An affair to remember

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When the going gets tough, the tough get going. On January 15 1999, Pakistan's prime minister, Nawaz Sharif, formally handed control of the state-owned Water and Power Development Authority (Wapda) to the army. In a last-ditch attempt to save the authority from financial collapse, soldiers are patrolling the country reading electricity meters, delivering bills and staffing complaint centres to try to stamp out electricity theft.

This is a bizarre twist in a complex tale which has dominated Pakistan's political agenda for the past five years.

In March 1994, former prime minister Benazir Bhutto unveiled an incentives package ? including a bulk power tariff of $0.65 a KiloWatt hour for the first 10 years' sales ? designed to attract private investors into generation. 34 contracts were issued under the scheme (see table) and by the middle of 1997, 19 such projects, all of them thermal, had reached financial close. The signed projects have a combined capacity of 3,150MW.

But the new Sharif government declared itself unhappy with its predecessor's initiative, claiming that the agreed tariff would bankrupt the offtakers, Wapda and the Karachi Electric Supply Corporation (Kesc). It also claimed that the foreign exchange needed to buy imports to run the plants would not be available and the distribution networks of Wapda and Kesc would be unable to cope with the additional supplies.

In June 1998 the government publicly accused a number of independent power companies of corruption and of violating their project agreements, serving intent of cancellation notices to eight companies and terminating the contract of a ninth. Six companies were put under a 90-day notice to answer unspecified corruption and kickback charges. But the project that has borne the brunt of the government's wrath is Hubco, the deal that preceded the 1994 power policy.
Hubco: A never-ending story?When the $1.64 billion Hubco power project signed in October 1994, it set a series of precedents (see deal box). The deal was the first independent power project to be financed in south Asia. It was also the largest financing for a private sector project in Asia and it provided a framework for the Bhutto government's 1994 power policy. At the time it was difficult to see how the deal could fail. But the events of the past 12 months have meant the project company stands vilified in front of the project finance market and some fear that the project may default on its loans or require refinancing.

The situation stems from accusations from the head of Pakistan's Ehtesab accountability bureau, Saif ur Rehman, that Hubco management offered bribes in 1994 to the then prime minister, Benazir Bhutto, and her husband, Asif Zardari, in exchange for changes to the original independent power producer (IPP) contract.

The contract had been agreed by Bhutto and then Sharif under previous terms of office. Rehman claims that this led to a sharp increase in the power tariff which the offtaker, Wapda, is unable to pay. Criminal charges have been pressed against Hubco in the Pakistani courts, while Hubco is pursuing international, offshore arbitration to force the government to honour its contracts and to drop its criminal charges.

Although Hubco offered to lower its power tariffs from October 1 1998, the accountability bureau is not satisfied. It insists that Hubco reduce its tariff with retrospective effect from 1994 ? when it was revised upwards by the Bhutto government ? and pay back at least PRs17 billion ($338.49 million) in excess payments received as a result of the revised tariff as well as PRs2 billion in local taxes. Rehman also wants Hubco to admit wrongdoing in obtaining tenders.

Says Philip Smith, chairman of the Hubco project and former director of treasury at National Power: ?We just want to get on with the operation of the plant. We are frustrated by unsubstantiated allegations of corruption which have gone on for the past 12 months. These are spurious arguments not supported by fact.?

Pakistan's Lahore High Court has lowered the project's original tariff of PRs1.4 billion a month to 80% of the agreed rate, which the project company say is sufficient to avoid an immediate default on the project's debt, but not enough to pay dividends to the company's shareholders. This move came after an individual filed a law suit against Hubco, claiming that the company was charging him too much for his electricity.

Refinancing the project has been touted as a possible solution. Says Jim Romanos, director of infrastructure at the Commonwealth Development Corporation: ?Refinancing is a possibility but not until negotiations get on an even keel. It would be difficult to enter into talks on restructuring the project before then.?

Another difficulty would be separating any particular areas of financing from loans provided by the government of Pakistan's National Development Finance Corporation through the Private Sector Energy Development Fund. The fund is provided by official agencies including the World Bank.

Says Saadia Khairi, managing director of global project finance at Citibank in London: ?International arbitration would be a quicker and cleaner way of resolving these disputes.? Citibank was a lead arranger on the deal and is the inter creditor agent for all existing lenders. Khairi says Hubco could probably consider re-negotiating the tariff if the government would stop harrassment of the company and its employees.

She suggests that the company could consider debt refinancing, a lower equity return and a reduction in operating expenditure as possible ways of shaving costs. Equally she says the government could compromise by reducing fuel taxes and costs.

Khairi compares Hubco's situation to that of Enron's Dabhol I project in India. With that project, a change in government resulted in the threat of contracts being cancelled, but eventually the issue was settled out of court before it reached international arbitration. Khairi hopes that this outcome will be repeated in the case of Hubco.

Both National Power and Citibank are also involved in the $1.6 billion Kapco privatization of Wapda's Kot Addu power plant. Like Hubco, the Kapco team has been accused of bribery and charging excessively high tariffs, but this project is having a far easier time than Hubco. Says Smith: ?Hubco is the largest of the IPP projects, drawing the most money from Wapda. It is also the crowning glory of the previous government.?

Khairi says she is confident about the long-term resolution of the disputes, ?but we are nervous about the short-term.? The announcement on April 15 1999 that Bhutto and her husband have been found guilty of corruption and sentenced to five years in prison for crimes unrelated to the power projects could give the Hubco team and other IPPs further cause for concern. The verdict was the first in a series of trials launched under Sharif's government into charges that Bhutto and her husband made billions of dollars from corrupt deals during two terms of office. **Exploding the myths**The IPP situation was not helped by the Pakistani government's decision to test-fire a ballistic missile on April 14 1999 in response to earlier testing performed by India. In May 1998, the countries carried out a similar series of tit-for-tat nuclear tests (see Project Finance, July 1998).

Following the first round of tests, Pakistan's currency plunged and its foreign exchange reserves fell to $410 million. The Karachi Stock Exchange also hit an all-time low of 768 points and the US imposed sanctions on both India and Pakistan.

Prime minister Sharif said this was the price Pakistan had to pay for becoming a nuclear power.

Ironically, Pakistan has turned to India for a possible resolution to its problems in the power sector, attempting to strike a deal to export what it claims is a surplus in its electricity output ? in fact Pakistani households regularly experience power cuts as a result of under-supply. In February 1999 Pakistan agreed to supply 300MW of electric power daily to India for the next 10 years, with the tariff and other commercial terms to be decided by both countries. But talks have reached a deadlock over price.

According to Indian power ministry officials, Pakistan was asking for seven US cents for one unit of power, while India's best offer was just three cents. Says an official from Power Grid, India's central transmission utility: ?Pakistan wants us to foot the bill for the fixed costs, but since it is not generating the power for India and giving us its surplus, it is fair that we pay only variable costs.? **The World Bank: caught between rock and a hard place?**Participation of the World Bank is key to the conclusion of the IPP issue. Many see the bank's role as a difficult one as it has a vested interest in both the government and the IPPs, but it has managed to use its position as a mediator to force the introduction of measures aimed at ending the disputes.

On January 21 1999 the World Bank announced the approval of a $350 million Structural Adjustment Loan to support the government of Pakistan in improving governance in key public sector activities, including power. A prerequisite of this loan was the setting up of the National Electric Power Regulatory Authority (Nepra), an independent IPP committee which will provide an orderly framework to resolve the disputes.

The other main objective of the loan is to restore the financial viability of Wapda and Kesc by ensuring that line losses are reduced, distribution is improved, and cross-arrears between energy utilities and governments are settled. The World Bank then hopes that the state companies will be privatized. This would not affect the contracts of the IPPs as the government would still be bound to guarantee the offtake payments. On April 7 1999 it was announced that the Pakistani government has set September 1999 as the deadline for the sale of a management stake and 51% equity stake in Kesc.

Another multilateral, the Asian Development Bank, is also providing aid to help Pakistan. On March 31 1999, the bank announced a $300 million loan to be repaid over 15 years, including a grace period of three years. And in December 1998 Pakistan, reeling under the economic and financial turmoil brought about by the US sanctions, negotiated a resumption of a $1.56 billion loan programme from the International Monetary Fund.

But as Project Finance goes to press, the Pakistani government and IPPs are awaiting what could be a significant breakthrough both for the Pakistani economy and the IPPs. The move involves the restructuring of the country's commercial debt by its London Club creditors. The Paris Club, which restructured $3.5 billion of bilateral debt in February 1999, has recommended the initiative, which could help provide an orderly framework for resolving the IPP disputes. Pakistani finance minister Ishaq Dar is to meet private commercial lenders to reschedule up to $850 million of commercial credit.

Says Douglas Strong, director and head of infrastructure and mining at ANZ in London: ?There are separate negotiations going on and everyone is waiting for the first domino to fall.? Strong believes the proposed restructuring will stabilize Pakistan's economic situation and provide a better environment for the resolution of the IPP disputes. Stephen Crew, head of global project finance at the bank agrees: ?We may not be round the corner yet, but at least we can see the corner coming.?

This seems to be the view of most of those involved in the IPPs. The bulk of projects are expected to come on line this year once the remaining notices of intent to terminate are withdrawn. And this could lead the way for future investment in the country, which has been stagnant since the IPP disputes began. Strong and Crew suggest that a potential growth sector is water, where projects could be financed by sponsor equity in local currency.

One undeterred foreign sponsor is Synergics Development of the US. The company has announced plans to invest nearly $1 billion in two hydroelectric projects with a total generating capacity of 684MW. A power-purchase agreement is expected to be signed between the Wapda and the US company by the end of March 1999.

Synergics plans to develop a 600MW plant at Kohala in Azad Kashmir and an 84MW plant in Matiltan in the north-west frontier province. It proposes to charge $0.4-0.5 a KiloWatt hour and transfer the company ? at no charge ? to the government of Pakistan after 20 years.

It is unlikely that these deals will secure financing in the near future. Says ANZ's Crew: ?Even with the sprucest policy-management spring-clean in Pakistan, the credit committees of international commercial banks will need a lot of persuading to back big-ticket non-recourse deals there in the foreseeable future.?

John Dewar, a partner at law firm Milbank, Tweed, Hadley & McCloy in London sums up the mood of all those who have shared the Pakistani IPP experience: ?It's been quite a performance.?

Hub power plant

*Latest reports say Hubco and the government of Pakistan have reached a standstill agreement on litigation pending against both parties. This is the first significant sign that the disputes over the project may soon be resolved.***Signing date:**October 2 1994**Location:**Hub, Balochistan, near Karachi**Cost:**$1.64 billion**Description:**The project involves the construction and operation of a 1,292MW oil-fired power plant**Sponsors:**National Power and Xenel Industries**Arrangers:**National Development Finance Corporation, Bank of Tokyo, Crédit Lyonnais, Citibank, NatWest Markets, Mediocredito Centrale and Sakura**Participants:**Habib Bank, Muslim Commercial Bank, Industrial Credit & Investment Corporation of India, United Bank, Allied Bank of Pakistan, Industrial Development Bank of India, National Bank of Pakistan, National Development Finance Corporation and Saudi Pak Industrial & Agricultural Investment **Multilateral agencies:**World Bank and Jexim**Export credit agencies:**Miti, Coface and Sace**Financial adviser to the consortium:**PricewaterhouseCoopers**Legal adviser to the consortium:**Clifford Chance **Legal adviser to the lender:**Allen & Overy**Financing:**This is split into eight tranches.

Tranche one is a PRs3.012 billion ($100 million) term loan lead-arranged by Pakistan's National Development Finance Corporation, funded by official agencies including the World Bank. Participants in this tranche are: Habib Bank, Muslim Commercial Bank, Industrial Credit & Investment Corporation of India, United Bank, Allied Bank of Pakistan, Industrial Development Bank of India, National Bank of Pakistan, National Development Finance Corporation and Saudi Pak Industrial & Agricultural Investment.

Tranche two is a $240 million, 12-year term loan, denominated in Ecus, French francs, Yen and US dollars, lead-arranged by Bank of Tokyo, Crédit Lyonnais, NatWest Markets, Citibank and Sakura. The World Bank is providing multilateral support.

Tranche three is $120 million, 12-year term loan denominated in Yen. It is arranged by Bank of Tokyo International, Citibank International, Crédit Lyonnais, Sakura and NatWest Markets and the multilateral agency is Jexim.

Tranche four is a $195, 12-year term loan, denominated in Ecus and lead-arranged by Bank of Tokyo, Crédit Lyonnais and Mediocredito Centrale.

Tranche five is an $86, million 12-year term loan denominated in Yen. It is lead arranged by Bank of Tokyo, Crédit Lyonnais, Natwest Markets, Citibank and Sakura. The export credit agency is Miti.

Tranche six is a $45 million, 12-year term loan denominated in French francs. The lead arranger is Bank of Tokyo and the export credit agency is Coface.

Tranche seven is a $148.8 million equity portion. The participants are National Power, Xenel Industries, Commonwealth Development Corporation, Entergy, Pakistan Power, Xenergy and K&M Engineering.

Tranche eight is a $222.7 equity portion. Private investors can purchase ordinary shares on the Karachi stock exchange and global depository receipts on the Luxembourg stock exchange.**Contractors:**Mitsui, Ansaldo, British Electric International and K&M

List of original 34 power projects.

Project	Net capacity (MW)
AES Lalpir	337
AES Pakgen	337
Al-Fajr Power	10.5
Altern Energy	13
BS Link-1 (tail) Hydel power project	9
BS Link-1 (head) Hydel power project	10
Consolidated Electric Power Asia	1320
Davis Energen	9.79
Enpak Power	754
Eeshatech	18
Fauji Electric Power	329.5
Fauji Kabarwala Power Company	144
Gul Ahmed Energy	125
Habibullah Coastal Power	123
Japan Power Generation	107
Jaya Far East Powerpak	120
Kohinoor Energy	120
Liberty Power Project	211
Multan Power Generation	114
Northern Electric	5.52
Power Generation Systems	110
Rousch Power	358
Rupali Power	458
Saba Power	109
Sabah Shipyard	273
Security Electric Power	275
Southern Electric	112.05
Spencer Powergen	256
Star Energy Ventures	196
Tapal Energy	119.5
Tractabel Khaleej Power	327.8
Tri-Star Energy	105
Uch Power	525
Wak Orient Power & Light	775

Source: Faridullah Khan, general manager National Highways

Authority and former joint secretary for power at Pakistan's

ministry of water and power.

The Islamic factor

One aspect which could further complicate the status of Pakistan's independent power producers (IPPs) is the government's commitment to Islamicizing Pakistan. In 1998 prime minister Sharif tabled a 15th amendment to the country's constitution to enshrine the injunctions of Islam as the supreme law of Pakistan. If the amendment is passed, the government would be obliged to enforce Shariah law. This could make some elements of the IPPs' contracts unenforceable, such as the payment of interest on loans (see Project Finance November 1998). But according to John Dewar, a partner at law firm Milbank, Tweed, Hadley & McCloy in London, which acted on among others the Saba and Uch projects, the amendment may be more of a political gesture than serious will on the part of the government to introduce Islamic law: ?For the moment the status quo ante goes on.?

Rousch power

*The project has been held up because Wapda did not grant the grid connection until February 1999 ? a year late. The plant is in test operation, coming on-line in the third quarter of 1999. The sponsors are in the process of securing an increase in financing to cover the extra costs of the delay. Says a spokesman from contractor and equity participant Siemens: ?We want to stay in the market and wait until it levels out. Pakistan is no place for making a quick dollar.?***Signing date:**March 31 1996**Cost:**$507 million**Location:**Sidhnai Barrage, near Lahore, Punjab**Arrangers:**ANZ and National Development Finance Corporation**Sponsors:**Rousch Finance and ESB International**Financial advisers to the consortium:**PricewaterhouseCoopers and ANZ**Legal advisers to the Lender:**Afridi and Angell, Norton Rose, Vellani & Vellani and Latham & Watkins**Description:**The existing proceeds are to help finance a 412MW build-own-operate power project in Punjab, Pakistan**Financing:**This includes a $140 million sub-debt loan from the National Development Finance Corporation ? financed in equal parts by the World Bank and Jexim ? a $33 million loan backed by a Hermes guarantee, a Dm20 million ($11.05 million) loan provided by Deutsche and a commercial loan of $137 million arranged by ANZ. The project also involves a $7 million working capital facility. The sponsors contribute $137 million, which will be raised by Siemens Project Ventures (52.35%), Rousch Finance (40.35%) and ESB International (7.3%)**Turnkey contractor:**Siemens

AES Lal Pir

The government issued notices of intent to terminate in July 1998 after levelling allegations of corruption against the project company. The company threatened to take the government to international arbitration with the support of the International Chamber of Commerce, subsequently withdrew its arbitration request in exchange for the government withdrawing its allegations of corruption. The situation remains unresolved as the government has asked the company to lower its tariffs. Says a source at sponsor AES: ?There is no room for tariff reductions in the project structure. This is not over yet. We have sent over our response and are awaiting the government's reaction.?

*The company is also awaiting the formation of a ninth independent IPP committee. Says the source: ?The government did not like the previous committees and does not seem satisfied with this one. But we think this committee is superior to its predecessors. Our meetings are business-like and people are willing to listen.?***Signing date:**May 15 1995**Cost:**$344 million**Location:**District of Muzaffargarh, Pakistan**Sponsor:**AES**Arrangers:**International Finance Corporation (IFC), Bank of Tokyo, Deutsche and Sanwa**Financial adviser to the utility/government:**IFC**Legal adviser to the consortium:**Chadbourne & Parke**Legal adviser to the lender:**Allen & Overy**Description:**Proceeds are to support the construction and operation of a 362MW oil-fired power plant in the province of Punjab. The project will be developed on a build-own-operate basis. Wapda will be the offtaker under a 30-year power purchase agreement. The plant began commercial operation on November 6 1997**Financing:**This is made up 28% equity from AES and IFC and loans from commercial banks and IFC (72%) on a limited recourse basis. The commercial bank loan is for ¥20.250 billion ($208 million) and will carry a 95% political risk guarantee from Jexim. Nichimen is guaranteeing the balance. The IFC's $40 million loan for its own account was signed on April 7th 1995. The Jexim guarantee was signed on May 15, 1995**Contractors:**Nichimen and Mitsubishi Heavy Industries

Liberty power project

The project has been delayed by negotiations over tariffs. Since the project signed, Tenaga has become the sole sponsor *and will acquire 100% of the equity. Tenaga will also accept the end-finance liability, which has yet to be quantified. Says Jim Romanos, director of infrastructure at the Commonwealth Development Corporation (CDC) in London: ?We are not making any new investments in Pakistan at the moment. We will wait and see what happens in the future.?***Signing date:**May 3 1997**Cost:**$264 million**Location:**Mirpur Methllo near Dharki, Sindh region**Sponsors at the time of signing:**Tenaga Nasional, Infrastructure Capital Group, Entergy, Union Texas Petroleum, CDC, Asian Infrastructure Development**Arranger:**ANZ**Financial adviser to the consortium:**ANZ**Legal advisers to the consortium:**Allen & Overy and Milbank, Tweed, Hadley & McCloy**Legal advisers to the lender:**Norton Rose, Linklaters &Alliance and Clifford Chance**Description:**A standard independent power project in the Sindh region of Pakistan. The proceeds are to purchase a 235MW gas turbine and a 235MW steam turbine.**Financing:**This consists of a $184 million term loan and an $80 million equity tranche.**Contractor:**Descon Engineering**Equipment supplier:**Ansaldo Energia

Projects cancelled due to lack of demand: Enron's Enpak project, Tractabel's Khalleg project and Southern Electricity's Ketti Bandar project