MONITORING REPORT ON PAKISTAN ENERGY REFORM PROGRAM

Progress up to September, 2015

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Overview

One of the major goals of the energy reform program is to improve the financial condition of the electricity sector through the introduction of:

(i) Measures to check systemic losses and inefficiencies;
(ii) Avoid delays in tariff determination;
(iii) Measures to ensure a targeted subsidy design and methodology which benefits deserving consumers; and
(iv) Mechanisms for managing debt in the power sector.

Multi Year Tariff

The National Electric Power Regulatory Authority (**NEPRA**) has already notified the "*NEPRA Guidelines for determination of Consumer end tariff (Methodology and Process) 2015*" which include guidelines for filing of multi-year tariff petitions, which is expected to eliminate the need for annual tariff determination and its consequent delays. The multiyear tariff petitions for FESCO, LESCO and IESCO have been submitted to NEPRA. Hearing on MYT for FESCO is complete.

Subsidies

Subsidies have been eliminated for most consumer categories, with the exception of low-income consumers. The Ministry of Water and Power is also in the process of reviewing the existing consumer categories to ensure that the subsidies which are being given by the Federal Government are actually passed on to deserving consumers.

Cost Recovery and Debt Management

A circular debt capping plan has been developed and placed on the website of the Ministry of Water and Power. The actions identified therein aim to gradually reduce payables in the power sector, and implementation of the plan has been initiated. The impacts of the plan are expected to be achieved over the short and medium term, and will be quantified over the coming quarters.

In end December 2014, overdue payables were kept below the cap at Rs. 218 billion. However, this was partially achieved by additional government borrowing through the Power Holding Company Limited (PHCL). While the stock of PHCL debt had increased to Rs 335 billion at the end of September 2015 from Rs. 239 billion in June 2014. Surcharges notified were struck down by the Lahore High Court, in appeal; the decision of the Lahore High Court has been suspended pending outcome of the appellate proceedings. The Supreme Court has also ordered payment of outstanding amounts to the Federal Government in twelve equal installments.

Additionally, in October 2014, a surcharge was introduced for DISCOs where NEPRA determined tariffs for FY2014 for residential (300 kWh and above), commercial, industrial, and bulk supply customers were below the national uniform tariffs that were previously notified in October 2013. The amounts collected through surcharge were deposited to a "*Universal Obligation*

Fund" to be kept in an escrow account maintained by the CPPA in order to maintain tariff uniform across the country. This surcharge has also been protected by the decision of the Supreme Court pending final outcome of the appellate proceedings.

The Ministry of Water and Power had also instructed four DISCOs to outsource collection to the private sector, and instructed all DISCOs to implement a revenue protection program. A long-term least-cost generation and transmission expansion plan is also under preparation which is expected to significantly enhance cost efficient generation and distribution of electricity which in turn is expected to enhance liquidity in the power sector while allaying debt. Overall losses in at the last 12-months declined from 19.0 to 18.21 percent. Collections in the same period improved from 88.6 to 90.7 percent, primarily due to improved monitoring of DISCOs financials and better load management across consumers in rural and urban areas, and industries.

Efficiency and Transparency in Public Sector Companies

In order to enhance efficiency in the performance of the public sector electricity companies, a series of performance contracts have been signed between the Companies and the Federal Government as shareholder, the most recent one being the performance contracts with the GENCOs and NTDC.

The NTDC performance contract in particular is of special significance since, through this contract, the Federal Government has essentially bound the shareholder, the Board and the management to their respective roles in the performance of the Company, while specific targets are to be set and reviewed through strategic business plan to be developed under the umbrella of the performance contract. This will give both the shareholder and the company the Federal Government to retain flexibility of targets in accordance with economic, policy and legal requirements. It is expected that the performance contracts signed with other public sector electricity companies will also be transferred to this model since it allows for a more realistic, well thought through and achievable mechanism of setting and measuring targets.

In order to further promote operational efficiency and competition, the Federal Government has also approved a program of privatization of DISCOs and GENCOs, for which Financial Advisors have also been appointed in some cases. The due diligence of FESCO has also been undertaken and multi-year petitions filed in accordance with the Guidelines notified by NEPRA.

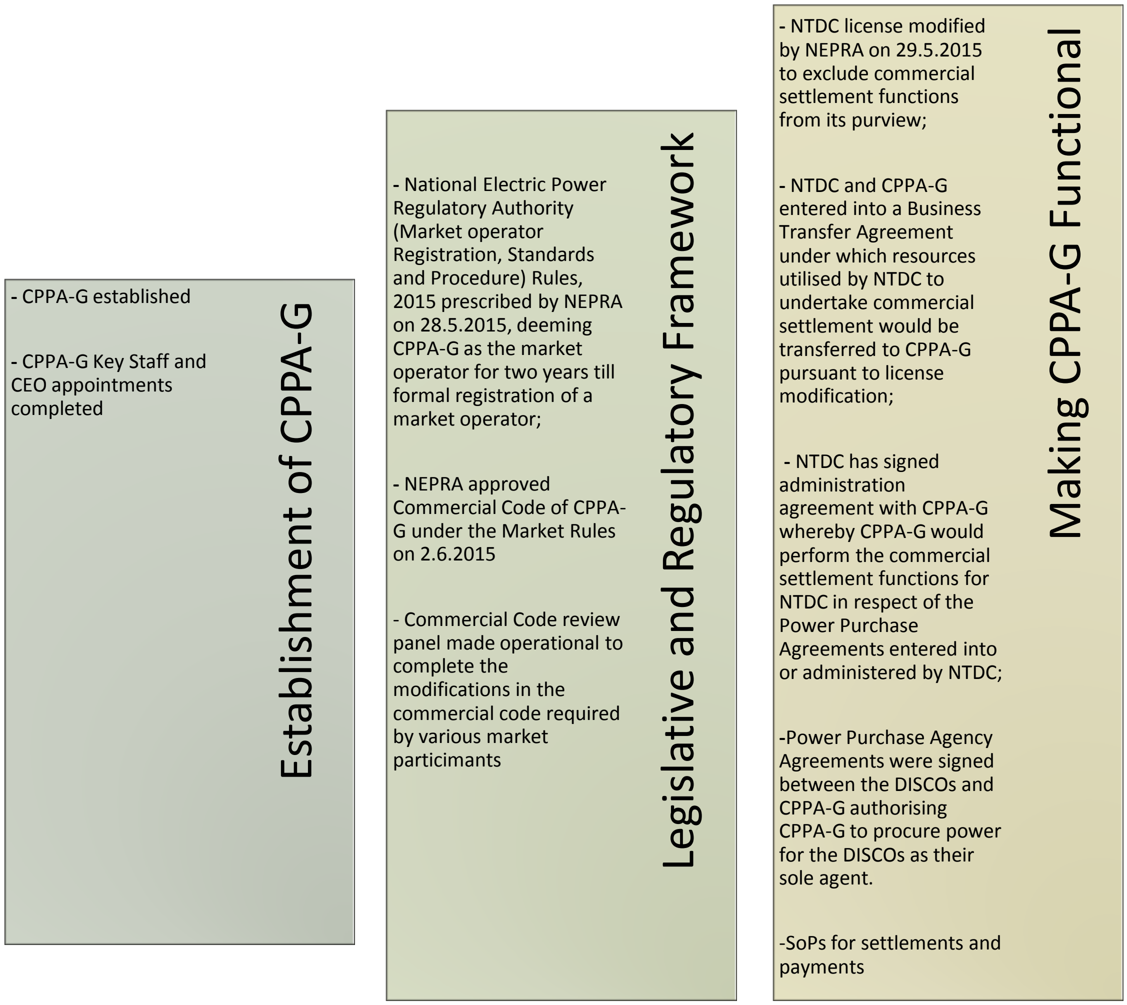
Transparency - Establishment of CPPA-G

In order to enhance private sector investment in the power segment of the economy, the Federal Government and NEPRA took a number of steps to segregate the technical and commercial operations of the National Transmission and Despatch Company Limited (**NTDC**), and transfer them to a newly established Central Power Purchasing Agency Guarantee Limited (**CPPA-G**). This segregation is expected to have the following benefits:

1. Greater transparency in power sector transactions;
2. Separate procedures governing settlement processes allowing for speedier financial settlements in the long run;

3. Involvement of the power sector in the development of the procedures governing commercial settlements through the establishment of a Review Panel under the CPPA-G commercial code thereby bringing greater transparency and buy in from the sector;

These benefits in turn are expected to have a positive impact on encouraging private investment in the power sector of Pakistan. The mechanism through which the CPPA-G was made functional is depicted in the following diagram:



Energy Efficiency

The Ministry of Water and Power issued guidelines on Minimum Energy Performance Standards (**MEPS**) in December 2014, and ENERCON also published a draft plan for phase out of appliances that do not comply with the MEPS for Fans, Motors, CFLs, and ACs. The impact of these measures is however yet to be quantified.

At the same time the "*National Energy Efficiency and Conservation Bill, 2015*" has been laid before Parliament by the Federal Government after approval of the Standing Committee on Energy of the National Assembly.