Guidelines for Determination of Tariff for Independent Power Producers (IPPs)

Ministry of Water & Power
Government of Pakistan

بسم الله الرحمن الرحيم

In the Name of Allah,
the Most Beneficient
the Most Merciful

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GUIDELINES FOR DETERMINATION OF TARIFF FOR IPPs

In order to remove ambiguities about various parameters for tariff determination and streamline the process of determination of tariff for Independent Power Producers (IPPs) consistent with the Policy for Power Generation Projects 2002, the Government of Pakistan under Section 7 (6) of the Regulation of Generation, Transmission, and Distribution of Electric Power Act (XL of) 1997 (NEPRA Act) has issued the following guidelines:-

1.1 Compliance with GoP Policies

NEPRA should fully comply with Government Policies and guidelines as modified, supplemented and revised from time to time by the Government.

1.2 Upfront Tariff

(a) NEPRA should now determine an upfront tariff, alongwith complete reference tariff table, and announce it on yearly basis. IPPs opting for this tariff be deemed to have NEPRA's approval and can be issued LOS by the competent agency. This will save a lot of time to individual IPPs. This will also save NEPRA from the repetitive process of hearings.

(b) NEPRA should give upfront tariff separately for each technology e.g. CC plants, conventional steam and diesel engines after accounting for the financial issues of ROE, interest rate etc.

1.3 Negotiation for Tariff – Avoidance of Multiplicity of Entities and Stages of Negotiations

If an IPP wishes to submit an un-solicited bid according to power policy of 2002 and wants to settle tariff through negotiations, NEPRA should determine the tariff in consultation with the IPP and the power purchasers.

1.4 Financial Assumptions Parameters for Determination of Tariff (upfront or negotiated tariff)

It is proposed that following principles be adopted:

a) Tariff should be determined allowing reasonable Internal Rate of Returns (IRR) on equity investment.

b) IRR be calculated over the life of the implementation agreement starting from the date of construction start (i.e. start of payments to contractors).

c) IRR should be equal to the long-term interest rates based on auction of ten year PIB held during the last six months plus a premium of "X"% to be determined by NEPRA.

d) For BOOT projects the investor's equity be allowed to be redeemed after completion of debt servicing. The redemption in equity be in equal installments from the time debt servicing has been completed till the end of the concessions period. Effect of exchange rate variation be compensated for equity redemption. The projects be transferred to GoP at the end of concession period at a notional cost of Rs. 1.

e) For BOO projects there should be no redemption of equity.

1.5 Interest on Loans

For determination of tariff by NEPRA for the fiscal year 2005-2006, the benchmark rate of interest be taken as KIBOR plus 300 basis points for a 10 year loan with 2 year grace as has been agreed in recent negotiations. The IPPs be given an incentive to arrange better terms of debt financing. If the IPPs arrange better terms by the time of financial close, the overall impact of reduction in debt servicing be shared on yearly basis in the following ratio:

Power Puchaser/Govt.: IPP = 60 : 40

1.6 Where-ever floating interest rate regime is adopted, local loans may be indexed to changes in benchmark interest rate, such as KIBOR, etc. Likewise, foreign loans may be indexed to changes in benchmark interest rate, such as LIBOR, etc., and variation in Pakistan Rupee to US$.

1.7 Tax on Dividend

It is proposed that the application of withholding tax or mechanism for its collection should not be a subject of any review or alteration by NEPRA. NEPRA should allow the IRR as per 1.4 above. Tax on dividend will be treated as a normal tax for the purposes of determination of tariff.

1.8 Indexation of various components of Tariff

Indexation of various components of tariff and adjustment for foreign exchange rates (true up) be automatic based on pre-determined formula and reference parameters. IPPs should not have to approach NEPRA frequently for tariff indexation. Only yearly submissions may be required.

1.9 Tariff through competitive process

The bidding process may be structured on either of the following two options:

a) bidding for a tariff

b) Offering an up-front benchmark tariff and bidders to quote a discount on the benchmark price.

1.10 It is proposed that once a tariff has been arrived at through competitive biddings based on either of the processes mentioned at Para 1.9 above, it should not be subjected to further review by NEPRA. The bidding process be structured and administered by PPIB (Ministry of Water and Power) in consultation with the power purchaser (WAPDA/NTDC), Ministry of Finance and NEPRA. The bidding documents (including various formula, formats, etc.), alongwith evaluation criteria, be also finalized by PPIB in consultation with the same agencies. The lowest evaluated levelized tariff would be recommended to the GOP for acceptance.

1.11 Transparency and visibility of Calculations of Tariff

It is proposed that NEPRA should provide complete soft and hard copies of its assumption, inputs and calculation of tariffs alongwith tariff model while announcing determinations to the concerned IPPs. This would enable better understanding of tariff decision.

1.12 Transmission and Interconnection

It is proposed that the construction of transmission line should be the responsibility of the power purchaser/NTDC unless the IPP, at its own choice, wants to undertake it on mutually agreed transmission charge with the power purchaser/NTDC.

1.13 Evaluation of Tariffs

As fuel cost is a pass through, prices of different fuels e.g. gas, oil, coal, etc., tend to distort the evaluation. Therefore levelized tariff be evaluated on the basis of capacity purchase price, efficiency (taking into account fuel cost) and O&M costs.

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