TOPE ADEBAYO LP

NERC'S ORDER ON THE DELINEATION OF DISCOS' ASSETS AND LIABILITIES

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Introduction

Nigeria's Power Sector is undergoing a significant transition following the 2023 constitutional amendment and the enactment of the Electricity Act 2023 (the "Act"), which together enable a two-tier regulatory framework; Federal and State-level regulation. Under the newly introduced framework, a State seeking to assume regulatory control over electricity activities within its territory must enact a State electricity law, establish a State electricity regulatory commission ("SERC"), and formally notify key stakeholders, including the Nigerian Electricity Regulatory Commission ("NERC") and the Distribution Companies ("DisCos") operating in the State.[1] Once notified, DisCos are required to incorporate a State-level subsidiary ("SubCo") within two months and transfer to it, all relevant assets, liabilities, employees, and contractual obligations within that State.[2] As of the date of this article, eleven States had initiated the transition to State-level electricity regulation, with some DisCos already incorporating SubCos. However, due to the lack of clear guidelines for delineating assets and liabilities, many DisCos have faced implementation challenges. To address this gap, NERC issued the Order on the Delineation of Assets and Liabilities of Distribution Licensees (the "Order") on 28 March 2025.[3] This article outlines key highlights of the Order and its potential implications.

Objective of the Order[4]

The major objective of the Order is to ensure a smoother transition by establishing a clear and uniform process for delineating the assets and liabilities of DisCos along State boundaries within their franchise areas, regardless of the transition status of each State.

Delineation of assets[5]

The Order prescribes the delineation of assets across States on the basis of geographical location, operational location, historical energy consumption and energy share, while also specifying assets to be retained by the DisCo Holding Company ("Hold Co").

[1] Section 230(2) of the Act
[2] Section 230(4) of the Act
[3] https://nerc.gov.ng/wp-content/uploads/2025/04/Order-on-asset-delineation.pdf (Last accessed May 4, 2025)
[4] Paragraph 12 of the Order
[5] Paragraph 19 of the Order

a. **Geographical Location:** Assets delineated on the basis of geographical location include physical infrastructure primarily used for electricity supply, such as substations, transformers, and distribution lines. Gross receivables owed by customers are to be allocated based on their respective origination location.

For electricity lines that span across multiple states, the Order mandates that these lines be prorated based on their physical presence within each State's boundaries. To accurately track energy offtake, inter-boundary meters are required to be installed at State borders. Furthermore, gross receivables owed by customers are to be allocated based on their respective origination location.

b. **Operational Location:** Assets such as cars, trucks and other service vehicles used for operations and maintenance are to be allocated based on their operational location.

c. **Historical Energy Consumption:** Inventory already captured in the Regulatory Asset Value **(“RAV”)**[6] including unallocated, in-transit and stored assets such as spare parts and consumables, are to be allocated on the basis of historical energy consumption used in determining the RAV.

d. **Share of Energy:** all uncommitted monies from the Metering Acquisition Fund sequestered from tariff paid by customers as at 31st of May 2025 are to be allocated based on share of energy.

e. **Assets Retained by HoldCo:** Certain assets, including existing Information and Communication Technology infrastructure and common facilities such as the Head Office building, are to be retained by the HoldCo. These assets are to be made available to SubCos under shared services agreements, with applicable fees determined in accordance with Transfer Pricing Regulations. Additionally, unassigned or unserviceable vehicles are to be retained by the HoldCo.

f. **Other Assets:** These include employees and contingent assets. DisCos are required to determine the optimal allocation of personnel between the HoldCo and the SubCos.

For contingent assets, such as receivables from judgment awards, the HoldCo is required to obtain prior approval from NERC upon crystallisation of those assets and before allocation.

[6] Under the NERC's 2012 Multi-Year Tariff Order methodology, the electricity tariffs chargeable by DisCos are determined upon consideration of the RAV. RAV represents the value of assets on which a DisCo is permitted to earn returns in the form of profit and depreciation. In assessing the RAV of any asset, NERC is guided by key considerations, including the prevailing prudent procurement price based on market surveys, and the “used and useful” principle, requiring that the asset must be physically used and useful in providing electricity services to current ratepayers before it can be included in the rate base. For the purpose of asset delineation, according to Paragraph 18 of the Order, the RAV of a DisCo is to be pro-rated among its SubCos in accordance with the proportion of historical energy consumption in each franchise State between January and December 2024.

Delineation of liabilities[7]

The Order mandates the delineation of liabilities (financial, contractual, operational and regulatory) on the basis of historical energy delivered and location of employees in the manner below:

a. **Historical Energy Delivered:** Market shortfalls and tax liabilities are to be allocated on the basis of historical energy delivered to each State between January – December 2024.

b. **Location of Employees:** Payroll-related liabilities including pension and other employee benefit are to be allocated on the basis of the location of the employee.[8]

c. **Contingent Liabilities:** These include potential obligations which may arise if certain future obligations are met. The HoldCo is required to obtain prior approval from NERC upon crystallization of these liabilities and before allocation to SubCos.

Delineation of legacy commitments and contractual obligations

a. **Loans and Advances:**[9] The Order acknowledges loans provided to DisCos by the Central Bank of Nigeria ("CBN"), commercial banks, and other investors for purposes including infrastructure projects whose repayment have already been factored into revenue requirements and end-user tariffs, as per the loan terms. These liabilities are to be apportioned among States based on historical energy delivered between January and December 2024. The CBN is tasked by the Order to determine the mechanism for transferring these obligations.

b. **Legacy Contracts Related to bulk Energy Purchase:**[10] Following NBET's planned exit, existing Power Purchase Agreements ("PPAs") between NBET and Generation Companies ("GenCos") and Independent Power Plants are expected to be novated to DisCos. In the interim, all current contracts, including Vesting Agreements ("VA") between NBET and DisCos, are to remain in effect, with liabilities associated with the VA equitably allocated to SubCos. The Order requires that the allocation ensures that the combined off-take of all SubCos equals or exceeds the DisCo's minimum current off-take obligation under these contracts. Once the market fully transitions to bilateral trading, DisCos may novate their PPAs to their SubCos.

[7] Paragraphs 20 and 21 of the Order
[8] The SubCo benefiting from employee's services post-delineation is to bear associated liabilities.
[9] Paragraphs 22 and 23 of the Order
[10] Paragraphs 24 – 28 of the Order

Next steps

The Order requires DisCos to:[11]

1. Carve out their network along State boundaries and install boundary meters at inter-State points.
2. Create an asset register for all power infrastructure in each State.
3. Evaluate and allocate contractual obligations and liabilities to the SubCos to be created in each State.
4. Identify all energy offtake trading points for each SubCo.
5. Submit to NERC, the required number of employees for service delivery in each State.
6. Within two weeks from 28th of March 2025, deliver the following to NERC:

    a. A comprehensive register of assets and liabilities with preliminary delineation along State lines.
    b. Updated staff allocation register between the HoldCo and constituent SubCos.
    c. A single line diagram showing points for installation of boundary meters across all the areas of interstate network connections.
    d. 3 most recent audited financial statements and the management accounts for 2022, 2023 and 2024.

Upon receipt of documentation outlined in 6 (a) - (d) above, NERC is to hold a delineation workshop within 21 days. DisCos who have received transfer orders for any of their constituent SubCos at the time NERC issues its final asset and liability transfer Order ("Subsequent Order") shall communicate the Subsequent Order to the respective SERC within 7 days of receipt.

Key considerations for DisCos

While implementing the Order may entail significant costs for DisCos, the financial and legal risks of poor or poorly coordinated execution are far greater. Missteps in implementation could expose DisCos to substantial penalties, liabilities, and disputes involving investors, lenders, employees, and regulatory bodies, including the Federal Inland Revenue Service. Thus, some key areas that require the focused attention of DisCos include:

[11] Pages 9 and 10 of the Order

a. **Consent and Authorization:** DisCos should conduct a thorough review of their constitutional documents, shareholder agreements, loan agreements, and similar instruments to identify all necessary consents or approvals required for asset and liability transfers. Early engagement with stakeholders is essential particularly in relation to pre-existing debt and may also guide optimal shareholding structure of the constituent SubCos.

b. **Clear Legal Separation:** A clear legal and operational separation between the HoldCo and each SubCo is pivotal to support the performance and investment appeal of SubCos within their respective State Electricity Markets ("SEMs"). Given the transfer of pre-existing liabilities to SubCos, careful structuring is required. Other measures should include establishing separate boards of directors, maintaining distinct bank accounts, documenting intercompany loans, and implementing other governance safeguards to assure potential investors.

c. **Asset Transfer:** DisCos must thoroughly review existing encumbrances on assets and engage with lenders to obtain the necessary consents for proposed asset transfers. To ensure clear ownership and separation, formal documentation must be executed to transfer legal title of assets from the DisCo to each relevant SubCo and such transfer must be in compliance with applicable Transfer Pricing Regulations. DisCos should also review rights and interests associated with assets, including rights of way or easements, to ensure they are validly transferred or replicated in favour of each SubCo.

d. **Shared Services:** Where shared services will continue post-transition, robust frameworks should be established. These may include intercompany service agreements, licensing arrangements, and compliant transfer pricing structures.

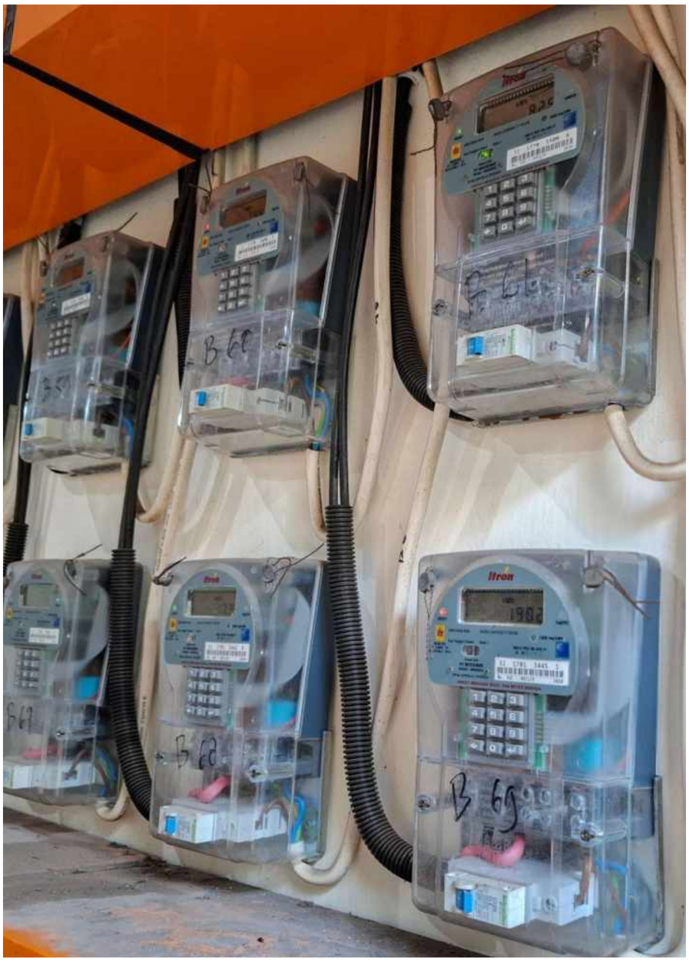
e. **Labour Matters:** This is a sensitive area requiring strict adherence to applicable laws. DisCos must review employment contracts to ensure they support the proposed transfer arrangements. It is best practice to ensure that transfer does not result in less favourable terms for employees. Where applicable, consultation with labour unions is advised. If renegotiation is required, clear communication, consent, and employee engagement are essential.

During the transition, some employees may be required to work across multiple SubCos; however, secondment arrangements should be formalised, time-bound, and structured to avoid the risk of triangular employment. Ultimately, each SubCo must have its own distinct and independent workforce.

f. **Other Contractual Arrangements:** DisCos must identify and review all contracts with third parties, including vendors and service providers, to determine notification or consent requirements for assignment of obligations or corporate reorganisation. Early engagement with counterparties is necessary to ensure continuity and contractual compliance.

Key considerations for DisCos

The practical implementation of the Order raises several concerns, particularly regarding the assignment of debts and liabilities. While the Order designates the CBN as responsible for determining the mechanism for transferring and ensuring the sustainable repayment of these facilities, the necessity of lender consent remains critical. Most facility agreements contain restrictions on assignment, and obtaining lenders' consent may prove difficult due to the potential complexity to be introduced by the transfer, associated risks, and anticipated restructuring costs involved. Additionally, there may be existing intercreditor agreements governing the rights and priorities among multiple lenders, further complicating any proposed transfer or restructuring of obligations. It is therefore essential that relevant stakeholders are proactively engaged to facilitate a smooth transition.



Another concern relates to the allocation of liabilities to SubCos based on historical energy consumption. This approach may not accurately reflect each SubCo's financial capacity, especially in cases where poor revenue collection persists. Improving collection efficiency at the SubCo level will be crucial to ensuring they can meet their allocated debt obligations.

In relation to network delineation, the installation of inter boundary meters at points where DisCo infrastructure crosses State lines is fundamental. These meters must support remote monitoring, real-time data transmission, and tamper detection to ensure accurate and reliable measurement of energy off-take by each SubCo.

Finally, questions remain about the feasibility of meeting the two-week timeline set out in the Order for the submission of key deliverables. Given the complexity of the required steps and the involvement of third parties, such as lenders, compliance within this timeframe may prove difficult. Nonetheless, it is important to note that, at this stage, only preliminary delineation of assets, liabilities, and obligations along State lines is required.

Conclusion

Given the unprecedented nature of the transition to State-level electricity regulation, the emergence of implementation challenges is inevitable. Addressing these issues will require continuous review and the development of clear guidelines and directives to facilitate a smooth transition. It is commendable that NERC has adopted a proactive and collaborative approach, including convening stakeholder consultation forums to gather valuable input on the way forward.[12]

The reorganisation of DisCos into SubCos introduces various risks, including significant regulatory risks, particularly where clear legal separation between the entities is lacking. To mitigate these risks, DisCos must adopt a strategic and diligent approach, including seeking legal guidance where necessary. On the regulatory side, effective coordination of regulatory principles, standards, and enforcement is critical. Accordingly, it is imperative for NERC and the respective SERCs to establish the intergovernmental coordination body as required by law.[13]

[12] https://nerc.gov.ng/media/nerc-hosts-workshop-on-methodology-for-delineation-of-successor-discos-assets-and-liabilities/ (Last accessed May 4, 2025)
[13] Section 230(9) of the Act

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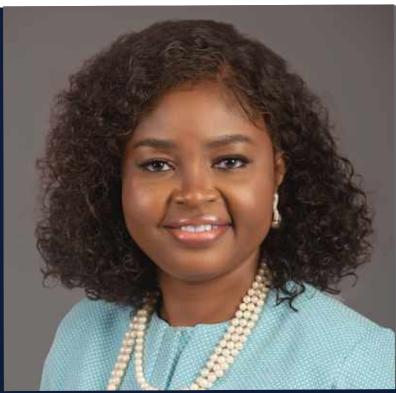
PRACTICE KEY CONTACTS



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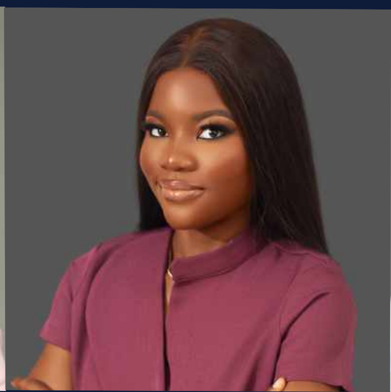

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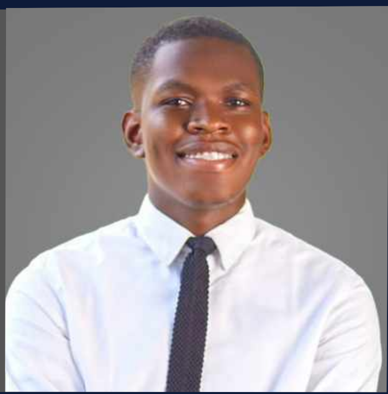

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