

GOVERNMENT OF PAKISTAN RESPONSE **ON ADB OBSERVATIONS**

ADB Report Disregards

The ADB Report does not:

- discuss the loss to the economy suffered in particular by the industrial and commercial sectors due to the load shedding, which according to certain estimates¹ is in the range of 219 Billion Rupees per annum in industrial sector, loss of 400,000 jobs and loss of exports of 75 Billion Rupees
- analyze international practices in power acquisition programs in emergency situations
- adverse impact of crises in international and domestic financial markets on investment in power sector especially GOP IPP program
- highlight the role of the Regulator in the approval of the tariffs for the RPP Program
- reduction in the liabilities of Buyer/GOP with the withdrawal of the SBLC of rental charges for the contract term
- acknowledge allocation of risks to seller with respect to site, fuel, guaranteed availability, and financing
- elimination of concessions in relation to restoration events, foreign exchange rate, convertibility, and project financing concessions
- acknowledge that these are fixed price contracts

¹ Beacon House National University Publication “State of the Economy Emerging From Crises”

Procurement Process:

S.#	ADB Report	Review Comments
1.	<p>GENCO are the buyers which exposes them to the project risk and they get drag into contractual and performance issues with the RPPs.</p> <p>NTDC / CPPA should have been the buyer.</p>	<p>If NTDC / CPPA is buyer:</p> <ul style="list-style-type: none">• RPP would require a separate generation license• Incorporation of special purpose company• Conduct of bankable feasibility studies• Consents from various governmental agencies• Defeat of purpose of RPP induction for bringing in emergency power• Regulator has accepted arrangements with GENCO as buyer of electricity from the RPPs• Regulator has approved gross tariff of GENCOs (including RPP Tariff) at which the electricity would be provided to the NTDC and therefore there would be no contractual or performance issues between the GENCOs and NTDC.
2.	<p>RFP included 7% down payment along with irrevocable confirmed SBLC guaranteeing the payments by the buyer.</p> <p>Substitution of confirmed SBLC with GOP guarantee and increase in down payment changes the financial, equity and project risk profile in favour of the seller.</p> <p>Change in down payment post receipt of bids is the major change in the financial term and contrary to good procurement practice and there should have been re-tendering on the changed conditions.</p>	<ul style="list-style-type: none">• GOP's financial difficulties which constrained it to substitute Standby Letter of Credit (SBLC) with GOP guarantee and higher down payment• Annual fee payable to the banks (7-10%) for confirmation of SBLC is a non-recoverable expense while increase in advance payment has reduced the subsequent contractual payment liabilities of the buyer as such payments are recovered through monthly rental charges• Confirmed SBLC of Rental Charges in US\$ over a period of 5 years is a very strong financial instrument equivalent to cash in hand of RPP against which it could raise (100%) debt financing as opposed to the offered GOP Guarantee along with (14%) down payment• In view of high exposure of banks in the power sector, liquidity problems in the financial markets and circular debt, the banks are not willing to provide debt financing to the RPPs• Substitution of the SBLC with the GOP Guarantee has actually adversely affected project risk profile against the sponsors to the protection of GOP• SBLC is encashable over the counter without any

		<p>contestation by the buyer without any time delays whereas in case of GOP Guarantee at least 45 days are required for the payments or upon full and final determination by arbitral tribunal in case dispute is raised by the GOP</p> <ul style="list-style-type: none"> • Higher upfront payment to the seller were secured through an advance payment guarantee of higher equivalent amount in favour of the buyer and therefore there were no change in the net financial position of the parties and that is why higher upfront payments were not considered even by the ADB in their financial model • Change in down payments after receipt of bids is considered material or adverse only if it impacted the financial, equity or project risk profile which is not the case. The changed conditions were in favour of the buyer rather than the seller and did not impact either the selection criteria or award criteria that could have obligated re-tendering • Changed conditions were adverse to the sellers and any re-tendering most likely would have resulted in lesser interest from the bidders and higher tariff quotes apart from delays
3.	<p>14% down payment reduces the equity risk of the sponsor in the project and the major concern is abandonment of project after recovering investment in the first three years.</p>	<ul style="list-style-type: none"> • Upfront payments are not equity payments • Upfront payments are mobilization advances for development, engineering, procurement and construction stages of the contract which are common place in all standard EPC contracts for the IPPs • In case of abandonment of the project buyer has the right to terminate the contract and recover outstanding amounts due to it as a secured party from the sale of plant and machinery • Conversely substitution of SBLC with the GOP Guarantee has adversely affected the ability of the sponsors to raise debt financing for the project
4.	<p>Contrary to the rules, GENCOs did not obtain its approval for the terms of the Contract from NEPRA.</p>	<ul style="list-style-type: none"> • NEPRA Act and Rules do not envisage any upfront approval for the terms of the contract entered by the GENCOs with third parties for additional capacity • Power acquisition program for the RPP was duly

		<p>authorised by the ECC and Cabinet, where NEPRA was consulted</p> <ul style="list-style-type: none"> • Terms and conditions of the rental contracts were ultimately derived from the RFP which was again approved by the ECC • Requirement of an ICB as preferred mode for acquisition of the RPPs was recommended by NEPRA
5.	<p>Provision of Fuel Payment LC prioritizes RPPs over IPPs</p>	<ul style="list-style-type: none"> • IPPs are at advantageous position because: <ul style="list-style-type: none"> • their cost for financing fuel inventory/working capital required for the purchase of the fuel is borne by the power purchaser • 75% of their capacity payments are paid in advance • they can invoke force majeure for non availability of fuel and receive capacity payments from power purchaser • Payment demand against Fuel Payment LC cannot be enforced before forty five (45) days from the date of invoice • Fuel Payment LC is not the primary or unconditional instrument and is a secondary or contingent liability • Assurance of fuel in the form of Fuel Payment LC is essential if RPPs are to operate as must run plants as recommended in the ADB Report
6.	<p>If the RPPs fails to meet the contracted capacity there is no penalty for lower than contracted electrical output.</p> <p>There are penalties for not meeting the contractual availabilities but these have to be charged to future rental payments which may not be practical if the seller abandons the contract.</p>	<ul style="list-style-type: none"> • Commercial Operations will not be accepted and agreed by the buyer unless seller achieves the contract capacity and penalties will be imposed on the seller • Rental charges payable to the Seller are revised downwards on pro rata basis commensurate with lesser contracted capacity • If the Contract Capacity turns out to be lower than ten percent (10%) than the buyer has the right to terminate the contract without any payment of termination charges • Most of the payments originate from the buyer towards seller during plant operations and therefore security from seller is not warranted • Buyer is treated as secured party pursuant to contract in the event that any outstanding liquidated damages are not paid by the seller

		<ul style="list-style-type: none"> • Buyer shall have security in the form of payables for at least sixty (60) days rental and fuel payments (equivalent to US\$ 45 Million for a typical 200 MW RPP), which can be set off against operational failures • Actual availability is calculated on an annual basis and if availability drops seller pays the penalties through a credit note • Dishonoring of credit note is a criminal offence • Equipment cannot be removed from site because buyer is consignee and its prior permission is required
7.	Table 3 of the ADB Report (Returns on RPPs) provides estimated annual returns for RPPs (based on ADB's own assumptions) which ranges from minus two percent to sixty one percent (-2% to 61%).	<ul style="list-style-type: none"> • References to the returns or evaluation of profits in Table 3 are inappropriate, statistically inaccurate and totally skewed • Project costs vary with different specifications, site characteristics, and time period etc • Source of the figures in the ADB report are undisclosed and are unsafe to rely • Bidding was not carried out on cost plus basis rather through evaluation of lowest tariff proposed by the bidders • Fixed & variable O&M, financing costs, working capital financing costs, return on equity, insurance, have not been fully accounted for in calculations • Calculated profits such as (-2% or 3%) are not commercially practicable and nor tenable in any context
8.	The RFP or RSA do not refer to Import Policy Order 2009 which provides mechanism to ensure certain minimum standards for import of second hand plant & equipment.	<ul style="list-style-type: none"> • Rental contracts are governed by the laws of Pakistan including Import Policy Order 2009 • Import Policy Order incorporates implementation of specialized third party pre-shipment inspection regime for specified old and used plant and machinery with adequate safeguards for ensuring serviceability and significant residual value
9.	Inconsistencies in the terms of contract relating to (i) performance guarantees, (ii) late commissioning penalties, (iii) recovery mechanism, (iv) buyer option on inability to commission in extended period and (v) mean site conditions.	<p><u>Differences in the Contracts</u></p> <ul style="list-style-type: none"> ▪ Different contracts signed pursuant to different Request for Proposals and governed by terms and conditions contained therein ▪ Each successive round of bidding process was an attempt to overcome impediments faced in previous

biddings and bring improvements

Variation in Performance Guarantees

- Bids floated by PEPCO for PPR Guddu, Young Gen, and Techno E were site specific with fixed capacities and specific Performance Guarantee amounts specified
- Bids floated by PPIB included Performance Guarantee (@US\$5000/MW)

Penalties for late commissioning post COD

- Assumption that penalties for late commissioning are equivalent to one month rental charges is not true in the illustrated cases
- Penalties specified in such contracts were in accordance with the terms of respective RFPs
- Example 1: Penalty rate for M/s. Walters RPP is US\$191 per day per MW upto a maximum amount of US\$ 17190 per MW for ninety (90) days is in accordance with the RFP
- Example 2: In Techno's case ADB's assertion is incorrect as period for penalties is 30 days after the cure period instead of 90 days and actual penalty is therefore equal to 10 days of monthly rental charges instead of 30 days
- Example 3: In Young Gens case ADB's assertion is again incorrect as period for penalties is 30 days after the cure period instead of 90 days and actual penalty is therefore equal to 10 days of monthly rental charges instead of 30 days
- Reasons for variations are logical as monthly rental charges vary from project to project based on the tariffs quoted in the bids
- 3 types of securities are available with buyer to ensure commercial operations on target date
- Prime security is Advance Payment Guarantee which is encashable to recover the advance payments made in case the Target Commercial Operations Date is not achieved by the Seller
- Secondly, Performance Guarantee which is encashable in full amount upon delay in the achievement of Target

		<p>Commercial Operations Date</p> <ul style="list-style-type: none"> ▪ Thirdly, penalties are imposed in specified amounts recoverable from monthly rental charges ▪ Provision for renegotiations do not impose any binding obligation on the parties to arrive at concluded settlement ▪ Mean Site conditions do not affect RFO based engines ▪ Mean Site Conditions for gas projects are matching with existing IPPs located in the vicinity (mean site temperature for Guddu RPP is matching with Liberty Power Plant and of Naudero RPP matching with Foundation Power) ▪ Rental contracts do not provide for adjustments of output with mean site conditions after commissioning
10.	<p>ECC directions that cost of power should not be higher than the first ten years tariff of the IPPs.</p>	<ul style="list-style-type: none"> • Prior to May 2008, bidding was conducted in line with ECC decision of 15th February 2008 • ICB for RPPs conducted after May 2008 were in accordance with framework approved by Federal Cabinet on 14th May 2008 • ADB Report has negated the general impression that the tariff of the rental projects is 45% higher than the IPPs tariff • Average tariff of fourteen (14) RPPs is approximately on average two (2) cents higher than comparable IPPs tariff at 60% plant factor (actual contemplated despatch regime of rental plants will bring this differential down)² • NEPRA approved tariffs used for comparison are based on prices and values of at least 1–2 Years earlier than the date of bidding for the RPPs

² Please see Table 7, Para 52, Page 21

S.#	Least Cost Options for Closing the Supply-Demand Gap ADB Report Recommendations	Review Comments
11.	Optimize Existing Installed Capacity	<ul style="list-style-type: none"> • SEPCOL (119MW) is being dispatched regularly • Issues with Japan Power are being settled and it will be available shortly • Tapal and Gul Ahmed are already available in KESC system. However some time due to non payments by KESC, they are non able to provide electricity.
12.	Mangla Raising	<ul style="list-style-type: none"> • Additional power through Mangla raising can only be obtained after the reservoir is completely filled. However, as per studies the reservoir is filled after every year. As such, this power may not be counted upon on regular basis. Consequently this additional 18% energy (and not MWs) will only be available during high-water years. Consequently thermal base load power generation of the needed capacity has to be created/acquired.
13.	Expedite work on Loss Reduction Program and GENCO Plats Upgrade	<ul style="list-style-type: none"> • PEPCO is already vigorously implementing the program – however, financial constraints are a big impediment.
14.	Demand Side Management (DSM)	<ul style="list-style-type: none"> • PEPCO is vigorously implementing the program and even DSM Advisors under the ADB program have already been put in place in four of the DISCOs.
15.	Resolution of Circular Debt	<ul style="list-style-type: none"> • Part resolution of the circular debt by the GOP in 2009 and 2010 has improved the situation and now no MWs are unavailable – except 500 MW on the average, because of the non availability of gas.