



## The Case of IPPs

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The Independent Power Producers Advisory Council (IPPAC) has put out an ad recently in newspapers titled 'YOUR RIGHT TO KNOW'. The ad says that over the last few months there has been a vicious campaign against the Independent Power Producers (IPPs). Apparently, IPPs have even been called 'Robber Barons' by senior government officials.

This does not recognize that 'the energy producers are working hard to help Pakistan fight the energy crisis'. According to IPPAC, 'We have endured delayed payments, unwarranted legal problems and numerous challenges to keep our plants running so that consumers DO NOT suffer!'

The basic question relates to the quality of service provided by the IPPs and whether in the process they are able to generate reasonable profits. The origin of the IPPs lies in the 1994 Power Policy announced by the government at that time of the PPP.

Today, there are 30 IPPs. 28 power stations are part of the PEPCO system, while two IPPs supply to K-Electric. Eight IPPs are relatively new and came into operation after 2010. As of 2014, the total electricity generation capacity of IPPs is 8975 MW. This is 37% of total installed capacity in the sector and 55% of thermal capacity. In comparison, the public sector GENCOs have total generation capacity of 4829 MW, equivalent to 54% of the capacity with IPPs

The two largest IPPs are KAPCO and HUBCO, with combined capacity of 2930 MW, representing 33% of the total capacity with IPPs. Most of the other IPPs individually have capacity below 250 MW. There are also five hydel IPPs now, with total capacity of 214 MW.

The share of IPPs in Power generated has risen steadily from 39% in 2009-10 to 43% in 2013-14. As opposed to this, the share of GENCOs has fallen from 20% to 12%. In its State of Industry Report, NEPRA says 'that the performance of IPPs is relatively better than GENCOs.

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However, most of the IPPs under Power Policy 1994 are not regular in submitting quarterly reports as per the PSGR'. This delay in timely submission of reports relating, in particular, to the level of thermal efficiency has probably led to some overcharging by IPPs.

.What is the level of profitability of IPPs ? The two largest IPPs, HUBCO and KAPCO, are publicly quoted companies and detailed financial information is publicly available. In 2014-15, the last financial year, HUBCO's net profits before tax increased by as much as 53%. The rate of return on equity now stands at over 31%. Similarly, KAPCO's net profits before tax rose by 27% in 2014-15, providing for the return on equity of almost 40%. Smaller IPPs have returns on equity generally in excess of 25%.

Therefore, IPPs are making large profits. Their return on equity is substantially higher than the average of all companies. On top of this, the extremely liberal 1994 Power Policy gave lifetime exemption to all IPP projects. Therefore, the post-tax rate of return is even higher and over twice the national average.

The lifetime income tax exemption is unprecedented and no other industry enjoys such special treatment. According to FBR, the annual revenue foregone is Rs 51.5 billion. Cumulatively, over the last four years this exemption has cost the exchequer Rs 200 billion.

How have such large pre-tax profits also been generated in the presence of structural problems in the power sector like the circular debt? The answer lies, first, in rapid growth in the price charged per Kwh by IPPs for supply to NTDC. Over the last four years, the price has nearly doubled. This has been passed through to consumers by enhancement in tariffs by DISCOs.

Second, IPPs have managed their liquidity problem of large receivables by building up large payables with fuel suppliers, like PSO and the gas companies. For example, at the end of 2014-15, payables of HUBCO were equivalent to 92% of receivables. Therefore, the circular debt problem has primarily affected entities like PSO and OGDC and not the IPPs.

The IPPs did make a major contribution to resolving the power shortage problem in the mid- to late- 90s. At that time almost 5000 MW of capacity was added. The investment was stimulated not only by generous fiscal incentives but also by a favorable formula for charges, including a fixed capacity charge irrespective of the output generated. This greatly reduced risks associated with investment.

The IPPs were mostly sponsored by local investors, with the notable exception of HUBCO.

Consequently, foreign exchange reserves of the country were used for the import of machinery worth over \$3 billion. This precipitated a foreign exchange crisis in 1996-97.

IPPAC also says that the amount of Rs 329 billion paid to IPPs in 2013 was undisputed and audited. This is not what the report of the Auditor General of Pakistan states. The disputed and overdue amount of Rs 11 billion is a minor fraction of the concessions and privileges to IPPs over the last two decades. However, following the arbitration award, payment must be made.

Finally, referring to IPPs 'Robber Barons' is perhaps unfair. But the IPPs must realize that the people of Pakistan in general and electricity consumers in particular have paid a heavy price to facilitate the reaping of high level of profit by them.

# YOUR RIGHT TO KNOW!

## Did you know that?

- The IPPs were NOT PAID the due amounts for almost A YEAR from June 2012 - June 2013.
- The Government of Pakistan (GOP) owed IPPs PKR 340 billion in April 2013. In July 2013 IPPs WERE PAID ONLY PKR 329 BILLION and the remaining amount of PKR 11 BILLION was disputed by National Transmission and Despatch Company (NTDC). The amount of PKR 329 billion was undisputed and audited.
- After two years of mutually agreed arbitration, this PKR 11 BILLION WAS ALSO DECLARED PAYABLE by a retired, honourable judge of the Supreme Court. NTDC had 75 days to make the payment which elapsed on October 29<sup>th</sup>, 2015. NTDC HAS NOT PAID and the amount is OVERDUE NOW.
- THE GOP OR PSO DOES NOT PROVIDE SUBSIDIZED OIL TO ANY IPP. Rather the IPPs have to pay taxes ranging from 22%-45% on the purchase of oil. As alleged by a senior government official, any notion of sale of this oil by IPPs is false, and is like robbing oneself.
- Recently IPPs have been called "Robber Barons" by senior government officials as claiming incorrect efficiency levels of their plants. Public should know that the THERMAL EFFICIENCY SPECIFIED in each IPP contract is DETERMINED BY NEPRA and IPPs CAN ONLY BILL AT APPROVED EFFICIENCY RATES. Every IPP bill is AUDITED BY 3 DIFFERENT DEPARTMENTS OF WAPDA to ensure NEPRA compliance, hence NO amounts were paid without audit!
- For the same fuel, POWER GENERATION BY IPPs IS ALWAYS CHEAPER THAN PUBLIC SECTOR PROJECTS, as acknowledged by NEPRA in its report.

The energy producers are working hard to help Pakistan fight the energy crisis. We have endured delayed payments, unwarranted legal problems and numerous challenges to keep our plants running so that our consumers DO NOT suffer!

Over the last few months there has been a vicious campaign against the IPPs. The public has the right to know the facts and should not believe any **baseless allegations**. If you have any queries or concerns, we welcome you to communicate with us via email at [ask.ippac@gmail.com](mailto:ask.ippac@gmail.com). We would also urge the media to do evidence based reporting.



IPPAC

Independent Power Producers Advisory Council