

# Unlocking Financing for Developing Independent Power Projects in Nigeria

Briefing Note: October 2016

## Contacts

**Dominic Spacie**  
Partner  
Dentons UKMEA LLP  
One Fleet Place  
London  
EC4M 7WS

T: +44 20 7246 7035  
E: [dominic.spacie@dentons.com](mailto:dominic.spacie@dentons.com)

**Omosuyi Fred-Omojole**  
Associate  
Dentons UKMEA LLP  
One Fleet Place  
London  
EC4M 7WS

T: +44 20 7246 7097  
E: [omosuyi.fred-omojole@dentons.com](mailto:omosuyi.fred-omojole@dentons.com)

# Unlocking Financing for Developing Independent Power Projects in Nigeria

## 1. Introduction: recent trends, opportunities and challenges

The deficiencies of Nigeria's power generation sector are widely acknowledged.<sup>1</sup> 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 steps to liberalise and attract investment into the power sector (such as overseeing the power privatisation programme<sup>2</sup> and the subsequent disbursement of the Nigerian Electricity Market Stabilisation Facility through the Central Bank of Nigeria (the **CBN**) to provide additional liquidity in the power sector), 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 renewables 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 independent power projects (**IPPs**), will significantly increase Nigeria's power generation capacity. However, developers of IPPs (**IPP Developers**) face a raft of challenges in developing successful IPPs. Some of 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 PLC (**NBET**);
- (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.

In this briefing note, we focus on IPPs and highlight:

- (a) some of the milestones that IPP Developers will need to achieve and associated challenges to be overcome in order to successfully develop IPPs; and
- (b) some of the key risks which lenders who finance IPPs (the **Lenders**) will expect to see managed to a satisfactory level in order to develop a bankable IPP that can be financed on a project finance basis.

---

<sup>1</sup> 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".

<sup>2</sup> 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 their 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**).

## **2. Developing power projects: avoiding the common pitfalls**

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,<sup>3</sup> 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

---

<sup>3</sup> 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".

satisfy the Lenders of social and environmental requirements. These requirements typically include:

- (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, the majority of which are still outstanding and have needed further restructuring, have resulted in liquidity constraints in the domestic debt market. The 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 domestic 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 is set out in Section 3 below.

### 3. Lenders' bankability assessment and risk allocation

The majority of an IPP's capital costs will be financed by the Lenders (alongside a smaller portion funded by the IPP Developers' equity investment).<sup>4</sup> Consequently, satisfaction of the Lenders' bankability requirements will be a critical precondition to funding the IPP on a limited-recourse or non-recourse basis and therefore a key consideration for the IPP Developers. Reference to "Lenders' bankability requirement" means the Lenders' expectation that material project risks relating to the IPP have been assessed and allocated satisfactorily to a project counterparty that is able to bear such a risk or, if retained by the IPP, is mitigated to the satisfaction of the Lenders.

The bankability assessment will be largely project-specific and will take into account a number of additional factors, such as the prevailing market practice in the relevant debt market, the nature and location of the IPP, the host country and the identity of the project participants. It is however typical for Lenders to expect the IPP Developer to have mitigated the following risks through the project documents and other ancillary commercial arrangements:

#### a. Mitigating fuel supply and/or transportation risk

The IPP's ability to generate sufficient revenue from the sale of power to cover its costs and repay its debt will depend upon its access to a secure source of feedstock gas delivered to the IPP. Accordingly, the Lenders (and their transactional advisers) will need to be satisfied that:

- (a) the Project Company will enter into a long-term gas supply agreement (a **Gas Supply Agreement**) with a creditworthy gas supplier (the **Gas Supplier**), which is typically an upstream producer, or indirectly through the Gas Aggregation Company of Nigeria;
- (b) the Gas Supply Agreement includes a firm feedstock gas throughput obligation to underpin the Project Company's ability to generate sufficient power to discharge its power generation delivery obligation to NBET under the power purchase agreement entered into between the Project Company and NBET (the **PPA**); and
- (c) the Project Company has entered into a satisfactory gas transportation arrangement that provides sufficient pipeline capacity and/or adequate contractual protection (e.g., through business interruption insurance) against the heightened risk of disruption to gas supply, for example resulting from frequent sabotage of onshore oil and gas pipelines and associated infrastructure in the Niger Delta region<sup>5</sup>.

In return, the Gas Supplier is likely to expect the Project Company to provide credit support to back-stop its payment obligations under the Gas Supply Agreement. This credit support may be provided in

---

<sup>4</sup> We have seen debt-to-equity ratios around the range of 70:30.

<sup>5</sup> Additional fuel supply risk mitigants include: (a) for the Project company to secure alternative fuel supply arrangements on a contingency basis; or (b) for the IPP to be developed to have dual fuel capabilities - for example, a power plant that is capable of using biofuel, diesel or heavy fuel oil for power generation in the event that gas feedstock is temporarily unavailable.

different forms, including a parent company guarantee from an IPP Developer or through a letter of credit (an **LC**), which may be structured as part of the financing to be provided by the Lenders (e.g., through an LC facility).

**b. Mitigating the EPC Contractor's payment and/or performance risk**

The IPP will not become operational or capable of generating revenue until it has been constructed and successfully commissioned for power generation. Consequently, the Lenders (and their transactional advisers) will expect:

- (a) the Project Company to enter into a turnkey engineering, procurement and construction contract (the **EPC Contract**) with a creditworthy, experienced and technically capable contractor (the **EPC Contractor**);
- (b) the EPC Contract to include incentives and penalties (as applicable) to ensure that the construction of the IPP is completed on schedule, within budget and in line with a pre-agreed set of specifications;<sup>6</sup>
- (c) the EPC Contractor to be under an obligation to pay liquidated damages for delays to the construction timetable or the power plant's failure to achieve a pre-agreed level of electricity output;<sup>7</sup>
- (d) the EPC Contract to include explicit controls over assignment, transfer and/or subcontracting of the EPC Contractor's obligations, e.g., by making the completion of any of these processes subject to (i) the Project Company's prior approval or (ii) the assignee, transferee or subcontractor satisfying minimum financial, reputational and technical requirements; and
- (e) the EPC Contractor to provide an acceptable form of credit enhancement in favour of the Project Company to back-stop its payment or performance obligations (including a parent company guarantee, a performance bond or an LC), particularly where the EPC Contractor does not have a credit rating.

**c. Mitigating the Operator's payment and/or performance risk**

Effective and uninterrupted operation of the IPP is clearly an essential precondition to the Project Company producing the power required to be sold to NBET under the PPA and for generating the revenues required to fund operating costs and debt service.

Accordingly, the Lenders (and their transactional advisers) will expect:

- (a) the Project Company to have entered into a long-term operation and maintenance contract (the **O&M Contract**) with a creditworthy, experienced and technically capable operator (the **Operator**), which might be an affiliate of the Project Company or a third party;
- (b) the Operator to be under an obligation to run the IPP based on pre-agreed key performance indicators that are in line with industry standard of performance for maximising the processing capability of the IPP;
- (c) an approved strategy and budget for procurement of spare parts and effecting scheduled maintenance, which is reflected in the financial model, the project accounts structure and finance documents;

---

<sup>6</sup> This will enable the IPP to satisfactorily complete the commissioning testing with minimal snagging requirements.

<sup>7</sup> The Lenders will also expect any overall cap on the EPC Contractor's liabilities to be at a satisfactory level.

- (d) the scope of operation and maintenance services, fees and any applicable limitation of the Operator's liability to be in line with current market standards; and
- (e) there to be explicit controls over assignment, transfer and/or subcontracting of the Operator's obligations, for example by making the completion of any of these processes subject to (i) the Project Company's prior approval or (ii) the assignee, transferee or subcontractor satisfying minimum financial, reputational and technical requirements.

**d. Mitigating NBET's payment and/or performance risk**

The PPA is the main source of revenue from which the Project Company will discharge its debt service obligations to the Lenders and payment obligations to the Gas Supplier under the Gas Supply Agreement. Lenders will therefore view the stability and predictability of the revenue stream under the PPA as critical to the project's bankability assessment.

In particular, the Lenders (and their transactional advisers) will expect the PPA to satisfy the following requirements:

- (a) the term of the PPA must exceed the tenor of the debt facility provided by the Lenders;
- (b) the PPA should provide a robust tariff structure that includes payment of capacity charges for dependable capacity and energy charges for electrical energy delivered, with the capacity component being sized to cover scheduled debt service;
- (c) NBET must be sufficiently capitalised<sup>8</sup> and its payment obligations<sup>9</sup> back-stopped through acceptable forms of credit enhancement products, such as:
  - (i) the provision of bank guarantees or letters of credit from acceptable financial institutions which may be back-stopped by a partial risk guarantee;<sup>10</sup>
  - (ii) letters of support from the Nigerian Government;<sup>11</sup>
  - (iii) guarantees from the Nigerian Government in order to maximise the credit rating of any debt instruments issued by NBET;
  - (iv) cash escrow accounts;<sup>12</sup> and/or
  - (v) a put and call option agreement which enables the IPP Developer to sell the IPP (or its shares in the Project Company) to the Nigerian Government at a predetermined price, which will be sufficient to cover the outstanding debt;<sup>13</sup>

---

<sup>8</sup> A funding option might be for NBET to issue debt instruments to institutional investors in the Nigerian capital markets.

<sup>9</sup> For example, in the event that NBET exercises its early termination rights under the PPA, which is likely to trigger NBET's compensation obligations in favour of the Project Company.

<sup>10</sup> For example, provided by the Nigerian Government or a multilateral financial institution, such as The World Bank or the African Development Bank.

<sup>11</sup> Depending on the precise drafting, a letter of support from the Nigerian Government might be construed as giving soft comfort to the Project Company in respect of the IPP, which may be insufficient to give rise to binding obligations on the Nigerian Government.

<sup>12</sup> The use of cash as a credit enhancement tool is likely to be a more expensive option from NBET's perspective given the prevailing liquidity constraint in the Nigerian power sector and the negative cost of carry associated with depositing cash in an escrow account.

<sup>13</sup> We understand that, on the Azura-Edo IPP financing, the project company mitigated the risk of NBET's termination of the

- (d) given the transitional nature of NBET,<sup>14</sup> there is a need for PPAs to address the process, risk exposure and protection related to NBET's transfer of its rights and obligations under PPAs to a distribution company, particularly where such a transfer results in a termination of any credit enhancement provided by the Nigerian Government in relation to NBET's obligations under the PPA; and
- (e) the scope of the "force majeure" provisions in the PPA will need to be consistent with the scope of the "force majeure" provisions across the suite of project documents, particularly the Gas Supply Agreement, EPC Contract and O&M Contract.

#### **e. Mitigating project interface risk**

Risks related to the transition of the project from the construction phase to the operation phase can be exacerbated if (as is often the case) the EPC Contractor is a separate entity from the Operator. It will be important to ensure that the works completed under the EPC Contract are acceptable to the Operator through its participation in the commissioning tests, thereby avoiding claims by the Operator that the IPP is incapable of proper performance or requires remedial works.

Separately, the commissioning process under the EPC Contract will need to be harmonised with the provisions of the PPA and O&M Agreement in order to ensure that there is a back-to-back position across the suite of project documents. Similarly, a delay to the commissioning of the IPP that results in payment of delay liquidated damages under the PPA should give rise to a corresponding payment of delay-related liquidated damages under the EPC Contract.

Lastly, the IPP Developers will need to identify the Project Company's counterparty (a **Project Party**) that is responsible for delivering any associated infrastructure or concluding arrangements for connecting the power plant to gas supply infrastructure and/or the grid network for power evacuation. In any event, the associated infrastructure and contractual arrangements will need to have been put in place before the IPP is commissioned to ensure that there are no delays to the commencement of the IPP's operational (revenue-generating) phase.

#### **f. Mitigating currency risk**

It is typical for the majority of loan facilities for IPPs to be denominated in a foreign currency (typically, US Dollars) to reflect the currency of material project costs (particularly under the EPC Contract) and given the short tenor available and high cost of obtaining Naira denominated facilities. A significant number of PPAs are structured on the basis that payments due from NBET to the power producer are denominated in Nigerian Naira.<sup>15</sup> The use of Nigerian Naira denominated revenues to service a foreign currency denominated loan facility clearly gives rise to a currency mismatch and several associated risks. These risks include (i) restrictions on convertibility of Nigerian Naira to a foreign currency, (ii) limitations on transfer of foreign currency out of Nigeria and (iii) devaluation of the Nigerian Naira against a foreign currency.

---

PPA by obtaining a "put and call option" from NBET and the Nigerian Ministry of Finance. Azura Report titled: "High Voltage – A Development Guide to the 459MW Azura-Edo IPP".

<sup>14</sup> The Electric Power Sector Reform Act 2005 anticipates that NBET will fulfil its intermediary bulk trading role (comprising (i) purchase of power from power producers under PPAs and (ii) resale of power to distribution companies under vesting contracts) until the power distribution companies have demonstrated their commercial viability (e.g., improving revenue collection and increasing operational efficiency) to purchase power directly from the power producers.

<sup>15</sup> We have seen instances where there is an additional mechanism providing for indexation of Nigerian Naira-denominated receivables to US Dollars.

In order to mitigate repatriation risk, the Project Company will need to obtain a certificate of importation, which serves as documentary evidence that the Project Company has brought foreign currency into Nigeria (through debt, equity or otherwise) for the purpose of developing, financing or operating the IPP and permits the Project Company to repatriate revenues from the IPP towards debt service in favour of the Lenders and/or distributions to the IPP Developers.

In addition, the Project Company may mitigate currency risk by obtaining currency hedging products or political risk insurance or utilising offshore collection accounts.

#### **g. Mitigating Project Party's performance risk**

In addition to Lenders receiving assurance of the financial standing, experience and technical capability of the Project Party, the Lenders will typically expect to be granted a direct contractual relationship with the Project Party through their entry into a direct agreement with the Project Company and the relevant Project Party (a **Direct Agreement**).

During negotiations of a project document between the Project Company and a Project Party (even where financing is not yet contemplated), it is recommended that the project document (i) includes a form of the Direct Agreement to be entered into between the Project Company, the relevant Project Party and the Lenders or (ii) recognises that the Project Company, the relevant Project Party and the Lenders will enter into a Direct Agreement.

#### **h. Controlling project revenues**

Given the limited recourse nature of project financing structures, the Lenders will seek to regulate the collection and use of the IPP's revenues as follows:

- (a) through the use of several designated accounts (which may include (i) revenue accounts, (ii) operating accounts, (iii) debt service accounts, (iv) debt service and maintenance reserve accounts and (v) distribution accounts, together the **Project Accounts**) that are secured in favour of the Lenders;
- (b) by including a cashflow waterfall in a finance document (for example, account provisions in the facility agreement or a stand-alone accounts agreement) that stipulates a synchronised order of priority for permitted withdrawals from the Project Accounts (typically, allowing payment of operating expenses, followed by debt service, topping up maintenance and reserve accounts before permitting distributions to the IPP Developers, subject to the satisfaction of any required distribution controls); and
- (c) imposing covenants on the Project Company only to make withdrawals from the Project Accounts in line with the cashflow waterfall.

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

The successful closing of the financing for the Azura-Edo IPP demonstrates that, under the right circumstances, well-structured IPPs in Nigeria will be able to source a combination of international and domestic financing and achieve financial close. In order to achieve these objectives, it is imperative that the Nigerian Government continues to demonstrate the political will to provide a suitable political, fiscal and regulatory environment that attracts private sector participation and investment in Nigeria's power sector.

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, 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) securing 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** or **Omosuyi Fred-Omojole**.

You might also be interested in the following briefing notes:

1. [A legal overview of M&A and financing transactions in Nigeria's oil and gas sector](#)
2. [Reserve-based lending in Nigeria](#)



**Dominic Spacie**  
Partner, London

[dominic.spacie@dentons.com](mailto:dominic.spacie@dentons.com)

Dominic is a partner in the Banking and Finance practice at Dentons. He has considerable experience in advising lenders, sponsors, investors and the public sector on all aspects of project financing, on both project-related documentation and the finance documents (debt and capital market solutions).



**Omosuyi Fred-Omojole**  
Associate, London

[omosuyi.fred-omojole@dentons.com](mailto:omosuyi.fred-omojole@dentons.com)

Omosuyi (Suyi) is an associate in the Energy, Infrastructure and Banking practice at Dentons. He has a broad practice which covers project development, project finance, export finance, structured trade and commodity finance transactions.

Suyi has recently been selected as one of "40 leading lawyers under 40" in the Nigerian Legal Awards 2016 for his Nigerian transactional experience and contribution to Nigeria-focused thought leadership.