall and ensure adequate returns on investments? We suggest several strategies that, if implemented, would ensure the survival and sustenance of companies through this lower price period and beyond. First, companies must demonstrate the determination to strive and survive in the business environment in spite of the glut and lower prices. They must think outside the box and think of what to do differently and where to go to lock in demand. It is a mindset, actually. Second, since Asian markets are the emerging big markets, companies should develop strategies that will give them a stronghold in these markets.

Also, the importance of innovation and technology at this crucial time cannot be overstated. Although it may sound strange and out-of-the-world to the average Nigerian, the oil industry has before now demonstrated the ability to be innovative and use such innovations to lower costs when necessary. In a bid to cut overhead costs, exploration and production companies can harness new technological advances such as digitisation, advanced computerised systems/analytics, and even robotics to squeeze out higher volumes of crude with less investment and less trouble. But these digital breakthroughs may not often extend to “above the ground” parts of the operation, and the technology is not easy acquired. In this regard, small companies can partner with or enter into strategic alliances with larger ones to ensure optimum recovery rates over the life of their fields. In doing so, oil and gas companies can confront oversupply with increased efficiency and output with reduced operational costs.

However, the biggest mistake that oil and gas companies can make in this difficult business landscape is to focus solely on reducing costs (either operating or general and administrative) and spending as an end in itself. Although they may need to do this to stay afloat, they must do

more to survive. The answer does not lie solely in laying off staff to slim down and selling off assets, as some companies are wont to do. That strategy is effective only in a very narrow range of market conditions and rarely effective enough to make businesses successful over the long term. Rather, we advise that companies should carefully consider the supply of assets, analyse the logistics of accessing available markets with particular reference to the Asian markets, and ensure their long-term presence in these markets.

Additionally, oil companies can embark on portfolio management and optimisation efforts. Oil and gas producers need to carefully evaluate their portfolios – field by field – with a view to critically ensure that each operation is a good fit for the company's core strengths, customer demographics, and preferences, as well as skill sets. Companies should strive to shore up demand and improve their profit margins by consolidating their strongest assets as this, in our view, is an essential element of survival in the energy industry today. They should consider the economics and wisdom of producing a marginal field as prices are low and come up with strategies for ensuring profits.

Smaller companies in weakened financial positions as a result of low oil prices can find strength through consolidation that can lead to mergers or outright acquisitions and bring about an increase in deal value. Local service companies would do well to enter into joint ventures with international service companies.

For downstream players, guaranteeing a buyer for their product is everything in business terms; therefore the need to confront demand challenges frontally cannot be underestimated. North American and European markets are shrinking to the point where they can no longer absorb all of the oil and gas refined in the region, let alone importing from other regions. (The US now exports less than 1 million barrels per day of energy products.) Nigerian and indeed African producers must increasingly look beyond their borders or shores for customers. Here we point again to Asia. While we concede that what is inevitably obtainable in global markets is fierce competition from the Middle East and other long-

time exporters who have established a large clientele hoping to serve Asian demands, we still believe that there is room enough for all so long as the product is of a high grade and the right market strategies are adopted. To compete effectively in this environment, therefore, upstream companies must either secure more robust and long-term relationships with established and new customers or seek out smaller niche markets to avoid head-to-head rivalries with the “big brothers” that have the potential to destroy their profit margins. Moreover, other African countries can be explored for the sale of products.

Hydrocarbon storage is another area that companies can look forward to exploring in these hard times to make good money. Since there is an oversupply of crude, there would definitely be a corollary need for storage facilities so as to store the crude or products until they are needed. Such storage facilities include tank farms, terminals, and pipeline infrastructure.

Adjusting to the New Reality

As Nigerian oil and gas producers ponder a way out and examine questions about locking in demand and thriving during a period of oversupply and lower prices, we advise that they should inevitably ask themselves this question: Do we need to improve the efficiency of our operation(s) or adjust our portfolio in line with the reality of the times? Indeed, in answering these questions, they should evaluate whether they are “Fit for 50” (\$50 per barrel), which is like being healthy and well enough to run a race even if you may not need to run one.

But even if being Fit for 50 seems too tough, oil and gas companies emerging from a period of high growth and rapid expansion and suddenly into an era of oversupply and low prices must now redirect their efforts towards other realistic strategies or options with a view to survival. The primary focus now should be on driving capital and operating efficiency to preserve margins and maintain the reinvestment rates necessary to grow production as well as discovering niche markets.

Conclusion

It is true that oversupply and lower prices represent a real challenge to the industry, but as we have stated earlier, that does not mean the future is all darkness and gloom. It just means that producers and refiners need to be smarter and prepared to adopt appropriate strategies that take advantage of the new reality. Indeed petroleum will continue to play a major role in the global economy as the world's energy consumption is projected to continue to rise at a rapid pace, increasing 53% by 2035, with much of that growth coming from China and India, according to numbers released by the US Energy Information Administration (EIA). Fossil fuels will continue to be, by far, the dominant source of that energy, supplying 78% of the world's energy in 2035, says the EIA. Another forecast, which is on all fours with the EIA projection cited above, suggests that gas, oil, coal, and even nuclear will still be the major sources for global energy supply by 2040, trumping biomass and other renewable energy sources.

Richard Atoshi Danladi is a corporate lawyer specializing in energy and commercial law. He has experience in strategically evaluating energy law and public policy options applicable in Nigeria in particular and Africa in general and in this light proffers

solutions to the gaps that exist in knowledge, institutional development, governance, legal, and regulatory framework for the energy industry in Nigeria and throughout Africa. Richard holds an LLB from the University of Ibadan.



Attracting New Investments into the Nigerian Petroleum Industry

Alexander Ogbechie
Ernest & Young



"Despite the tough economic situation, Nigeria's petroleum base still remains one of the largest in the world and, as such, should always remain somewhat attractive to investors."

The oil industry, with its history of booms and busts, has been in its deepest downturn since the 1990s, if not earlier. Average earnings are down for companies that made record profits in recent years, leading them to decommission more than two-thirds of their rigs and sharply cut investment in exploration and production.

The cause is the plunging price of a barrel of oil, which at one point fell more than 70% compared with June 2014 levels. Prices have recovered a few times over the last year, but they are below what producers need to drill profitable wells. Speculation has been the main driver of recent upturns in the oil price – with the latest increase coming on the back of the Russian and Saudi Arabian plan for a production freeze to be discussed at the informal meeting of the OPEC States in Algeria (September 26 – 28). However, there are still doubts about how much sustained positive effect on supply any agreed upon freeze would have. Industry experts think it will be years before oil returns to \$90 (USD) or \$100 per barrel, a price that was pretty much the norm over the last decade.

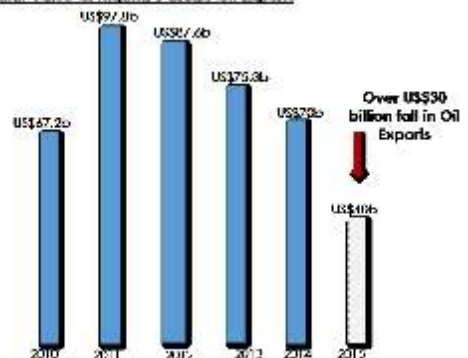
Oil and the Nigerian Economy

Oil prices in low altitude and a prolonged glut in the global oil market have indecently exposed Nigerian vulnerability to external shocks. Worse still, for decades crude oil has accounted for more than 90% of Nigeria's foreign exchange earnings, and 65% of Government income. The recent lower than usual oil price has therefore resulted in significant economic stress – not only has the country's foreign exchange reserves significantly been depleted, the domestic economy has weakened.

With the recent lower than usual oil price and revenue crash, investment in Nigeria's oil and gas sector seems fragile. There is every reason to feel concerned about Nigeria's oil and gas future, especially, as stated above, this is the industry that sustains the economy of Africa's largest economy – or hitherto largest economy, so to speak.

The sharp decline in the nation's oil receipts in 2015 alone has proved bookmakers right that the era of Nigeria's dependence on crude oil as its primary source of foreign exchange is gone. There was a time when high return on investment (ROI) remained the major attraction for many involved in the oil and gas business, whether in the upstream or downstream. But it does appear that there is a reversal of fortune in the once burgeoning trade in oil and gas, especially in the last year, which experienced a drop of \$30 billion between 2014 and 2015.

Financial Value of Nigeria's Crude Oil Exports



Source: The Nigerian Export Promotion Council

Nigeria at a Crossroads

Over recent years, International Oil Companies (IOCs) have divested some Niger Delta onshore and shallow water assets. It's claimed that the



divestment has been part of strategic reviews and in line with the federal government's aim of developing Nigerian companies in the country's upstream oil and gas business – IOCs shifting their focus from onshore to the more challenging frontiers of deep offshore, which currently accounts for 60% of Nigeria's production. In addition, the divestment by the majors aimed at changing the onshore corporate landscape and creating material brownfield opportunities for indigenous upstream players looking to enter the Nigerian upstream space. Nigerian independents gambled by acquiring interests in IOC divested assets, paying large sums. Unfortunately, these investments haven't reaped the expected rewards yet.

Angola recently overtook Nigeria as the largest producer of crude oil in Africa, as militant activities continue to cripple Nigeria's crude oil production. Militant attacks on oil production infrastructure have led to a drastic fall in output since February 2016, heaving pressure on Nigeria's oil sector. According to OPEC, Nigeria produced only 1.51 million barrels per day in July, down from 1.55 million barrels per day in June. Government's recent decision to resume amnesty payments to former militants may not be able to put an end to all the attacks, as the Niger Delta Avengers (the most active militants) are not been included in the deal. Long term, the government will need to agree to a more encompassing deal that covers the various militant groups.

In addition to the ongoing security concerns, Nigeria is struggling from prolonged delay and

policy uncertainty. One of the steps the federal government is expected to take to attract investors is passage of the Petroleum Industry Bill (PIB), which was conceived more than 10 years ago. The PIB has been under discussion and consideration for such a long time that investors are starting to look elsewhere due to the perceived uncertainty. With more than 50 African countries having oil or searching for it, it's fair to say, Nigeria is at a crossroads.

Nigeria has lost hundreds of billions of dollars in investment due to non-passage of PIB. The Minister of State for Petroleum Resources, Dr Ibe Kachikwu, recently said that the nation was losing more than \$15 billion annually to non-passage of the PIB. In April of this year, the Senate started the legislative procedure on a new draft of the PIB, named the Petroleum Industry Governance Bill (PIGB), and it scaled the first reading on April 13. The PIGB was harmonized by the Senate and House of Representatives following a prolonged silence by the Presidency on the PIB despite continued agitation for its passage by the citizenry.

Our neighbor, Ghana passed its Petroleum Production and Exploration Bill into law on August 4, 2016, to replace the Petroleum (Exploration and Production) Act of 1984. Ghana's Minister of Energy, Emmanuel Buah, said the new law would create an attractive environment for potential investors to participate in the sector by providing certainty and transparency in the ground rules for operations. One can now wonder why it is taking eons for Nigeria to pass the PIB!

The Investment Imperative

I am of the opinion that, capital, whether it is from investment banks, international oil companies or other sources of funding, will be scarce in the medium to short term, which makes it imperative for all stakeholders within the Nigerian oil and gas space to work together to improve the competitive position of the industry and restore investor confidence.

Despite the tough economic situation, Nigeria's petroleum base still remains one of the largest in the world and, as such, should always remain somewhat attractive to investors. Earlier this year, Nigeria signed Memorandums of

Understanding with several Chinese firms for more than \$80 billion in new investments, spanning five years, in the oil and gas industry covering pipelines, refineries, gas and power, facility refurbishments and upstream financing. The hope is that this would be a first of many in a bid to turn around the sector and place it among the best in the world.

The Chinese deal is good news, but Nigeria needs a broader base of investors to effectively and optimally develop the country's petroleum industry. Every country needs foreign investment in various capacities to improve its economy. This requires formulation of strategic policies that will attract such investment and generate revenue and employment opportunities in the economy. The PIB has now been broken into four sensible parts: Governance and Institutional Framework for Oil and Gas; Fiscal Reform; Licensing Rounds; Revenue Allocation and Management. As stated earlier, the PIB scaled the first reading in April. Speedily passing the first part, Governance and Institutional Framework, should shore-up international confidence and attract desired investments. Terms can be competitive without being patronizing. Nigeria must rightly learn from

its experience and be more astute in negotiating with foreign investors and counterparts.

There is need to restructure the country's oil and gas industry operations by introducing transparency, simplifying access to assets, maintaining sanctity of contracts, instilling corporate governance in all our dealings, and reducing overall project costs for cost effectiveness. It is imperative to encourage creativity and opportunity for partnership among Nigerian companies in order to scale up to big projects in the face of current complex industry challenges.

Despite being an economy that relies majorly on proceeds from crude oil exports, successive governments have been unsuccessful in putting in place adequate structure that will ensure policy stability and continuity in the economy. Attracting investment into the petroleum industry would require planning, deliberate effort, and right policies. This must be the task ahead of the present government, and it must ensure that these structures are put in place to attract the much-needed investment into the economy.

The time to rise to the investor challenge is now.

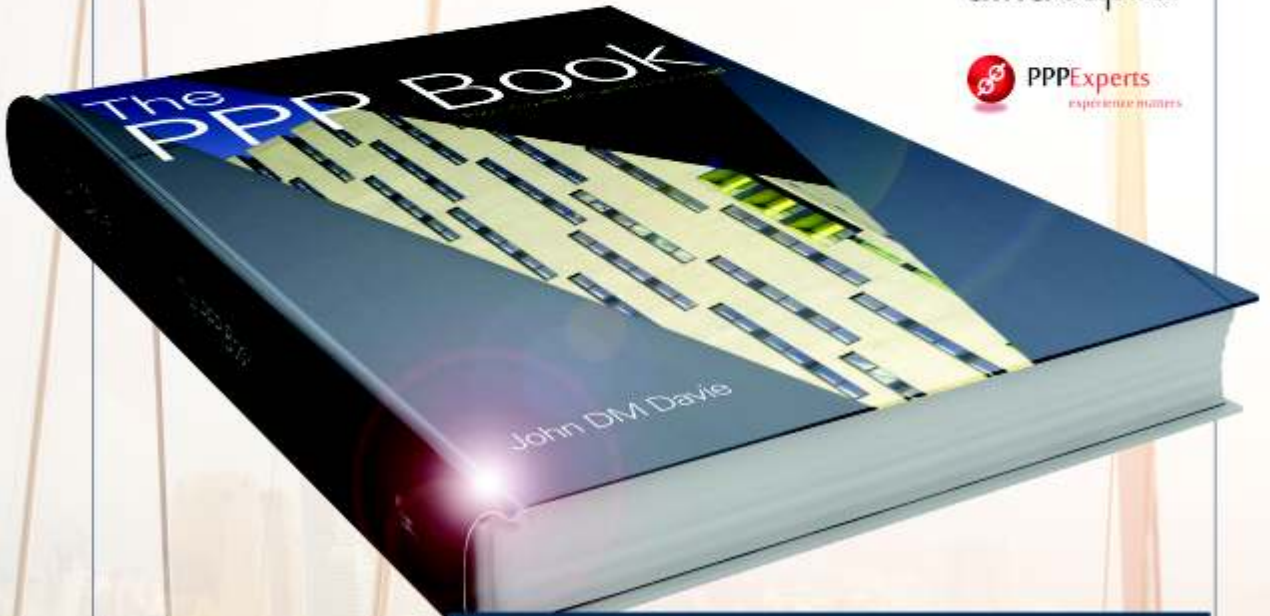
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ALP Seminar Series was conceived as a forum to evoke discourse regarding practical, commercial and legal issues facing decision-makers engaged in business in Nigeria. It aims to stimulate innovative strategies and outline pragmatic solutions. We expect the Seminars to strengthen existing synergies and help create new ones. The Seminar Series is now a yearly event propelled by an advisory committee of professionals with diverse business expertise.

The Seminar Advisory Committee consists of Mr Omamofe Boyo (Oando Pic), Boma Ozobia (Sterling Partnership), Ajibola Olomola (KPMG), Kayode Akinkugbe (FBN Capital), John Delano (ALP) and Oluyele Delano (SAN) (ALP).

The topic for the 2017 Seminar is still under consideration. Please email us, if you have suggestions with regard to topics for discussion at the next Seminar.

See more information about the Seminars at www.akindelano.com/alpseminars.php



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