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SHEBERGHAN GAS GENERATION ACTIVITY (SGGA)

Contract No. EPP-I-00-03-00004-00, Task Order No. AID-306-TO-12-00002

Monthly Report

Period: June 1 – June 30, 2012

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Acronyms and Abbreviations

ADB	Asian Development Bank
AEAI	Advanced Engineering Associates International, Inc.
AGE	Afghan Gas Enterprise
APPF	Afghan Public Protection Force
ARDS	Afghanistan Reconstruction and Development Services
CEO	Chief Executive Officer
CO	Contracting Officer
COB	Close of Business
COO	Chief Operating Officer
COP	Chief of Party
DABS	Da Afghanistan Breshna Sherkat
E&Y	Ernst & Young
GIRoA	Government Islamic Republic of Afghanistan
HQ	Headquarters
IL	Implementation Letter
IPP	Independent Power Plant
MEW	Ministry of Energy and Water
MoC	Memorandum of Collaboration
MoE	Ministry of Economy
MoF	Ministry of Finance
MoM	Ministry of Mines
NEPS	North East Power System
NW	North West
OAA	Office of Acquisition and Assistance
OPIC	Overseas Private Investment Corporation
SGDP	Sheberghan Gas Development Project
SGGA	Sheberghan Gas Generation Activity
SMG	Sheberghan Management Team
SWG	Sheberghan Working Group
TFBSO	Task Force for Business and Stability Operations
USAID	United States Agency for International Development
USD	United States Dollar
USG	United States Government
VTC	Video Teleconference

1 COUNTRY TEAM STAFFING

Expatriate Staff	Functional Title
Peter Jezek	Chief of Party
Edrees Saljuki	Senior Institutional Advisor
Charles Moseley	Director; Administration, Finance, Security, and Capacity Building
Richard Tainton	Director, Operations
Dave Davis	Director, Security and Transport
Dan Potash	Financial Modeling Specialist
Ernest Gerloff	Private Power Advisor
Wayne Register	Procurement/Contract Specialist
Michael Scholder	Project Finance and Economics Manager
Stroud Kelley,	Leader, Legal and Regulatory Team
Key Afghan Staff	Position
Amanullah Khan	Deputy Director, Security
Eng. Zalmai	Deputy Co-Director, Joint Gas Working Group
Sher Rahman Mohmand	Customs Specialist & Training/Capacity Building Coordinator
Shokrullah Poyan	Senior. Project Associate
Mohammad Bahir	Electrical Engineer/AutoCAD Specialist
Muzhgan Waseeq	Manager, Office of Chief of Party
Farida Hamidi	Administrative Program Coordinator
Khusraw Razbaan Ahmadzai	Manager, IT and Facilities
Razia Rasooly	Manager, Human Resource and Training
Atiqullah Besmil	Manager, Finance and Disbursements
Hanifullah Aziz	Manager, Procurement and Contracts
Abdul Haleem	Manager, Security and Transport Control Center

2 SECURITY

APPF is providing all armed security services. AEAI/SGGA staff provide oversight of and coordinate APPF services and all other required security services including security intelligence, control of access to the SGGA Office and Residence Compound, and operation on a 24/7 basis of SGGA's Security and Transport Control Center.

3 COMPLIANCE REVIEW

During the month, the audit firm Ernst & Young under a USAID-funded contract undertook a review of AEAI/SGGA Task Order compliance with the requirements specified in OAA Notices OAA-IP-2012-008 and OAA-IP-2012-013 dated April 7, 2012 and May 31, 2012 respectively. SGGA management and staff collaboration with the E&Y team included a kick-off meeting in which key SGGA expat and all Afghan managers participated, the provision of copies all documents requested by E&Y, and responses to all E&Y questions in group and individual meetings. The latter included one-on-one meetings of E&Y's team with SGGA Afghan managers as decided and scheduled by E&Y.

The statement that follows was provided to E&Y to explain continuing SGGA use of local procurement contracts and arrangements that were entered into under earlier USAID-funded Task Orders with AEAI:

"AEA/SGGA is transitioning from a multi-Task Order Administration System to a SGGA- specific Administration System. The completion of this transition is on-hold pending a long-delayed Modification

of the SGGA Task Order to reflect the requirements of USAID-GIRoA Implementation (IL) Letter No. One. The IL was finally accepted by the Ministries of Mines and Finance on May 26, 2012. During this continuing transition period, SGGA depends on and is funding sub-awards of earlier AEAI Task Orders. Most or all of these "inherited" sub-awards will be re-competed once USAID confirms actual SGGA performance requirements through the mentioned Modification of the SGGA Task Order."

On June 27, AEAI Headquarters approved a SGGA Task Order Normalization Plan that provides for SGGA Employment Agreements be entered into promptly with Afghan staff still working under now expired-AEAI Task Orders and the re-competition under SGGA requirements of all local procurement contracts and arrangements that were entered into under earlier USAID-funded Task Orders with AEAI.

4 REVISION OF THE SGGA SCOPE OF WORK

On June 20, AEAI/SGGA received a letter from the Contracts Officer concerning a Change Order and Revision of the SGGA Scope of Work. The revised due date for AEAI/SGGA's response to the letter is July 3, 2012.

5 PROGRAM ACTIVITIES DURING JUNE

5.1 General Activities

- a) Stroud Kelley, Esq., arrived on June 20 and assumed his function as the head of the Legal and Regulatory Team. He has reviewed the project status, various project and ancillary documents, and legal materials and provided comments related to the drilling tender, gas supply agreements and AGE corporatization issues.
- b) The SGGA team continued the expansion of working relationships with MoM, AGE, MEW, DABS, MoF and ARDS; the formation of effective joint operations with DABS is well under way; MEW joint operation is lagging behind, but progressing; attempts to work effectively with MoM have not been as effective as desirable – confrontational relationship remains in spite of AEAI changing MoM staff interfacing with MoM. Project office in MoM is staffed only by AEAI staff. (In contrast the recently set up Project office in DABS is staffed by a combined AEAI and DABS team.) One part time staff has been assigned this month by the Director General, MoM as Project counterpart, but his insufficient availability remains a major concern to AEAI . On June 27th the Contracting Officer requested AEAI HQ to replace the current Chief of Party, principally in an attempt to improve the relationship with the MoM, following complaints raised by the Director General of Policy and Promotion, MoM .
- c) Ernie Gerloff and Eng. Zalmai made a site visit to Sheberghan and Mazar-e-Sharif on 10th and 11th of June 2012 to gather data for the upcoming Drilling Tender. They visited the Bashikurd and Juma gas fields, reviewed the existing facilities of Afghan Gas Enterprise, the General Directorate of the Oil and Gas Survey (the former Northern Hydrocarbons Unit) and DABS to develop closer working relationships for the benefit of all Sheberghan Gas to Power Program stakeholders. Ernie Gerloff made a presentation to the SGGA team members on the results of his review for use in their work efforts.
- d) Peter Jezek and Richard Tainton had meetings separately with Senergy, Schlumberger and Weatherford seeking inputs to preparation of the drilling tender. The meetings identified areas requiring improvement as well as challenges resulting from the small number of wells to be drilled (one to two). The meeting with Senergy also involved negotiations of a subcontract to provide well drilling oversight services. Richard Tainton and other SGGA team members met with USAID representatives to present findings on June 30.

- e) Peter Jezek and Edrees Saljuki attended meetings with USAID/Washington, State Department and the World Bank during the w/o June 25th to review the status of the Sheberghan Gas to Power Program and answer questions about implementation obstacles encountered. They also attended a meeting in AEAI headquarters to deal with operational issues.
- f) Refinements were made to the initial financial model to confirm the economic viability of the entire project value chain and its long-term sustainability. A presentation on the model was made to Jules “Mike” Jordy, USAID Technical Advisor for the SGGA. Later, the model was distributed to Allen Eisendrath, Acting Office Director & Energy Division Chief, USAID Office of Energy & Infrastructure. The models are being continually updated as per the latest cost and price estimates. Model creation and updating will be an important component of capacity building at GIRoA Afghan entities involved in the transactions and decisions.
- g) As requested by Eng. Zia Gul, Director General of Planning, MEW and Eng. Shekeeb Nessar, COO of DABS, the SGGA team performed a quick review of the Power Sector Master Plans’ Interim Report prepared by Fichtner. AEAI’s comments were sent by e-mail to DABS, MEW and USAID to support a 3 day review meeting in Stuttgart, Germany, Fichtner’s home office, which DABS and MEW will attend on the 26th through 29th of June to review comments on their work.

5.2 Sheberghan Working Group

The Sheberghan Working Group Meeting was re-scheduled for June 19th after several delays caused by scheduling conflicts and security incidents. The meeting went well with the participating stakeholders including MoM, DABS, OPIC, ADB, TFBSO and USAID. Unfortunately the VTC connection with USAID/Washington could not be established, apparently due to “bridge equipment” technical difficulty in Washington, DC. The minutes of meeting are attached and have been distributed to all SWG stakeholders with the presentations made during the meeting.

5.3 MoM - SGDP/IL and Other Gas Supply Elements of the Gas-to-Power Initiative (Program)

- a) **Draft Implementation Letter (IL)** – The first of three planned Ministry of Mines submissions of IL conditions precedent features seven of the conditions precedent, nearly half of the overall fifteen. Five of the seven are complete, one awaits signed conflict of interest statements from the MoM procurement committees, and the final is the opening of the USD non-commingled bank account at Da Bank of Afghanistan by MoF. The Minister of Mines signed the letter and we presently await action by the Ministry of Finance to complete the action. Delivery of the first submission to satisfy conditions precedent is expected in the first week in July, assuming that the bank account is opened. Meanwhile, good progress has been made on the second package scheduled for submission at the end of July. Two of the five IL conditions precedent for the second submission are directly related to cash controls within the Ministry of Mines. We have worked closely with the Ministry of Mines’ Directorate of Finance and are probably only about two weeks from completing those items. Additionally, the Sustainability Plan condition precedent has been extensively developed, but is facing serious challenges due to institutional issues within the gas sector and revenue realization issues on the power sale side (electricity revenues will be the only source of money paying for gas supply and processing and energy conversions [the IPP] and transmission and distribution costs). SGGA is requesting a review meeting with USAID/Kabul to reach an understanding before pursuing these issues with other stakeholders, namely the MoM. Additionally, the issue of risk allocation needs to be resolved and recorded in writing to facilitate issuance of the drilling tender and AEAI subcontracting with Senergy.
- b) **Bashikurd/Juma Gas Field Development Tender** – During June there were meetings with Senergy, with which AEAI plans to subcontract certain drilling oversight work. AEAI and

Senergy are finalizing the statement of work and will soon submit a request to USAID for consent to subcontract with Senergy, subject to satisfactory resolution of the liability issues. Senergy will supply the technical specifications for the drilling tender and oversee the selected contractor's well drilling and rehabilitation performance. There are presently a couple of different ways to optimize the tender specifications, which should be issued as a technical bulletin after the tender is released, or could be completed prior to tender release, causing a delay of tender issuance. The most critical issue arises out of the fact that only 1-2 new wells are to be drilled under the USAID-funded well drilling contract to be executed by the MoM. With the current high demand for drill rigs it is anticipated that 6-8 months after contract signing will be required to mobilize a rig. Because of the very small number of wells to be drilled (1-2) the mobilization and demobilization charges will make the drilling very expensive. Also the drilling industry indicates that based on their experience at least six wells are required to be completed by the same driller to benefit from the "learning curve", because only actual drilling will deliver the experiences required to make the drilling more efficient/less costly in the terms of time and money. With only 1-2 new wells planned the benefits from the learning curve will NOT be realized.

5.4 MEW Work

MEW's Planning Department is setting up the offices for the Joint MEW-AEAI team with completion expected in July. MEW had requested AEAI's review and comments for the Terms of Reference for Surobi II hydroelectric power plant feasibility and turnkey contracting and AEIA provided its comments to MEW. This effort was in addition to the review of the Fichtner Power Sector Master Plan interim report.

5.5 Meetings with DABS

AEAI met with DABS SMG representatives on several occasions to discuss various issues related to the Sheberghan Gas to Power Program implementation. AEAI outfitted and moved into an office in the DABS building and is working on daily basis with designated DABS staff. AEAI's Power Lead met with the DABS Chief Operating Office regarding the latter's request for a quick review of the Power Sector Master Plans' Interim Report prepared by Fichtner. AEAI's comments, primarily, the Fichtner lack of power evacuation schemes from Sheberghan area to NEPS, were sent by e-mail to DABS, MEW and USAID.

5.6 Capacity Building & Sustainable Institutional Development

Most joint capacity building and sustainable institutional development activities are on hold pending the Modification of the SGGA Task Order.

6 STATUS OF DELIVERABLES

As indicated in every monthly report since April, AEAI must defer the final preparation of deliverables until Sections C and F of SGGA are revised to reflect the evolved scope of USAID support of the Gas-to-Power Program. Significant preparatory work continues that it is anticipated will permit early submission of front end deliverables soon after Sections C and F are revised. AEAI received on June 20 from USAID draft Scope Mod (Sections C and F) with a request to respond by COB June 23. AEAI requested extension of the deadline because of the need to incorporate information obtained during the industry meetings in Dubai on June 21 and 22. After the CO email requesting new Chief of Party is

appointed by AEAI, AEAI requested delay in submittal date to July 17 thus facilitating participation of the new COP in the Scope Mod work.

7 IMPORTANT GENERAL ISSUES TO BE ADDRESSED

- 1) Memorandum of Collaboration (MoC) - As stated in the April monthly Report. USAID has agreed to have all parties sign an updated MoC once the Implementation Letter is signed. – The original MoC that was signed in September 22, 2011 in Washington by four of the Sheberghan Gas-to-Power Stakeholders. Key objectives of the proposed updated MoC are the incorporation of final information regarding USAID's now final Sheberghan Gas Development Project design, and the inclusion of all key Stakeholders as Signatories of the MoC. Even more importantly, AEAI believes that discussing and agreeing the Updated Memorandum of Collaboration with MoM, MEW, MoE and DABS in the presence of AEAI led by senior USG representative, preferentially at the level of Ambassador, is a critically important relationship building and commitment-reaching act. This action was agreed in principal by USAID/Kabul, but the implementation is still pending.
- 2) Sovereign Guarantee – During the meetings in Washington with the World Bank it was determined that the willingness of the IMF to agree to an exemption opening the path for a sovereign guarantee to be granted depended largely on the “commercial quality” of the projects within the Sheberghan Gas to Power Program. Specifically, if the projects within the program are deemed commercially viable and sustainable and if the supply of electricity resulting from the program underpins economic growth within the service area, both the World Bank and the IMF should be inclined to support the program. In subsequent meetings OPIC indicated that alternate risk mitigation mechanisms could be sought.
- 3) Ministry of Mines need to, in writing, acknowledge that they are accepting liability inherent in gas well drilling and completion. This liability acceptance is a prerequisite to executing a contract with a gas well drilling contractor and for AEAI and its proposed subcontractor Senergy to be able to take on behalf of the MoM the responsibility to oversee the gas well drilling contractor. The drilling and oversight work cannot be done without satisfactory resolution of liability allocation.
- 4) Structure of the gas well drilling tender – based on information obtained and conclusions drawn from the well drilling industry meetings held during the June 21-22 timeframe, the gas well drilling tender should be restructured to allow reasonable implementation schedule accounting for the long lead time required for a 2000 horse power drill rig and Cr alloy tubing and other equipment that must be resistant to H₂S. The tender or packages on the tender should be tendered under the Hydrocarbon Law and not as a “construction contract” as it is currently framed. The drilling contractors indicate that they will not accept the contract as currently presented and indicated that they have annotated their bids to the recently tendered ADB-funded well work over procurement that has been tendered under the same framework as the proposed USAID-funded well drilling and work over tender. This however would require rework of the tender and re-approval of the documents.
- 5) Sustainability Plan – The work completed so far by AEAI on the Sustainability Plan IL Condition Precedent identified major obstacles to completing the Sustainability Plan. The key issues are the institutional structure of the gas supply and processing entities that cannot be MoM departments, but must be commercially viable and sustainable entities instead. The electricity sale and revenue collection, the only source of funds paying for the entire chain of projects, should be derived from the commercialization of electricity sale in the target electricity supply area (Mazar-e-Sharif, Sheberghan and other cities in NW Afghanistan. This component should be an integral part of the Sheberghan Gas to Power Program. The integration of the SGDP, SGGA and the commercialization program must be very tight to assure a believable Sustainability Plan can be developed on a schedule compatible with the implementation of the gas well drilling and

processing plant completion/operation. This integration or lack of it will undoubtedly also impact bankability of the IPP.

- 6) MoM operations – the performance of MoM observed since the beginning of the SGGA and even prior to it documents lacks human resources allocated by the MoM and apparent lack of commitment of MoM to the program. As an example, majority of the work done on satisfying the Conditions Precedent identified in the IL by USAID has been done by AEAI staff. MoMs lack of human resources allocated to the SGDP leads to a significant risk of unsustainability of works developed with USAID funding. This leads to major concerns of AEAI professionals over the viability of capacity building in MoM.

8 KEY AEAI IMPACTS

With minimal input from MoM staff, during the month of June AEAI continued to work on satisfying the IL Conditions Precedent creating a lack of sustainability

AEAI established operational joint Project office in DABS with strong and continuous engagement of DABS staff and the DABS SMG. This was clearly demonstrated during the Sheberghan Working Group Meeting held on June 19, during which AEAI and two members of the DABS SMG made joint presentations.

9 CONSTRAINTS ENCOUNTERED

The most serious remaining constraint encountered by AEAI in the month of June continued to be a challenging relationship with MoM. After previously working directly with the Abdul Jalil Jumriany, Director General for Policy and Promotion, the SGGA team has been relegated to working with his assistant, Najibullah (Najib) Amirzai, Executive Manager Resources Policy & Programs, who, despite the importance of the SGGA work, has not been assigned full time to the SGDP/SGGA, lacks the required background and gives the SGGA team short shrift, as illustrated below:

- 1) The SGGA team arranged an appointment with Najib to review the Commercial Viability presentation on Saturday, June 23rd, 2012. Dan Potash, Wayne Register and Michael Scholder were scheduled for 4:00pm, but he claimed another meeting come up, so they started early at 3:20pm, in an attempt to squeeze the presentation in before he had to leave. Najib was extremely focused upon capacity development and urged us to begin quickly. Near the beginning of the presentation, Najib expressed concern about wasting the money on western contractors before we know if we have any gas field reserves. Dan Potash explained that it would cost more than the drilling to conduct such an assessment. After a couple of phone call interruptions, Najib indicated that he had to leave for the 4:00pm meeting and asked us to visit the following morning to complete the presentation.
- 2) Dan Potash and Michael Scholder met with Najib at 9:45am on Sunday, June 24th, 2012. They were able to complete most of the presentation down to the next to last slide. Najib was pulled out of the meeting early due to a requirement from the Deputy Minister. He was very apologetic and promised that he could give us undivided attention on Monday, 2:00-4:00pm to complete the Commercial Viability presentation and review the Sheberghan Gas to Power Transaction Overview.
- 3) Ernie Gerloff, Stroud Kelley, Dan Potash and Michael Scholder arrived for the meeting with Najib at 2:00pm on Monday, June 25th, 2012. Upon arrival, they discovered that Najib was not in the office, though he arrived at 2:10pm, to indicate that he was called to the official IL signing ceremony with USAID (Note: USAID never informed AEAI about this signing ceremony in spite of

AEAI being the Implementing Partner for the SGDP). He asked to re-schedule for 3:30pm. Ernie Gerloff, Stroud Kelley, and Dan Potash waited until 5:30 pm, but Najib did not return or call, so everyone returned to the main office. They later learned that the ceremony had ended before 4 pm.

- 4) On Tuesday, June 26th, Wayne Register rescheduled the meetings for 8:00am on Wednesday. Dan Potash and Michael Scholder arrived for the first presentation at the 8:00 am meeting on Wednesday, June 27th and learned that Najib had called in sick, but did not inform AEAI. So there was no meeting on that day.
- 5) The meeting was re-scheduled for 1:15 on July 1 for Ernie Gerloff, Stroud Kelley, Wayne Register and Michael Scholder. Michael Scholder completed the Commercial Viability presentation and Ernie Gerloff gave part of his presentation, but was interrupted when Najib had to depart for another meeting, one in which the MoM was opening bids for the purchase of a few passenger vehicles.

During the month of June the SGGA team has lost its Chief of Party due to pressure from the MoM. MoM point of contact with SGGA been assigned to a lower level, part time MoM representative, and now the remaining staff (professionals with 20 – 35 years each of relevant experience) are treated in a very discourteous manner. The MoM staff does not appear to appreciate that the SGGA team are working to facilitate a \$ (financial information omitted) investment from USAID. MoM should be required to demonstrate its recognition of the importance of the investment by allocating adequate and experienced human resources to the project and commitment to cooperate with AEAI and USAID demonstrated by actions to ensure the project's sustainability.

Lack of certainty concerning the timing of revisions of Sections C and F of the SGGA Task Order to bring them in line with the requirements of the above mentioned Implementation Letter Number One.

This continues to be our very critical constraint because it contractually limits AEAI's authority to engage in several aspects of the now fully defined scope of the Gas-to- Power Program. Until Sections C and F are revised, AEAI is unable to definitize scopes of work, schedules and budgets of required sub-contracts and seek CO approval to sub-contract with already identified firms. Revisions of Sections C and F are also required for AEAI to be able to complete its country team staffing and to complete and submit SGGA deliverables.

10 KEY PENDING AND UPCOMING USAID ACTIONS

- 1) As soon as possible conclude adjustments in Sections C and F of the Task Order. This should be done in line with the results of industry consultations obtained during the month of June and the actions that need to be taken to allow program implementation. Equally the actions required to complete the Sustainability Plan should be incorporated in the scope and budget of the Task Order Mod. The division between the Base Period and the Option Period of the Task Order is no longer sustainable as a result of the delay in completing the gas well drilling and related activities.
- 2) A joint USAID-AEAI meetings as soon as possible, led by an ambassador-level USG representative, individually with GIRoA stakeholders, mainly the Minister of Mines, Minister of Energy and Water, Minister of Finance, Minister of Economy and the CEO of DABS, to discuss the current configuration of the Program, explain and discuss the role and responsibility of AEAI under the recently concluded SGDP Implementation Letter and discuss the up-dated MoC to reflect the final scope of IL, seek minister-level commitment in specific areas of the program, thus improving accountability and probability of success. Also, all of the relevant stakeholders should be signatories of the Updated MoC in a public signing event.

- 3) Continue to anticipate and be prepared to respond promptly to AEAI request for consent to subcontracting gas well drilling and rehabilitation advisory and oversight services with Senergy Oil and Gas, Ltd. Senergy was included as a prospective sub-contractor in AEAI's original SGGA proposal.