TRF-122.

No.P-II-7(08)/1990
Government of Pakistan
Ministry of Water and Power

Islamabad, 25th August 2009

Mr. Khalid Saeed
Chairman NEPRA
Islamabad

CHAIRMAN
Dy. No. 1811
Date: 26-8-09

Subject: **EXPANSION OF UCH POWER PLANT (UCH-II) DECISION OF NEPRA ON REVIEW PETITION FILED BY UCH-II.**

I am directed to refer to NEPRA's decision dated 26th June 2009 in the Matter of Motion for Leave for Review filed by Uch-II Power (Private) Limited (Uch-II). As you are aware that Uch-II vide its letter dated 3rd July 2009, addressed to NEPRA and copied to the Minister & Secretary, Water & Power and PPIB and subsequent letters/meetings with the Ministry and PPIB, has raised certain critical issues. Uch-II has stated that the international investors will not be able to take the project forward without amicable resolution of the issues raised therein. In order to understand Uch-II point of view and find a way forward, several meetings were convened and participated by the Ministry, PPIB, PEPCO (WPPO) and the Sponsors of UCH-II. The issues raised by UCH-II have technical and financial dimensions and required detailed discussions, deliberations and further information from the Sponsors, their EPC contractor/equipment supplier, PEPCO (WPPO), PPIB, etc. Consequently considerable time was spent to reach to a conclusion which exceeded the period allowed for submission of a request for reconsideration by the Government as specified in Section 31(4) of the NEPRA Act 1997. After detailed deliberation, the Government of Pakistan is of the opinion that the issues raised by UCH-II are significant and merits reconsideration. In order to avoid any substantial injustice and facilitate the implementation of an indigenous gas based project, the Government of Pakistan submits the request for reconsideration of the Decision dated 26th June 2009 of the Authority on the following four key issues i.e. Heat Rate, O&M Costs, Lenders Fee and Working Capital.

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Heat Rate

2. The issues of efficiency (heat rate) of the new plant at COD and adjustments/corrections applicable for the first year of operation were discussed in detail between WPPO and Uch-II on 8th July 2009 in Islamabad and on 10th and 17th July 2009 in Lahore. After seeking opinion of the gas turbine manufacturer (General Electric) regarding interpretation of the correction/adjustment curves, the parties (WPPO & Uch-II) agreed on a net efficiency of 49.360% for the 1st year of plant operation, instead of 49.551% earlier communicated by WPPO to NEPRA and given in NEPRA Decision. Following adjustments to the efficiency guaranteed by the EPC Contractor has been agreed between WPPO and Uch-II;

a)	Efficiency Guaranteed by EPC Contractor	50.258%
b)	Recoverable & Non-Recoverable Adjustment as per GE Curve (519HA773)	0.508%
c)	Blow Down Adjustment	0.18%
d)	Miscellaneous Adjustment	0.10%
e)	Temperature Adjustment	0.11%
f)	Total Adjustments (b+c+d+e)	0.898%
g)	Net Efficiency (a-f)	49.360%

3. It is therefore proposed that NEPRA may revise its determination based on net efficiency of 49.360% for the 1st year of plant operation, as mutually agreed between the Power Purchaser and Uch-II. However, in case net thermal efficiency of Uch-II Project is proved/demonstrated to be higher than 50.258% at COD, then appropriate adjustments should be applied on the efficiency achieved based on the heat rate test.

O&M Costs

4. Uch-II has accepted the fixed O&M cost determined by NEPRA, however, has shown concern on Variable O&M determined by NEPRA on two accounts:

(i) **Non-inclusion of Rental Charges for Crane (to be used for Maintenance of Gas Turbines)**

We understand that Crane will be required to carryout gas turbine inspections/repairs. In case, the cost or lease rentals are not already covered under the EPC Cost or other items, NEPRA should consider permitting the crane rental charges to Uch-II.

(ii) **Plant Factor to be used for calculating Variable O&M**

Uch-II has stated that while determining tariff, NEPRA has shifted certain costs from Fixed to Variable O&M and has applied 91.32% plant factor (instead of 60%) to determine the Variable O&M Cost per unit (Rs/kWh). According to Uch-II, transferring the Fixed O&M to Variable O&M and calculating the Variable O&M component of tariff by assuming 8,000 running hours (91.32% plant factor) as opposed to Company's submitted tariff on 60% plant factor has resulted in a significant difference in the cost recovery.

5. NEPRA may review the same and remove the anomaly. In this regard the company has already held two meetings with NEPRA to explain the issue.

Lender's Fees

6. As per the information provided by Uch-II, International Lenders require the Company to maintain Cash in Debt Service Reserve Account or place an LC equal to the half yearly or quarterly debt servicing installment (principal payment and interest/mark-up). Uch-II has provided documentary evidence from the Financing

Documents for the Uch-I Project (Uch Power Limited). NEPRA may allow the same to Uch-II subject to documentary evidence at the time of Financial Close.

7. Uch-II project is proposed to be financed by Export Credit Agencies (ECAs), multilaterals and other international lenders (such as IFC, US EXIM Bank etc) through foreign currency loans. It is standard practice of the international lenders to recover the fees of their advisors (technical, legal, insurance, gas, etc.) trustees, inter-creditor agents administrators supervisors, etc. from borrowers. It is proposed that NEPRA may consider to allow the same to Uch-II at actual, subject to documentary evidence, with a maximum cap of US$ 500,000/- per annum, as requested by Uch-II.

Cost of Working Capital

8. The invoicing and payment mechanism under the 2002 Power Purchase Agreement provides for 70% Capacity Purchase Price (CPP) payment at the end of the relevant month, while 30% of CPP is paid at the end of next month (i.e. 30 days after the end of the relevant month). As the expenditure are incurred by the Company at different times (i.e. in advance, during the month, at the end of the month and in the following month), hence, a timing gap remains between the expenditure incurred by the Company and payments made by the Power Purchaser. Invoices for Pass-Through Items (such as General Sales Tax) paid by the Company during the month are raised (along with evidence of payment) at the beginning of next month and Power Purchaser makes payment after 30 days of invoice submission.

9. In order to cover this timing gap, Uch-II has requested for provision of Working Capital facility in various heads. After due deliberations, it is proposed that the Company's request for Working Capital on account of Insurance, HSD inventory for startup/shutdown and Fixed/Variable O&M may be considered favorably by NEPRA, however, NEPRA may determine the amounts of working capital required for Uch-II in various heads, in view of cash payments cycle and net of interest earnings, if any. The Working Capital requirements for Debt Payment (in addition to Debt Service Reserve Letter of Credit) may be reviewed by NEPRA on merit and supporting documents presented by the Company. Further the Power Purchaser through its letter dated 17th August 2009 has confirmed the payment of GST amount along with the monthly energy invoice which will reduce the working capital requirement for GST from 38 days to 7-8 days.

10. Uch-II has submitted that it has not included gas price and excise duty in the calculation for Working Capital. In case there is timing difference in their payments under PPA and GSA, Working Capital would be required to bridge the gap. Uch-II request appears justified in view of an earlier Determination by NEPRA for Green Electric Private Limited (GEPL).

11. In the end we would like to state that Uch-II is a very important project from national prospective due to the reasons that (a) the 404 MW project will help to eliminate load shedding from the country and strengthen the supply network and

stabilize voltage in the province of Balouchistan (b) the project is based on low BTU gas from Uch Gas Field which has no other use than power generation; (c) the substantially lower tariff compared to oil fired power projects will support GOP's efforts to keep the electricity tariff in affordable limits and save million of dollars spent on import of oil (d) it will bring in much needed foreign investment of around 500 Million US$ in Pakistan which is particularly important in the wake of international financial meltdown and difficult local conditions (e) the project will create revenue opportunities for the state run oil and gas company (OGDCL) and last but not the least, it is located in a remote and economically deprived area of Balouchistan where it will create job opportunities for the local people during construction and operation phase of the project and support socio-economic uplift of the local area.

12. In view of the above, NEPRA is requested to reconsider the issues. This letter issues with the approval of the Minister.

13. It is also requested that the matter be disposed off expeditiously as well. kindly acknowledge receipt

U Farooq

(Umar Farooq)

Deputy Secretary (Power)

Attachments:

1. Uch-II letter dated 3rd July 2009 addressed to NEPRA
2. Uch-II letter dated 21st July 2009 addressed to PPIB
3. NTDC letter dated 27th July 2009 addressed to PPIB
4. Uch-II letter dated 29th July 2009 addressed to PPIB
5. Uch-II letter dated 7th August 2009
6. NTDC letter dated 17th August 2009.

Cc.

Mr. Pervaiz Khan, (Authorized Representative) Uch-II Power (Pvt.) Ltd.48, Khayaban –e-Iqbal Main Margalla Road F-7/2, Islamabad.

Annex-1

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July 3, 2009

1.16.15/NEPRA/ar

Arshad Mehmood
The Registrar
National Electric Power Regulatory Authority
Islamabad

Subject: **Decision of the Authority in the Matter of Motion for Leave for Review filed by Uch- II Power (Pvt.) Limited**

Dear Sir:

Reference NEPRA's decision dated June 26, 2009 against the motion for leave for review filed by Uch-II Power (Pvt.) Limited's (Uch-II) on May 6, 2009.

We have reviewed NEPRA's decision in detail and are disappointed to note that NEPRA has further deducted an aggregate amount of US$16.306 million from Project Cost (excluding financing costs which will be trued up at COD) requested by Uch-II in review motion. Inclusive of earlier deductions of US$45.381 million, to-date deductions in Project Costs by NEPRA now aggregate US$61.68 million.

1. Critical Issues

In the latest order, apart from arbitrary reductions in Project Cost, NEPRA has disallowed following four critical elements while approving the tariff. Each of these issues is significant enough to jeopardize the project economics and reliability of plant over the project life and needs to be addressed before we proceed further.

1.1 Heat Rate (Review Request 1)

First of all, we would like to appreciate NEPRA's acceptance of our position to apply degradation and other adjustments (including measurement uncertainty) to the tested heat rate at COD in order to derive the commercial heat rate applicable for the first year of operation.

We also understand that the 'heat rate test of the Complex to be carried out jointly by CPPA and the Petitioner at the time of the COD' will be conducted at normal plant operating conditions which are different from the EPC testing conditions, therefore the test will be performed separately from the EPC performance testing.

For avoidance of doubt, we would request that the above is specifically clarified in the Order "Section I. (iii)" which only indicates adaptation of the results of heat rate test at COD.

With regards to the specific details of the CPPA assessment of degradation and other adjustments we would like to register our concern that CPPA shared its assessment with NEPRA without consulting with Uch II first, thus denying Uch II an opportunity to respond to its findings prior to submitting the same to NEPRA. We are of the opinion that the reasoning applied by CPPA as contained in the final order by NEPRA, on a number of instances, contradicts established engineering principles and operating experiences of the power industry. In particular, we disagree with the notion that OEM correction curves are not to be applied in preference to generically derived numbers.

While we would wish to discuss the same in more detail with CPPA immediately, in the interest of time and to achieve the development schedule, we suggest instead that the above mentioned degradation/adjustments

DG (Prj) kindly review 4/7

DH (Proj. Appr.)

Dated 14-07-09

to the heat rate determined during the test at COD be allowed in line with the OEM degradation/ correction curves specific to Uch-II project in consultation between CPPA and the Petitioner, thereby allowing to capture the actual degradation during the first year when no degradation allowance is currently available resulting in fair and equitable payment from our customer. We believe this is the most reasonable position in the given circumstances and will be acceptable to NEPRA.

1.2 O&M costs – Local and Foreign (Review Request 14)

The tariff determination by NEPRA for Variable O&M (Foreign) and Variable O&M (Local) assumed the base load generation using availability figures of approximately 90%. On the contrary as our cost base assumed 60% load factor, costs are not fully recovered, i.e. LTSA, chemical and water usage, etc. LTSA costs are of significance especially as we may be running the plant at part load but paying the full payment of factored fired hour.

The detailed impact analysis of O&M revenue as compared to Uch-II O&M costs was carried out by the Company. It suggests that the impact of NEPRA determination due to methodology adopted will impact the Company adversely and we will not be able to retrieve our costs fully.

Accordingly, the revised numbers were submitted in line with the NEPRA's methodology (and based on 86% average load factor) in our response to the review motion. However, it seems that inadvertently, the calculations carried out by NEPRA missed out the key elements determining the O&M components. Accordingly, we once again request NEPRA to allow the O&M costs based on average load factor of 86% as summarized below:

- O&M Fixed (Foreign) – US$ 6.811 million
- O&M Fixed (Local) – US$ 5.148 million
- O&M Variable (Foreign) – US$ 2.250 million
- O&M Variable (Local) – US$ 1.086 million

The above cost details are separately attached as annexure-A.

1.3 Lenders Fees (Fixed O&M) (Review Request 13)

As part of the Financing Assumptions, we requested the cost of the Debt Service Reserve Letter of Credit and Lenders Fees (including fees of lenders advisors) during the operations period, however these were disallowed by NEPRA.

As this project involves debt from the international finance market (ECA's, multilaterals and foreign commercial banks) we reiterate that these financing costs are an integral part of all internationally financed projects. The lenders require the project company to either maintain cash in Debt Service Reserve Account or meet this requirement through a Letter of Credit; and to bear all lenders fees (such as administration and supervision fee, etc.) and expenses of their advisors appointed to perform various functions on their behalf. These include fees of inter creditor agent; trustee; technical advisor; insurance advisor; gas advisor; legal advisor (local and foreign) who assist in the financial monitoring of the project on an ongoing basis.

We confirm that similar arrangements are in place under Uch I financing documents (supporting documentation can be shared if required). Whereas the details of requested costs have already been provided during determination proceedings, which we will substantiate with documentary evidence under Fixed O&M cost component of tariff. Accordingly we request NEPRA to allow these costs.

1.4 Working Capital (Review Request 16)

NEPRA has rejected the tariff component of working capital requested by Uch-II on the ground that the payments received from the power purchaser and payments to the fuel supplier are likely to match. We would like to once again clarify that the fuel payments are currently excluded from the requested working capital component of the tariff assuming that OGDCL will agree to the proposed payment terms which are in line with the PPA. In case there is a timing difference in fuel payments under PPA and GSA then we will approach NEPRA for additional working capital requirement for bridging this financing gap and adjustment of related tariff component accordingly upon production of documentary evidence before COD.

Moreover, NEPRA's decision was based on CPPA's recommendation (ideally) that all the payments for EPP and CPP will be made on 30th day from the invoice receipt date by the power purchaser and for any delay in payment, interest charges @ KIBOR plus 450 basis points shall be paid by the CPPA. Accordingly, there is no need of financing cost of working capital to be allowed to Uch II. You would appreciate that interest on delayed payment cannot compensate cash flow shortfall which in turn not only affect the operations of the power station but the overall IRR of investors. The requested working capital is not wholly intended to cover power purchaser payment delays but it is required to bridge the inherent gap in the timing of cash outflows such as: operational period plant insurance premium which will be paid annually in advance whereas related cash inflow from power purchaser will be received over 12 months period. Similarly, all variable O&M costs that will be incurred and paid during first month of operation will be recovered from power purchaser after end of second month of operations following the PPA payment cycle.

The current status of payments between the IPP projects and WAPDA (WPPO) clearly show that the use of a working capital facility and the costs of the associated fees is clearly needed to keep the project company viable and deliver power to the grid. These delays in payment despite repeated assurances from WAPDA (WPPO) that the situation will be resolved, have significantly impacted the IRR for these projects. We have experienced during the last three years that WAPDA is continuously behind payments as scheduled under Uch Power (Pvt) Limited (UPL) PPA which has forced UPL to obtain a working capital facility to ensure timely payments to third parties including lenders to avoid payment defaults. However, this has added to the cost of operation and also delay in payment of dividends to shareholders hence affecting the IRR. Accordingly, we have to assume a cost of working capital for Uch II project.

We have already shared detailed workings in support of our contention during the tariff determination proceedings. In case NEPRA is still of the view that Uch II should finance this component of tariff from its own resources, we request NEPRA / CPPA to help us understand how we could finance the timing difference in cash inflows and outflows (keeping in view the inherent limitation of PPA payment cycle) without reducing the guaranteed IRR of 15%. In view of the foregoing, we request NEPRA to allow the financing cost of working capital.

2. Project Costs

Having reviewed the determined Project Cost, in the interest of time and to achieve the development schedule, we would like to reserve our position and would approach NEPRA for a favorable consideration on or before Financial Close if we could not achieve the reductions as desired by NEPRA.

3. Clarifications Required

NEPRA is also requested to clarify certain matters attached herewith as Annexure B, included in our review motion dated May 6, 2009. We request NEPRA to provide these clarifications before Uch II approaches PPIB for the issuance of Letter of Support (LOS).

Conclusion

The revised tariff determined by NEPRA has significantly eroded the IRR to as low as 9.11% as analyzed below against the guaranteed IRR of 15% offered under the 2002 Power Policy:

IRR offered under the 2002 Power Policy	15.00%	
IRR based on NEPRA determination	9.11%	(A)
Impact on IRR as per NEPRA calculations:		
• heat rate assumptions	2.47%	
• cost of working capital facility	1.22%	
• DSRA cost & Lenders' advisors fees	0.48%	
• O&M costs as requested	1.72%	
Total	5.89%	(B)

It will only be possible for us to achieve 15% IRR under the 2002 Power Policy if NEPRA allows us the differential IRR of 5.89% as derived in B above. Clearly, the points raised above have impacted the returns of the international investors. If NEPRA does not favorably reconsider all four points cited above, the international investors will not be able to take this project forward as the IRR determined by NEPRA is well below the IRR offered under the 2002 power policy.

In view of the above, we look forward to a favorable consideration and amicable close of the above outstanding issues by NEPRA.

Sincerely,

Pervaiz Khan
Authorized Representative

Cc: Khalid Saeed, Chairman – NEPRA

Raja Pervez Ashraf, Minister for Water & Power – Ministry of Water & Power
Shahid Rafi, Secretary – Ministry of Water & Power
Fayyaz Elahi, Managing Director – PPIB

Uch-II Project Development Team

Encl. As above

Uch-II Power (Private) Limited
Schedu[illegible] f O&M Costs

Annexure A

US Dollars in '000

	Fixed O&M Cost			Variable O&M Cost			Grand Total
	Local	Foreign	Sub-total	Local	Foreign	Sub-total	
O&M Contract	2,943	327	3,270	-	-	-	3,270
Production Costs	19	453	472	334	61	395	867
Routine Maintenance Costs	188	309	497	140	336	477	974
Major Repairs and Refurbishment	184	1,177	1,361	121	928	1,049	2,410
Inspection and Overhauls - including LTSA	331	3,749	4,080	70	924	994	5,075
Infrastructure	415	136	551	415	-	415	966
Environmental Costs	17	2	19	6	1	6	25
Property Rent and Rates	72	-	72	-	-	-	72
General & Administration	616	271	887	-	-	-	887
Maintenance Capital Expenditure	363	388	750	-	-	-	750
Total	5,148	6,811	11,959	1,086	2,250	3,336	15,295
Breakup of Local and Foreign component	43%	57%	100%	33%	67%	100%	
Breakup of Fixed and Variable component			78%			22%	100%

Annexure B

Clarifications Required

The clarifications are required from NEPRA with respect to the following points:

Review Request 6 – Insurance during construction
We appreciate that NEPRA has allowed US$7.428 million as insurance premium during construction period to be adjusted at actual at the time of COD based on the documentary evidence. However, in paragraph 6.2 of the decision, it is stated that insurance premium of US$7.428 million is approved subject to a maximum of 1.35% of EPC cost. We understand that rate of 1.35% of EPC cost is applicable for one year and for complete construction period, the approved premium of US$7.428 million has been allowed subject to documentary evidence.

Review Request 10 – Non LTSA Spares
NEPRA in order dated May 6, 2009 has asserted that it can consider cost for non LTSA spares substantiated by documentary evidence at COD. Since no amount has been mentioned in latest order, therefore, the same is not included in total project cost. Accordingly, the cost for non LTSA spares will be reflected in final project cost at COD and relevant components of tariff will be trued up accordingly.

Excluded Assumptions
As requested in our Review Petition and our consequent letter dated June 3, 2009, in line with the Authority's acknowledgment during the Review Hearing, we were expecting that all assumptions detailed on pages 28 to 33 of the Tariff Petition will be specifically addressed in the revised decision. However, these assumptions are still not documented in revised order. We once again request NEPRA to specifically confirm all the tariff assumptions e.g., accounting assumptions, WHT on EPC payments and stamp duty, etc. as included in Uch-II's tariff petition.

Annex-2

Uch-II Power (Private) Limited

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July 21, 2009

1.16.2/PPIB/ar

Fayyaz Elahi
Managing Director
Private Power & Infrastructure Board
Islamabad

Date: 21-07-09

Subject: Decision of the Authority in the Matter of Motion for Leave for Review filed by Uch - II Power (Private) Limited

Dear Sir:

This has reference to our letter of July 3, 2009 to NEPRA copied to PPIB on the subject in response to NEPRA's decision dated June 26, 2009 wherein most requests outlined in the Review Motion were settled except for the following four key issues which need to be addressed to ensure that the investors' return is in line with the 2002 Power Policy.

1. Heat Rate
2. O&M Costs – Local and Foreign
3. Lenders Fees (Fixed O&M)
4. Working Capital

Subsequent to the above referred communication, Uch-II development team elaborated upon the issues in further detail during a meeting held on July 8, 2009 with PPIB and WAPDA and various subsequent meetings. Following the understanding reached during these meetings, Uch-II development team will furnish the additional supporting information to PPIB shortly.

Lately, we have been made to understand that NEPRA has concluded the tariff determination process at its end and any further consideration for change in tariff has to come through a re-submission of tariff petition by Uch-II. It is of extreme concern to us that since the filing of tariff petition on November 21, 2008, a period of eight months of extensive efforts has lapsed. If we were to re-initiate the tariff petition process we may end up with the same issues reached at the current stage. Thus re-submission of a tariff petition will not help clear the issues in a more expedient manner. It would be more beneficial for NEPRA to take into consideration the four issues raised and resolve them soonest so as not to delay the LOS milestone. The EPC price has been negotiated, agreed and held firm since November 2008. Subject to the LNTP, It is valid only to September 2009. Uch II will have to renegotiate the EPC price, payment schedules and completion time if we are unable to settle these issues immediately and proceed further to finalize the EPC agreement negotiations.

Please note that Uch-II investors have spent considerable time and funds in advancing the project development to its current level. It will not be possible for us to remain engaged in an 'open ended' process indefinitely. In view of the urgency attached with this project of national importance, we request for an immediate intervention by PPIB/ GoP.

Sincerely,

Pervaiz Khan

Pervaiz Khan
Authorized Representative

Cc: Raja Pervez Ashraf, Minister for Water & Power – Ministry of Water & Power
Shahid Rafi, Secretary – Ministry of Water & Power
Shah Jahan Mirza, Director Policy & Finance – PPIB

Uch-II Project Development Team