GHANAIANS DISCUSS PRIVATIZATION OPTIONS WITH INDIA AND UGANDA

EXECUTIVE EXCHANGE IN NEW DELHI, INDIA & KAMPALA, UGANDA

NOVEMBER 2014 – The U.S. Energy Association organized a thirteen-day executive exchange for sixteen senior executives, Ministry officials and members of Parliament from Ghana to review the privatization models in New Delhi and Uganda. The executive exchange visit was funded by the U.S. Agency for International Development (USAID)/Ghana.

The Ghanaian delegation meeting with high level Indian officials. Seated: Mike Awuah, Ministry of Finance, Minister Sheila Dikshit, Deputy Minister Jinapor and Secretary R.V. Shahi.

The objective of the executive exchange was to expose the Ghanaians to distribution utility long term concession and partial privatization models in other developing countries. Over the course of 10 days, the Ghanaian delegation met with the major players involved in the privatization of the Delhi and Uganda distribution utilities including government officials, past and present utility executives and members of the regulatory commission, consumer groups, and the media.

DELHI MODEL

The reform process began with legislation, specifically the 1999 Electricity Act that created independent regulators at both the national and state levels. The reform process was motivated by the huge technical and commercial losses and by street protests over constant power cuts and a lack of electricity. The government focused on the following key issues in determining the privatization strategy:

- private sector participation in the power sector;
- fair, transparent and open sector regulation;
- the protection of the interests of all stakeholders;
- encouragement of investments in the energy sector;
- reduction of aggregate transmission and distribution losses;
- improvements in the quality of service and other key performance indicators; and
- the reduction of subsidies and cross-subsidies.

BIDDING PROCESS

Six entities (AES, BSES, China Light & Power, Reliance Power and Tata Power) were pre-qualified but only two entities, BSES and Tata submitted proposals in response to the request for proposals (RFP) issued by the New Delhi Government. Several Indian speakers cited a reluctance by international buyers to bid in part because it was so high profile (the nation's capital).

Unlike the Orissa Project, where investors bid a price (and paid) for 51% of the assets of the utility and a 51% equity position in a future SPV, the process for New Delhi required bidders to bid for a 5-year transitional arrangement on the basis of improvements in aggregate technical and commercial losses. The evaluation criterion was, fundamentally, loss reduction per unit price.

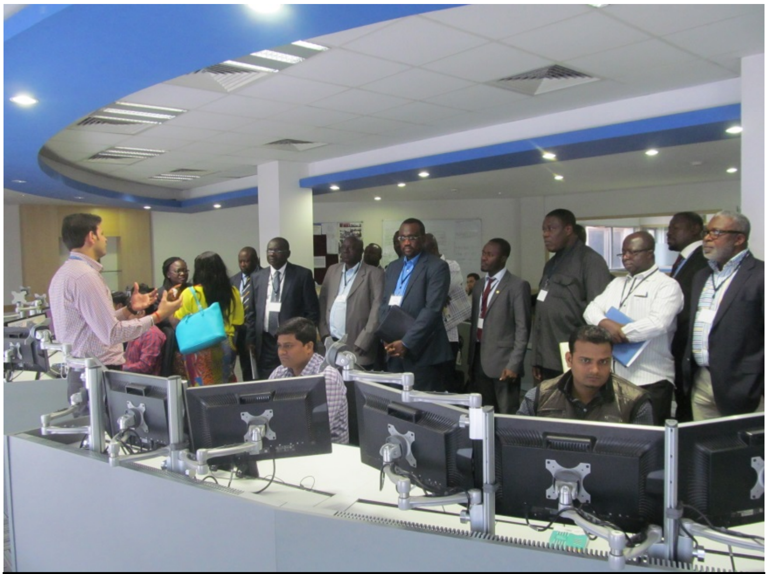
- The project consisted of a 25-year concession agreement negotiated as a renew, operate, and transfer (ROT) arrangement between TPDDL and the holding company. After 25 years, all assets go back to the government.
- The risks associated with issues of right of way (ROW) and land acquisition were retained by the holding company.
- 51% interest in the Joint Venture is privately held by Tata Power and 49% is publicly held. TPPDL is 100% managed by Tata Power. There is no government interference in the day to day operations.
- There was a transitional period of 5 years when the government established appropriate market conditions in recognition of the long gestation period of investments in the sector.

Tata Delhi chief executive and Deputy Minister Jinapor discuss Tata Power's achievements.

- The liabilities of the predecessor company (state owned utility, DVB) were disaggregated into serviceable and unserviceable liabilities. The serviceable liabilities, transferred to the DISCOMs, were capped for each year of the transitional period. All unserviceable liabilities were issued to the holding company, giving the new DISCOMs a clean balance sheet.
- The government guaranteed a return on equity of 16%.
- In 2011 when there was the need to invest in additional infrastructure, both the government and Tata Power had to contribute equitable amounts in order not to dilute the equity stakes.

FAILED ORISSA MODEL

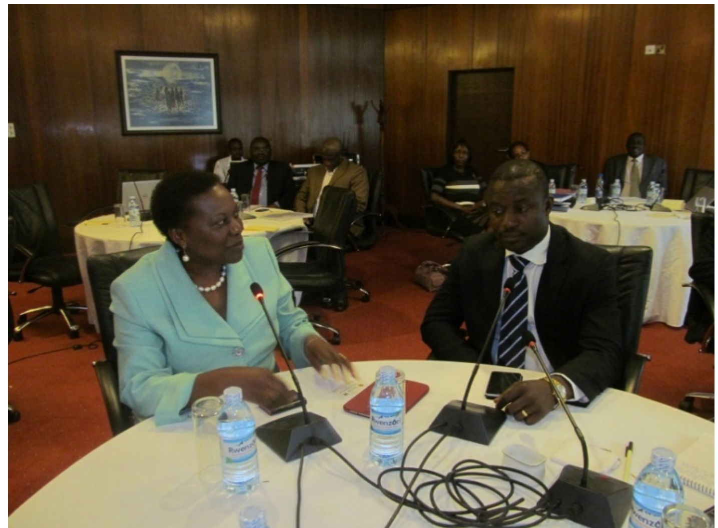
The participants also wanted to talk about a failed model so several speakers discussed what went wrong in Orissa. The Orissa privatization model focused on investment as the main criteria. The main problems revolved around the valuation of assets and losses and government support. Compounding the problem was that the value of the assets was inflated and many assets weren't even registered so a value could not be assessed. The World Bank said the loss level for all four utilities was around 35% - in reality it was closer to 55%. This incorrect target made it impossible for the utilities to hit the benchmark of 25% set by their regulator. The Orissa government also did not support the utilities or have any transition period so the overvalued utilities with higher losses and fewer customers than expected and all the liabilities still on their books had an incredibly difficult time with privatization.


Delegation visits the NDPL control center.

KEY TAKEAWAYS/INDIA

- Political will is crucial at all stages and must be consistent. Delhi was successful because the same party won three elections in a row, in large part because of the power improvements.
- The regulator has a huge role to play and must be free from political pressure. DERC has been pressured to not raise tariffs four times which has hurt the utilities.
- Government handholding is critical for the first 5 years. The handholding phase included a $600 million infusion of cash into the utilities to invest in infrastructure and once a month meetings between the Power Minister and all the generation, transmission and distribution companies.
- Ghana should seriously consider privatizing the metro areas first. Secretary Shahi suggested Ghana start with towns, show some results, gain confidence, and then go to rural areas. As 90% of rural electrification is grant funded, it is unprofitable for the private sector to electrify rural areas and people would question why a public utility gets grants/subsidies. The political reality is that you cannot give government subsidies to a private utility but the tariff would be too high if it included the cost of rural electrification.
- The public will expect the private company to fix everything. The government and utilities should launch a campaign to fully explain the process and manage expectations.
- Sort out the distribution side prior to the generation. The problem in India was the distribution utility could not pay so generation could not increase and struggled.
- Set reasonable targets. The Orissa model did not work because Orissa had unreasonable targets by regulators who said 50% losses should be down to 25%.

- Avoid tariff shock. Have multi-year tariffs and don't put off tariff increases. DERC delayed increases several times so when they finally did increase rates it was often over 20% at a time. Smaller increases every year would have been more palatable to the public.
- Resolve the labor/union issues prior to privatization. The government and utility addressed and solved lots of employee grievances as they went along including the biggest one - people were working as contract or temporary staff.
- Use a transaction advisor early in the process.
- The government will probably have to invest more money in the privatized company as well - $600 million in Delhi. Do not think that just because it is privatized, the government will no longer have to invest.

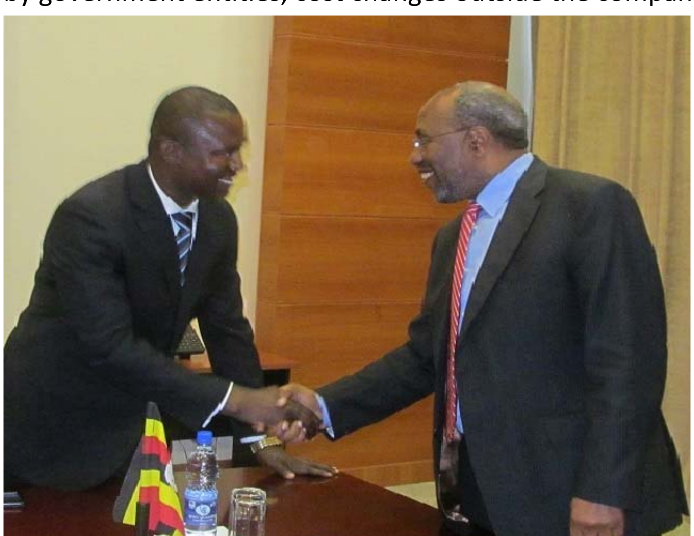


Minister of Energy Irene Muloni of Uganda and Deputy Minister Jinapor.

UGANDA MODEL

Uganda began the reform process with the PERD Act 1998 that created a mandate for divestiture, provided for divesture committees, and listed entities to be divested including the electricity board. The 1999 Electricity Act established the regulator and provided for the sale and use of electricity and licensing and control of transmission, generation and distribution activities. It also introduced competition and created the successors to the state utility (Uganda Electricity Board). Uganda had a transaction advisor from when the strategy was agreed upon through implementation who evaluated assets and investment needs. The advisor also helped draft licenses, regulations, concession and sales agreements. Preparation for the privatization took 3 years and included unbundling the Uganda Electricity Board.

The bidding process did not run smoothly as all of the pre-qualified bidders expressed concerns about the political risk, government readiness, and political will for the process and withdrew. The bidder with the most interest sent in a list of preconditions and issues that must be addressed including collection rates, non-payment by government entities, cost changes outside the company's control, tax issues, the regulator's inability to give a tariff in time when they submit an application (took too long), cost reflective tariffs, insufficient escrow account, assistance in disconnect, foreign exchange protection, and an insufficient power supply (most important). Once the issues were addressed, the party put in a bid for the distribution system and was subsequently awarded the distribution concession for a period of 20 years with an 18 month transition period. The bid submission and evaluation took 3 years.



Deputy Minister Jinapor meets Prime Minister Ruhakana Rugunda.

The Umeme distribution concession covers 98% of electricity sales and is regulated by the Electricity Regulatory Authority (ERA) with energy loss targets, collections targets and operating cost allowances, reviewed every seven years. The concession model is a single buyer model with a Government of

Uganda Support Agreement. Under the concession, Umeme is required to repair, upgrade, and expand the distribution network. Umeme was also guaranteed a 20% return on investments.
A key issue was what should be done about rural electrification as no private company would be interested. Uganda created the Rural Electrification Agency that handles centralised planning and management of the rural electrification programs. The country has been divided into 14 service territories to make administration of the rural franchises manageable. The rural electrification services and infrastructure is managed by duly licensed franchisees.

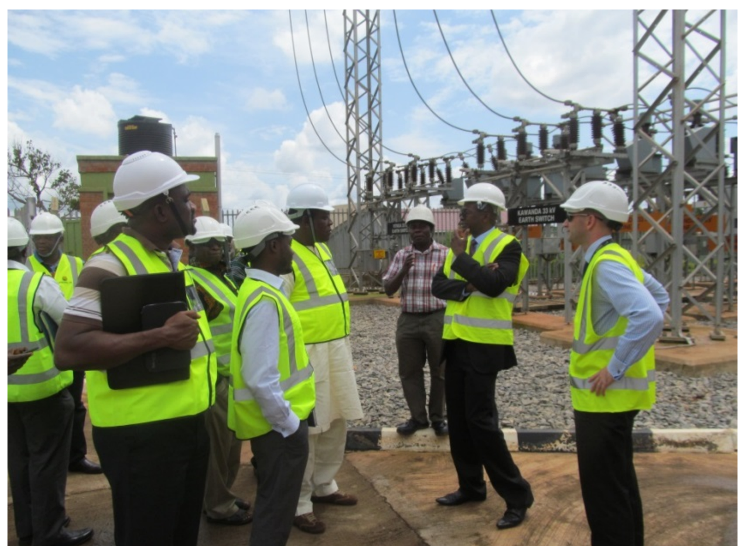
KEY TAKEAWAYS/UGANDA

- Use a transaction advisor – more than one is better.
- Retrenchment and terminal benefits was very sensitive and how you handle this is very important. In hindsight, Umeme thinks a fundamental mistake was that the Ugandan government did not provide for a fund under the law to deal with retirement benefits.
- Rural electrification should not be privatized. Uganda created a government agency (REA) to take care of grid expansion.
- Ghana should make sure the Minister of Energy is in charge of the privatization, not Finance.
- Get stakeholders involved early in the privatization process so if the distribution utility does well as a private company then stakeholders (businesses, government, individuals) benefit financially as well. When the public was able to buy stock, more people turned in neighbors for stealing electricity and had a greater understanding of the need to curb losses and be efficient.
- A strong regulator is crucial. The regulator must be able to put in parameters that the concessionaire must adhere to, and be able to measure and monitor him.
- The regulator must know how to prioritize investment.

RECOMMENDATIONS BY THE DELEGATION

The delegation wrote a report outlining the different models and giving recommendations for the Ugandan government including:

1. **Preparation**: A transaction advisor should be hired to help with the preparation of the project.
2. **Regulation**: The legal regime should be made more complete by clarifying issues such as the institutional framework and tariffs. Furthermore the regulator must be strengthened and made more independent by shielding it from unwarranted political pressures.
3. **Project Scope**: In allowing private sector participation in Ghana's distribution sector, it is strongly recommended that the focus is placed initially on the urban centers.



Ghanaian executives visit a UMEME substation built post-privatization.

4. **Government Support**: The Ghana process may be structured to include guarantees on return on investment, the capping of serviceable liabilities, interest free loans and bulk power subsidies and should preclude tariff shocks to the consumer until the reform program is fully accepted by the population.
5. **Payment for electricity consumed by Government Departments and Agencies**: To prevent recurrence of public sector delinquency in bill payments, the Government of Ghana should install prepayment metering at all Government facilities starting from the Presidency, health, police and the military (particularly in Uganda).

6. **Power Supply:** Ghana should continue expanding the generation base in parallel with the reform of the distribution function.

7. **Communication**: Adopting similar communication strategies to enable engagement with stakeholders with clear roadmaps of project deployment is recommended.

8. **Institutional Framework**: Ghana should establish a holding company to enable the distribution companies that will succeed ECG to start with clean balance sheets. Advancing loans and providing capital grants and other incentives for some period of time to support the successful development of the process may also be given some consideration.

PROGRAM PARTICIPANTS

Hon. John Jinapor	Ministry of Energy and Petroleum	Dep. Minister
Hon. Cletus Avokah	Parliamentary Select Committee On Energy	Member
Hon Francis Arthur	Parliamentary Select Committee On Finance	Vice Chairman
Hon James Yanwube	Parliamentary Select Committee On Finance	Dep. Ranking Member
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