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# Nigeria Power Series - Part 1: Developing Bankable Independent Power Projects in Nigeria

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## 1. Introduction

The Dentons Nigeria Power Series comprises briefing notes on the Nigerian power sector. In this first instalment, we will consider some recent trends in the Nigerian power sector and provide an overview of some key considerations for developing bankable independent power projects (**IPPs**) in Nigeria.

## 2. Recent trends, opportunities and challenges

The deficiencies of Nigeria's power generation sector are widely acknowledged.[1] It is hoped that the current drive by the federal government of Nigeria (the **Nigerian Government**) to increase Nigeria's power generation capacity will have a significant impact on its economic and sociopolitical development. Whilst the Nigerian Government has taken some significant steps to liberalise, increase liquidity and attract investment into the power sector (such as implementing the power privatisation programme,[2] direct funding[3] and entry into the Power Africa memorandum of understanding with the Government of the United States of America[4]), there is still a huge amount of work to be done by the Nigerian Government, the domestic private sector and international partners to develop Nigeria's power sector.

In addition to developing renewable energy projects (particularly solar and hydro) and captive power projects to diversify Nigeria's power generation mix, the development of greenfield gas-fired power generation projects by private developers, commonly referred to as IPPs, will significantly increase Nigeria's power generation capacity. However, developers of IPPs (**IPP Developers**) face a raft of challenges in developing successful IPPs. These challenges include:

(a) the high cost and extensive timeline involved in achieving an acceptable allocation of risks and rewards among stakeholders;

(b) the difficulty in raising commercial debt funding for project development activities, particularly following the recent tightening of credit to emerging market borrowers;

(c) obtaining uninterrupted access to feedstock gas for power generation and achieving a bankable offtake arrangement with Nigerian Bulk Electricity Trading Plc;

(d) low regulated domestic electricity prices which do not reflect the costs of power generation; and

(e) navigating a labyrinth of political, legal and regulatory frameworks in order to successfully develop and operate IPPs.

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[1] In 2015, power supply in Nigeria averaged 3.1 GW for approximately 180 million people, which is estimated to be only a third of Nigeria's minimum demand. PWC report titled: "Powering Nigeria for the Future".

[2] The power privatisation programme comprised: (a) the unbundling of the National Electric Power Authority, the vertically integrated state-owned entity, into: (i) six generation companies; (ii) 11 distribution companies; and (iii) a transmission company; (b) the sale by the Nigerian Government (through the Bureau of Public Enterprise) of its majority interests in the power generation and distribution companies to private sector participants, primarily comprised of Nigerian investors and their international technical partners; and (c) the Nigerian Government subcontracting the management of the national grid operator, the Transmission Company of Nigeria, to Manitoba Hydro International (together, the **Power Privatisation Programme**).

[3] For example, the CBN's disbursement of the Nigerian Electricity Market Stabilisation Facility.

[4] Power Africa has played a key role in increasing access to liquidity and credit enhancement products from US Government agencies (such as OPIC and USAID) and increasing the levels of technical capacity in the domestic power sector.

## 3. Developing bankable power projects: avoiding the common pitfalls

The commercial banks and development financial institutions that finance IPPs (the **Lenders**) will typically expect IPP Developers to have completed a number of project development milestones prior to the debt financing phase of the IPP, which include:

### a. Relationships between project development partners

Developing an IPP in Nigeria, as in many emerging markets, is time-consuming,[5] capital-intensive and sensitive to in-country political, economic, social and regulatory risks. Consequently, IPPs are usually undertaken by a number of co-venturing developers who agree to pool resources (including funding, assets, know-how and expertise) and share the risks and rewards associated with the development and operation of the IPP.

The development partners will usually enter into commercial agreements (e.g., a joint development agreement, a shareholders agreement and/or a development and cooperation agreement) in order to formalise their relationship and document their respective rights and obligations during the development and/or operation phases of the IPP.

### b. Engagement with stakeholders

IPP Developers' engagement with a project's other key stakeholders – the local community, regulators and any adjoining landowners (together, the **Stakeholders**) – is crucial for disseminating project-related information, identifying and addressing concerns and obtaining Stakeholders' support for the IPP. Engagement with Stakeholders may help to address legal and other challenges to the IPP which might otherwise arise at a later stage. Development of a well-considered action plan early in the project development phase – one which identifies the Stakeholders and their representatives and which sets out formal procedures for engaging with these Stakeholders – can be an effective tool for engaging with Stakeholders.

### c. Land procurement and perfecting proprietary rights

IPP Developers will need to ensure that the company incorporated to own the project assets and enter into project documents on their behalf (the **Project Company**) has obtained a proprietary interest in the project site land, which is typically evidenced through a certificate of ownership.

Alternatively, the Project Company may obtain a long-term lease of the project site land under a lease agreement with satisfactory terms, particularly robust termination provisions. Lenders will typically expect the Project Company to (a) exercise its proprietary rights to the project site land free of adverse rights and (b) create security over its proprietary rights to the project site land in favour of the Lenders.

### d. Satisfying social and environmental requirements

The majority of international financial institutions have adopted the Equator Principles, a risk management framework for determining, assessing and managing environmental and social risk of projects, which is based on the International Finance Corporation's standards on social and environmental sustainability.

As a precondition to obtaining project financing for an IPP, the Project Company will be required to satisfy the Lenders of social and environmental requirements. These requirements typically include:

[5] It is reported that the lead time on the Azura-Edo IPP, the first fully-privately-financed greenfield IPP in Nigeria, was six years from the start of the project to financial close – Azura Report titled: "High Voltage – A Development Guide to the 459MW Azura-Edo IPP".

(a) completion of feasibility studies to ascertain the impact of the project on the community and environment; and

(b) the Lenders' technical consultants' approval of the remedial action plans, which may include compensation, resettlement and decommissioning arrangements.

### e. Obtaining regulatory permits

The IPP Developers and/or the Project Company will be required to obtain certain permits, authorisations, approvals and/or waivers from the relevant Nigerian regulators in order to validly construct and/or operate the IPP (together, **Permits**). The scope of applicable Permits for an IPP is wide ranging and will typically include Permits relating to the following activities: construction of the power plant, power generation, environmental, health and safety procedures, equipment importation, obtaining insurance, reinsurance and foreign exchange.

Experience has demonstrated the need for an IPP Developer/Project Company to:

(a) engage its transactional advisers to conduct extensive due diligence on the IPP in order to ascertain the exact scope of requisite Permits;

(b) develop an action plan with stipulated procedure, timelines and allocation of responsibility for obtaining the Permits;

(c) anticipate that the Lenders will insist that all relevant Permits are obtained as conditions precedent to drawdown of their loans;

(d) consider the additional risks associated with obtaining the Permits, such as (i) delays to the transaction timetable where there is no deadline by which processing of a Permit must be completed and (ii) increased transaction costs resulting from the payment of applicable fees for obtaining or extending a Permit;

(e) make conservative assumptions on the requirements, process and timeline for obtaining the Permits when developing the transaction timetable;

(f) engage with the relevant regulatory authorities at an early stage in the project development phase;

(g) pre-agree the process, scope and consequence of extensions to any applicable "longstop dates" for the completion of the transaction due to delays in obtaining the Permits; or

(h) mitigate the risks related to cancellation of Permits, arbitrary delays in granting or extending Permits through obtaining political risk insurance and/or by including such events within the scope of "political force majeure" provisions in the project and finance documents.

### f. Sourcing funding

During the Power Privatisation Programme, Nigerian banks provided more than 80 per. cent. of the acquisition debt provided to the purchasers of power generation and distribution assets. These acquisition facilities, some of which are currently underperforming and require restructuring, have resulted in liquidity constraints in the domestic debt market. The Central Bank of Nigeria's (**CBN**) has imposed restrictions on Nigerian banks' level of exposure to industry sector by reference to a percentage of their loan portfolio.

This CBN regulation and the recent unavailability of foreign exchange in the Nigerian financial market (linked in part to low global oil prices and Nigeria's recent monetary policies in response to reduced oil export revenue) have further exacerbated illiquidity in the Nigerian debt market. Consequently, IPP Developers will need to source funding for IPPs from both the domestic debt market and international Lenders – not only commercial banks, but also export credit agencies and development finance institutions.

Funding from international Lenders will typically be structured on a limited-recourse or non-recourse basis and, therefore, involve a rigorous bankability assessment and risk allocation process, a summary of which will be set out in Part 2 of this briefing note.

## 4. Conclusion – where there's political will, there's a way

To achieve the Nigerian Government's targeted increase in electricity wheeling capacity, there is a general consensus that the Nigerian Government will need to take a number of additional wide-ranging steps to incentivise the development of a pipeline of bankable IPPs on a sustained basis, which include:

(a) ensuring fiscal stability, cost reflectivity and transparency of the electricity pricing structure that supports a level of economic returns to IPP Developers without compromising affordability of power supply to final consumers;

(b) facilitating a reliable supply of gas from upstream and midstream activities and facilitating investment in power transmission and distribution infrastructure to avoid a scenario where generated power becomes a stranded asset;

(c) improving liquidity and continued provision of credit enhancement of NBET to preserve the bankability of PPAs;

(d) providing regulatory and fiscal support to distribution companies in their deployment of technology and funding of capital expenditure programmes required to develop a robust system of metering, billing and revenue collection;

(e) implementing investment-friendly market reforms in order to attract private investment; and

(f) reducing system inefficiencies across the power value chain whilst reducing bureaucracy within the relevant governmental agencies.

This briefing note is provided for information purposes only and does not constitute legal advice. For further information on the content of this briefing note or legal advice, please contact **Dominic Spacie**, **Danielle Beggs** or **Omosuyi Fred-Omojole**.

You might also be interested in the second instalment of the Dentons Nigeria Power Series briefing notes (titled: "**Unlocking Financing for Developing Independent Power Projects in Nigeria**"), which will be launched in December 2016.

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