



# Legal Due Diligence Report

## Transition of Government-Owned Electric Power Distribution Companies (DISCOs) to Private Ownership

June 2015

### USAID POWER DISTRIBUTION PROGRAM

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# USAID POWER DISTRIBUTION PROGRAM

## LEGAL AND REGULATORY DUE DILIGENCE

### TRANSITION OF GOVERNMENT-OWNED ELECTRIC POWER DISTRIBUTION COMPANIES (DISCOS) TO PRIVATE OWNERSHIP

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# PREFACE

Since 2010, the United States Agency for International Development (USAID) has provided active support to the Government of Pakistan (GOP) to facilitate reform of the country's electric power sector with emphasis on improved commercial and technical performance of generation, transmission and distribution operations. The implementing partner for USAID's Power Distribution Program (PDP) to specifically address reforms for government-owned electric power distribution companies (DISCOs) is International Resources Group (IRG), an Engility company. IRG has worked closely with the DISCOs in Pakistan as well as relevant federal and provincial government offices, private sector and stakeholders on a series of distribution reform measures and programs.

In October 2014, IRG sub-contracted the Lahore-based law firm of Cornelius, Lane & Mufti (CLM) to conduct due diligence of the legal and regulatory aspects that should be understood, considered and addressed with the objective of transitioning present-day government-owned and managed DISCOs to private ownership and management. The outcome of this work has culminated in two reports:

1. Legal Due Diligence Report: Transition of Government-Owned Electric Power Distribution Companies (DISCOs) to Private Ownership.
2. Regulatory Due Diligence Report: Transition of Government-Owned Electric Power Distribution Companies (DISCOs) to Private Ownership.

Munawar-us-Salam, Partner at CLM, served as Consultant Team Lead and oversaw the entire process of preparing the reports. Able assistance was provided by Usman Akram Sahi, Senior Associate at CLM, and Sayyed Mubashar Masood, Associated Counsel to CLM, as well as the entire team at CLM. Special thanks to James Connelly, Abid Latif Lodhi, Mary Louise Vitelli and Mary Webster for their guidance during preparation of these reports.

The Report presented herein addresses legal due diligence aspects and has been conducted under Subcontract No. 4013-FPI-CLM.

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# ACRONYMS

AEB	Area Electricity Board
AJK	Azad Jammu & Kashmir
BESOS	Benazir Employees Stock Option Scheme
BPC	Bulk Power Consumer
BPS	Basic Pay Scale
BTPL	Bahria Town (Pvt.) Limited
BTA	Business Transfer Agreement
CCI	Council of Common Interests
CCoP	Cabinet Committee on Privatization
CCoR	Cabinet Committee on Restructuring
CCoR-PSE	Cabinet Committee on Restructuring of Public Sector Entities
CEO	Chief Executive Officer
CLM	Cornelius, Lane & Mufti
CMOD	Competitive Market Operations Date
CPPA	Central Power Purchasing Agency
CPPA-G	Central Power Purchasing Agency (Guarantee) Limited
CRPEA	Contract Registrar and Power Exchange Administrator
CTBCM	Competitive Trading Bilateral Contract Market
D&S	Design and Standards Department
DISCO	Government-owned Distribution Company
ECC	Economic Coordination Committee
EOBI	Employees' Old-Age Benefits Institution
ESA	Electricity Supply Agreement
FATA	Federally Administered Tribal Areas
FBR	Federal Board of Revenue
FESCO	Faisalabad Electric Supply Company
FOR	Free on Rail
G&T	Generation and Transmission



GENCO	Government-owned Power Generation Company
GEPCO	Gujranwala Electric Power Company
GOP	Government of Pakistan
HESCO	Hyderabad Electric Supply Company
HR	Human Resources
IESCO	Islamabad Electric Supply Company
IGTDP	Integrated Generation, Transmission and Distribution Plan
IPP	Independent Power Producer
IRG	International Resources Group
KESC	Karachi Electric Supply Company Limited
KWh	Kilowatt hour
LESCO	Lahore Electric Supply Company
MEPCO	Multan Electric Power Company
M/I	Material Inspection Department
MoF	Ministry of Finance
MWP	Ministry of Water and Power
MW	Megawatt
NEPRA	National Electric Power Regulatory Authority
NPCC	National Power Control Centre
NTDC	National Transmission and Despatch Company
O&D Agreement	Operation and Development Agreement
O&M	Operation and Maintenance
PC	Privatization Commission
PC Board	Privatization Commission Board
PDP	Power Distribution Program
PESCO	Peshawar Electric Supply Company
PEPCO	Pakistan Electric Power Company
PPA	Power Purchase Agreement
PPIB	Private Power and Infrastructure Board
PPIB Act	Private Power and Infrastructure Board Act, 2012



PPP	Public Private Partnership
PPRA	Public Procurement Regulatory Authority
PSE	Public Sector Entity(ies)
QESCO	Quetta Electric Supply Company
SBTA	Supplementary Business Transfer Agreement
SECP	Securities and Exchange Commission of Pakistan
SEPCO	Sukkur Electric Power Company
SGV	SyCip, Gorres, Velayo&Co, and Associates
SO	System Operator
SOP	Standard Operating Procedures
TESCO	Tribal Area Electric Supply Company
TDS	Tariff Differential Subsidy
TNO	Transmission Network Operator
USAID	United States Agency for International Development
VIM	Vertically Integrated Model
WAPDA	Pakistan Water and Power Development Authority
WPPO	WAPDA Private Power Organization

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# EXECUTIVE SUMMARY

## Overview

Demand for electricity in Pakistan continues to exceed supply; the efficiency, affordability and reliability of how the country's limited power supply is distributed are of critical importance. Since publication of the 1992 Power Sector Reform Plan (Reform Plan), a series of reform measures have been implemented in Pakistan's power sector. In 2013, the Government of Pakistan (GOP) issued the National Power Policy, which reaffirmed Government's intention to privatize government-owned electric power distribution companies (DISCOs) with the objectives that private capital, if properly structured, will result in improved efficiency, affordability and technical reliability of power distribution. This Policy mandate was in line with earlier policies leading to the introduction of private investment in power generation starting in 1994.

In order to prepare the DISCOs to be privately owned and managed, it is essential to understand the legal and regulatory frameworks in which this proposed shift in ownership and management will take place. In this regard, the Consultant has prepared two Due Diligence Reports: (1) this Legal Due Diligence Report (Report); and (2) a complementary Regulatory Due Diligence Report. Each report assesses various aspects to be considered in the transition of government-owned DISCOs to private ownership and management. Annexure I provides the meaning of defined terms used in this Report.

These reports include:

- a. Review and analysis of legal and regulatory requirements which may have an impact on: (i) commercial aspects of distribution activities; (ii) private investment interest; (iii) distribution of electricity; and (iv) privatization.
- b. Review of legal and regulatory parameters affecting corporate and commercial operations once any DISCO is under private ownership and management.

## Context of Power Sector and its Reform

For more than two decades, the GOP has supported reform of the country's electric power sector. A number of policies have been published to support phased market transitions and reforms. Sector reform plans have consistently supported objectives that included private sector investment in the power sector, improved sector efficiency, and rationalization of electricity prices to achieve full cost recovery. As early as 1985, the GOP issued power reform policy but in 1992/93, the GOP issued the Reform Plan in support of foundational objectives that included structural and institutional reforms.



Prior to the initiation of the Reform Plan, the Water and Power Development Authority (WAPDA) served as the sole government agency responsible for the implementation and management of power sector operations. WAPDA had a “Power Wing,” a “Water Wing” and various other administrative departments. WAPDA was structured as a vertically integrated utility engaged in generation, transmission and distribution of electric power.<sup>1</sup> The Reform Plan required the unbundling of WAPDA’s Power Wing into separate and distinct business units for generation and distribution market segments, while the transmission segment was to be housed under a single government-owned entity with continued responsibility for the integrated operation of the electric power sector and wholesale market. (See text box for illustrative highlights of reform for power sector)

In 1998, the Government issued the “1998 Action Plan” that prescribed the modus operandi for transition from this vertically integrated monopoly structure to a competitive wholesale power market. Per the GOP 1998 Action Plan:

- a. WAPDA’s Power Wing was unbundled into 12 limited liability companies that include three generation companies (GENCOs), National Transmission and Despatch Company Limited (NTDC), and eight DISCOs.
- b. The Pakistan Electricity Power Company (Pvt.) Limited (PEPCO) was incorporated to provide stewardship for the transition

Illustrative Highlights Reform of Pakistan’s Power Sector	
Period	Description
1992	Reform Plan – setting the framework of power sector reform.
1994	Amendment of WAPDA Act to facilitate restructuring and privatization.
1997	Legislative framework for independent regulator (NEPRA).
1998	Action Plan – setting the modus operandi of Reform Plan. Assigning stewardship function to PEPCO to implement Reform Plan. Incorporation of 12 limited liability companies.
1998-2002	Consultative process and methodology by Policy Committee on Restructuring of WAPDA Power Wing constituted by ECC.
2001-2002	Grant of distribution license by NEPRA to DISCOs.
2004	Implementation of contractual arrangement for transfer of business and manpower transition.
2007	Functional separation of WAPDA Power Wing and corporatized entities.
2012/2013	Recognition of additional 2 DISCOs.
2013	Latest National Power Policy stipulating objective of privatization as well as reform of CPPA.
2015	Policy of GOP to carve out market operations from NTDC and vesting them with CPPA-G for reform of CPPA.

of the power functions of WAPDA, except hydroelectric generation that remains with the Power

<sup>1</sup> With the exception of certain service territory in Karachi (Province of Sindh), which fell within the jurisdiction of Karachi Electric Supply Company Limited (KESC, now K-Electric Limited).



Wing of WAPDA, to the 12 new government-owned companies, to attain managerial and financial autonomy.

- c. The National Electric Power Regulatory Authority (NEPRA) was established as an independent regulator responsible for preparing and implementing all regulation of the sector including generation, transmission and distribution.

In 2002, change in the market was solidified with the issuance of license by NEPRA to the three generation companies, eight distribution companies and the national transmission and despatch company under the NEPRA Act.

In 2007, WAPDA functions were bifurcated into: (i) WAPDA functions for water and hydropower and (2) PEPCO for management of generation, transmission and distribution.

## **Privatization of Electric Power Distribution in Pakistan**

In today's market, there are ten government-owned distribution companies (DISCOs) serving the Pakistan power market; although, as reviewed herein, business and assets for two of those DISCO operations are yet to be legally transferred. Customers include residential, commercial, industrial, agriculture, bulk and government. In addition to the government-owned DISCOs, two private distribution companies<sup>2</sup> have also been issued licenses to undertake distribution business.

### **Government-owned DISCOs in Pakistan**

1. Faisalabad Electric Supply Company Ltd. (FESCO)
2. Gujranwala Electric Power Company Ltd. (GEPCO)
3. Hyderabad Electric Supply Company Ltd. (HESCO)
4. Islamabad Electric Supply Company Ltd. (IESCO)
5. Lahore Electric Supply Company Ltd. (LESCO)
6. Multan Electric Power Company Ltd. (MEPCO)
7. Peshawar Electric Supply Company Ltd. (PESCO)
8. Quetta Electric Supply Company Ltd. (QESCO)
9. Sukkur Electric Power Company Ltd. (SEPCO)
10. Tribal Area Electric Supply Company Ltd. (TESCO)

Each DISCO is responsible for a specified service area and is required to abide by NEPRA regulatory requirements. The financial state of the power sector is such that considerable state financial resources are required to subsidize provision of electricity to consumers.

Since the Reform Plan, the GOP proposed a number of actions to promote competition and efficiency in the sector, including the privatization of FESCO and possibly other DISCOs. However, those privatization actions did not progress, except privatization of KESC, now "K-Electric," in 2005, which

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<sup>2</sup> K-Electric and Bahria Town (Pvt.) Limited.



also subsequently required additional incentives from the GOP, including guaranteed power supply in certain circumstances for an additional period of five years.

## **Objective of Legal Due Diligence Report**

The objective of this Report is to provide a comprehensive overview of how government-owned distribution companies are operating in Pakistan and to identify issues relevant to privatization of these companies. A comprehensive review of the governance frameworks under which distribution operations are conducted includes observations with respect to legal, institutional and commercial arrangement combined with key findings and recommendations for actions to move forward GOP's reform plan to privatize government-owned DISCOs.

### NOTES:

- i. This due diligence is strictly focused on electric power distribution, specifically, the status of government-owned distribution companies.
- ii. This due diligence emphasizes legal aspects; regulatory aspects are addressed in a complementary due diligence report; financial, social, environmental, technical and other aspects may otherwise be addressed.
- iii. This due diligence is focused on legal aspects of privatization of DISCO; it does not specifically consider management contracts or partial privatization or privatization processes in general.
- iv. This due diligence assesses the distribution sector and companies as a whole and does not distinguish or highlight specific DISCO attributes with respect to privatization; such follow-on detailed analysis of each DISCO is recommended.
- v. The terms “power” and “electricity” and “electric power” are used interchangeably as is standard industry practice.

## **Methodology**

In order to prepare this Legal Due Diligence Report (Report), the Consultant has regularly consulted with IRG / PDP staff and has submitted periodic reports, which have been instructive in preparing iterative drafts and achieving expected results.

This detailed review and analysis of the legal framework with respect to privatization of government-owned DISCOs to private ownership and management is based on:



- a. Comprehensive literature review of existing Pakistan laws, regulations, policies, and DISCO incorporation documents and other legal documents as made available to the Consultant.
- b. Meetings and interviews with key stakeholders including the Ministry of Water and Power (MWP), Privatization Commission (PC), NTDC, Central Power Purchasing Agency (CPPA) a department of NTDC, various DISCO managers, and PDP. In this regard, a draft legal due diligence report was shared with the MWP, PC and NEPRA in April 2015 and various presentations were presented by the Consultant and consultative sessions were held, after which this due diligence report has been modified to reflect stakeholder responses.
- c. Assessment of GOP power sector reform objectives, completion of commitments to date, including time-based actions and status of implementation, or reasons for not implementing same.
- d. Identification of key gaps and measures to improve distribution operations and to build investors' confidence in the Pakistan power sector for the purpose of effective privatization.

## Key Findings and Recommendations

Government's power sector reform objectives envisage that government-owned DISCOs will be privatized and that private distribution companies will be responsible for planning and managing their individual systems to meet consumer demand within their service territory.

Some of the key findings and recommendations discussed herein include:

1. Finding: The Pakistan Power Market is in transition. The structural reforms anticipated as part of the GOP sector reforms have not been completed. As a result, the financial interactions and management roles of government institutions remain more integrated in distribution than would ordinarily be expected in a corporatized market. Currently, the sector entities, including the DISCOs and NTDC, are in the process of adopting the framework for operationalization of CPPA-G in phases as proposed by the GOP. NEPRA has approved the modification of the NTDC Transmission License and approved the re-organization of NTDC. Additionally, NEPRA has also approved the Market Rules and the Commercial Code laying down the foundation for operationalization of CPPA-G. Thus, the first phase of the process for separation of the market operations has been accomplished.



Recommendation: The GOP must complete its objectives and accomplish the activities for the second phase with the consultative process involving all the sector players, so that the CPPA-G actions as market operator are solidified.

2. Finding: Approvals for privatization of distribution companies are in place. The privatization of all the government-owned DISCOs (except TESCO) has been approved by the Council of Common Interests (CCI). In addition, the Cabinet Committee on Privatization (CCoP) has approved that DISCOs be placed in the GOP privatization program for early implementation, which has also been ratified by the Cabinet. Currently, the financial advisors for each DISCO are conducting individual due diligence for each DISCO.

Recommendation: The Consultant understands that the privatization program shall be formulated based on reports of financial advisors and thereafter approval of CCoP and Cabinet (if required) based on such program for each DISCO shall be obtained. This report may facilitate early corrective actions, which would facilitate timely completion of the privatization scheme.

3. Finding: GOP seeks to use a Public Private Partnership model. GOP has indicated that privatization of FESCO, IESCO and HESCO be modelled on a specific Public Private Partnership (PPP) Model. PPP models typically cause investors to pause, but this model is prescribed to require only divestment of 26% shares along with management control, and has been approved/ratified by the Cabinet in 2014.

Recommendation: It is important that this PPP model be clearly structured and communicated to investors, as there are, internationally, varied understandings of what a PPP model implies.

4. Finding: Participation of provinces in privatization. It is essential that key stakeholders (Provinces) be consulted throughout the DISCO privatization process, as also directed in the approvals of CCI for privatization of the DISCOs.

Recommendation: In order to ensure that CCI directions are implemented, particularly with respect to requirement of Provincial Chief Secretaries, who are to be members of the Privatization Board and the Chief Minister of the relevant Province (i.e., where a distribution company is to be privatized) shall be a member of the CCoP for that matter. Review of approval by CCoP and the Privatization Board for compliance with the direction of CCI is required.

5. Finding: Considerable legacy aspects with respect to WAPDA restructuring remain. Issues ranging from employee entitlements, issuance of DISCO shares, legal vesting of immoveable properties of



DISCOs and legal documentation of two of the 10 government-owned DISCOs for transfer of business require resolution prior to meaningful privatization.

Recommendation: The GOP should establish a “DISCO Privatization Committee” to specifically address the WAPDA legacy issues discussed in detail herein.

6. Finding: Regulatory guidance needs to be prepared. For government-owned as well as private-owned distribution, NEPRA will regulate the sector. NEPRA has yet to frame and notify the rules for investment and power acquisition programs for the DISCOs as required under Section 32 of the NEPRA Act. These rules are essential to implement the national energy plans and to guide private sector investors.

Recommendation: NEPRA is in the process of making these rules; however, it is extremely critical that this is done at the earliest.

7. Finding: Power Pool Allocation issues preclude efficient distribution operations. The present power pool allocation amongst DISCOs is based on an informal arrangement framed by NTDC in 2005/06 at a time when adequate supply was available to meet DISCO electricity demands. Since that time, a very substantial gap between demand and supply of electric power has emerged, and DISCO planning and expansion is impeded.

Recommendation: In order to address this gap and till such time it continues, MWP should frame a mechanism for an equitable allocation of power from the power pool to the each DISCO. Such formula should be approved by CCI and regulated by NEPRA. This would promote confidence of the private investors and facilitate the privatization process.

## **This Report**

This Legal Due Diligence for transition of DISCOs to private ownership and management includes nine chapters as discussed and prescribed in the Consultant Terms of Reference:

1. Framework of the Power Sector – A brief overview of: the significant legal regime in field; the institutional arrangement having interface with the DISCOs; key aspects of the DISCOs operations; various initiatives of the Power Sector Reform and its development; and the initiatives of GOP for privatization, all of which are succinctly discussed.
2. Reform Plan and WAPDA Restructuring – A review of the reform plans of the GOP and studies / reports prepared in this regard. This Chapter also discusses the relevant consents and approvals



required for such reform plans, a history of the restructuring of the nation's vertically integrated power sector monopoly (WAPDA), and related legacy issues that continue to pervade the sector (i.e., assets, employees, etc.).

3. Power Pool and Future Power Acquisitions – A review of the commercial arrangements for the Power Pool and identifies gaps and issues in the allocation methodology for the same; the need to frame appropriate rules for power acquisition programs of DISCOs; and recent developments to operationalize CPPA-G, to take over the “market operations” of NTDC. The concept of second-tier supply business / wheeling is also discussed in the context of the NEPRA Act.
4. Corporate Structure of Government-owned DISCOs – Review and analysis of the corporate structure of DISCOs. This Chapter also reviews the status of share capital of DISCOs and the requirement for issuance of shares to WAPDA / President of Pakistan, which would be integral for privatization. Further, matters relating to the Board of Directors, including their appointment and issues arising out of such appointments have also been reviewed.
5. DISCO Procurement – Review of the basic laws and regulations pertaining to procurement as they relate to DISCOs, including review of public procurement laws and the 2005 IPPR Regulations.
6. Disputes and Litigation – A review of some of the major disputes and litigation pertaining to the distribution sector. This Chapter reviews the issues arising out of: tariffs; surcharges and other charges; allocation of Power Pool; employee matters; taxation matters with the Federal Board of Revenue (FBR); and review of litigation pertaining to carving out of service territory of IESCO.
7. DISCO Assets and Employees – A review of the legal and contractual framework on the basis of which the relevant business, assets and employees were to be transferred from WAPDA to DISCOs after their incorporation, with particular analysis of SEPCO and TESCO. This Chapter also analyses issues pertaining to employees in light of the Manpower Transition Program, and PEPCO's involvement in employee matters, and other related matters.
8. Consents and Approvals for Privatization – A review of the Constitutional requirements (approval of CCI) for privatization of the DISCOs, and analysis of the relevant consents and approvals of CCoP and the Cabinet. The Chapter also discusses the framework by which the PPP Mode has been indicated for the proposed privatization of FESCO, IESCO and HESCO.



9. Key Findings and Recommendations – This Chapter highlights the key due diligence findings, which have been identified on the basis of literature review, consultations and analysis of the legal framework, and provides the Consultant’s recommendations with respect to these findings.

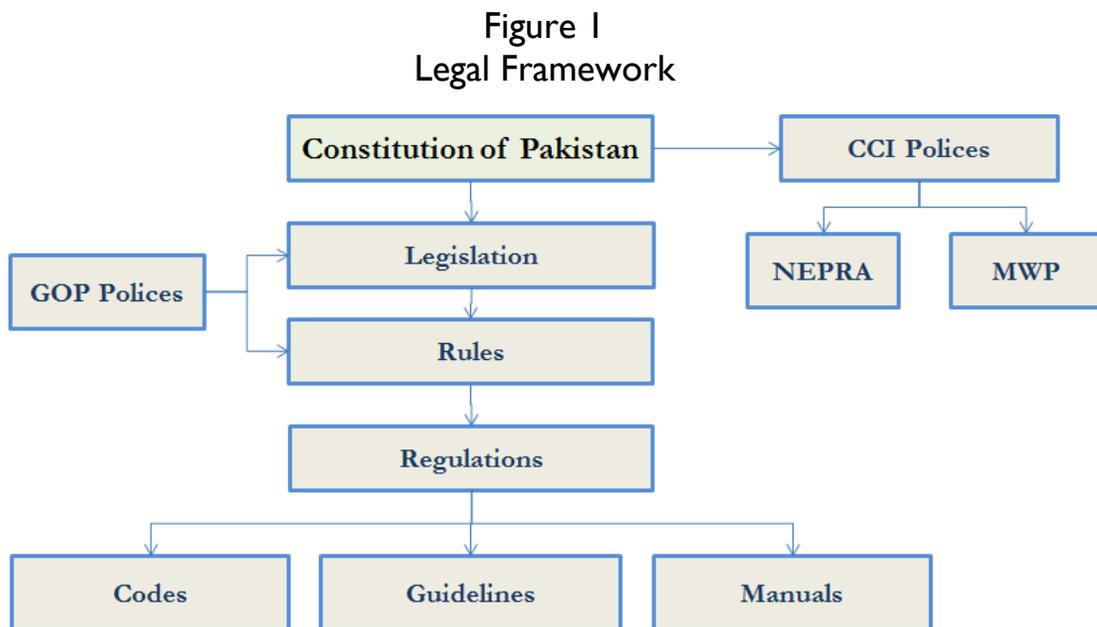
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# CHAPTER – I FRAMEWORK OF THE POWER SECTOR

## I. LEGAL FRAMEWORK

The legal hierarchy guiding Pakistan’s power sector includes certain constitutional provisions, laws, rules, regulations, guidelines, codes, manuals and policies. Annexure II provides a list of various laws, rules, regulations, guidelines and policies etc., pertinent in the context of this Report. Figure 1 provides the hierarchal arrangement for the legal framework.



The legal framework primarily includes:

1. Constitution of Pakistan: Relevant provisions are Articles 9, 154 read with item no. 4 of Part II of the Federal Legislative List, 157, 158, and 161.
2. Laws: The legislative enactments in the context of Power Sector include: (i) NEPRA Act; (ii) WAPDA Act; (iii) Electricity Act; (iv) AEDB Act; and (v) PPIB Act. In addition, in the context of privatization, PC Ordinance is also relevant.
3. Rules and Regulations: NEPRA is authorized by the NEPRA Act to frame and notify Rules and Regulations:



- a. Rules require the approval of the federal government through the Cabinet Division.<sup>3</sup>
  - b. Regulations do not require any approval or notification beyond that provided by NEPRA.
4. Other NEPRA Documents: NEPRA is also legally authorized to issue documents and approve codes and in some cases must have issued them:
- a. Approved Consumer Service Manuals.
  - b. Informational Manuals and Documents.
  - c. Grid Code.
  - d. Commercial Code.
  - e. Distribution Code.
5. Power Policies issued, from time to time, including 1994 Power Policy, 2002 Power Policy, 2006 Renewable Energy Policy and National Power Policy, 2013.

Enforcement of these legal instruments is carried out by the courts of Pakistan and, where applicable, NEPRA Tribunals.

## **II. POWER SECTOR INSTITUTIONAL ARRANGEMENTS**

NEPRA, established in 1997, is responsible to operate as an independent regulator of sector operations including financial and technical compliance by licensees including the DISCOs. Because these companies are incorporated, the Companies Ordinance applies to their affairs and management. As a result, DISCOs are subject to a variety of corporate rules that include but are not limited to Public Sector Corporate Governance Rules, which deals with appointment and removal of Board of Directors.

Today's Pakistan power market (except independent power producers or IPPs) mainly comprises of government-owned companies, illustrated in Figure 2 below, and primarily comprises:

- a. Four government-owned generation companies (GENCOs).
- b. Ten government-owned distribution companies.
- c. One National Transmission and Despatch (Grid) Company (NTDC), which until recently comprised:

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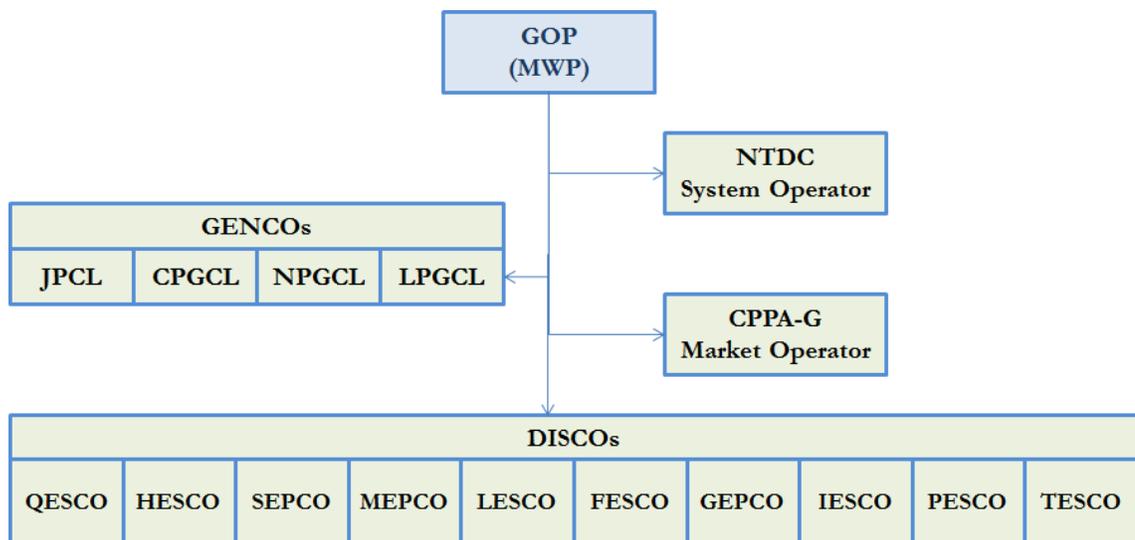
<sup>3</sup> Cabinet Division is under the Office of the Prime Minister.



- i. Central Power Purchasing Agency
  - ii. System Operator
  - iii. Transmission Network Operator
  - iv. Contract Registrar and Power Exchange Administrator
- d. One Central Power Purchasing Agency (Guarantee) Limited (CPPA-G) recently authorized to conduct the market operations under the National Electric Power Regulatory Authority (Market Operator Registration, Standards and Procedure) Rules, 2015 (the Market Rules). This is in furtherance of the process for reform of CPPA stipulated in the National Power Policy, 2013 approved by CCI and the policies framed by GOP. The sector entities, namely DISCOs and NTDC, in first phase of transition, as per the approval of the ECC (2015 ECC Approval) and the regulatory framework, have executed contractual arrangement for operationalization of CPPA-G, leading to legal transfer of the undertaking of the following departments of NTDC:
- i. Central Power Purchasing Agency
  - ii. Contract Registrar and Power Exchange Administrator

Thereafter in the second phase, to be accomplished within a period of two years, this process is to be further developed by way of consultative process with all the stakeholders.

**Figure 2**  
**Government-Owned Companies**





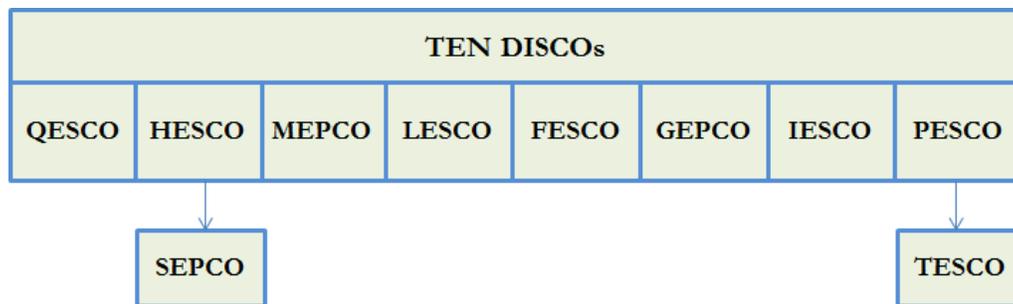
PEPCO was established in 1998 to provide stewardship of the transition of WAPDA to divested market operations. However, over more than 15 years, this divestiture has not taken hold and the role of PEPCO continues to influence sector operations including distribution operations.

Additionally, the nature of the electricity sector in Pakistan is such that government intervention continues to exist, often to a greater extent than the market structure design anticipated. Further, due to the deficit underlying power sector operations, government financial assistance is made at sector level including a tariff subsidy for which specific procedures have been developed and involves role of the Ministry of Finance (MoF). MWP is the government agency responsible for policy-making relevant to all power sector operations, subject to the overarching role of CCI for formulating and regulating policies in aspects with respect to “electricity”.

### III.DISTRIBUTION COMPANIES

There are 10 *licensed* distribution companies (DISCOs) in Pakistan, in which the GOP owns 100% shares that are distributing electric power to the end consumers, exclusive of the area served by K-Electric. Eight of these companies were incorporated in 1998 under the Companies Ordinance and licensed in 2001 and 2002 under the NEPRA Act. The remaining two were subsequently incorporated and licensed by carving out licensed territories of two distribution companies out of the existing eight. Figure 3 illustrates the arrangement for the DISCOs.

Figure 3  
Distribution Companies (DISCOs)



Additionally, nine distribution licenses have been issued to Small Power Producers (owner of generation facility of below 100 MW gross capacity subject to conditions stipulated therein) and one to a Captive Power Producer: most of the captive and small power producers distribute electric power to only those consumers (generally industrial) that have been specifically mentioned in their respective licenses through



an isolated distribution system. Hence, their distribution territories are very small vis-à-vis the DISCO territories.

## IV. KEY ASPECTS FOR DISTRIBUTION COMPANIES

**DISCO Territory.** Licensed DISCOs in Pakistan have exclusive rights to their service territories and have a universal obligation to serve any customer meeting eligibility criteria – in other words, they cannot turn down such customer requests for power.

**Governance of Government-owned DISCOs.** The Office of the President legally owns the issued share capital of DISCOs and MWP has been assigned to manage these shares, effectively as custodial owner of the shares. Secretary, Water and Power, who is *ex officio* the Chairman PEPCO, holds the proxy for and on behalf of the President of Pakistan for these shares of DISCOs. As individual corporate entities, the DISCOs are legally bound to be managed and overseen by a Management Team and Board of Directors respectively. Each DISCO has its own Articles of Association<sup>4</sup> in which standard corporate governance procedures are included. The Government has maintained close ties with the DISCOs, and also in the management of DISCOs fiscal regimes through PEPCO.

**DISCO Functions.** DISCOs are responsible for the supply of electricity from substations below 220kV to consumers at different distribution voltages. Each DISCO is responsible for the operation and maintenance of all distribution infrastructures within its licensed territory.

**Distribution Customers.** The challenges faced by DISCOs include servicing its consumers, the numbers for which vary amongst service territories. (See text box for illustrative categories of consumers)

**DISCO Management.** Each of Pakistan’s public sector licensed DISCOs has a Board of Directors, Management Team and Staff.

- a. Board of Directors – responsible for oversight of the management team, approval of company activities.
- b. Management Team – responsible for oversight of day-to-day operations, preparation of reports, daily figures, petitions for tariff.

### Illustrative DISCO Customer Categories

- Residential (including lifeline).
- Commercial.
- Industrial.
- Agriculture.
- Single point bulk.
- Temporary Supplies (e.g., seasonal industries, public gathering places).
- Public Lighting.
- Residences attached to Industrial Complexes.

<sup>4</sup> Companies Ordinance, 1984, Sections 26-28.



- c. Staff – responsible for the implementation of day-to-day distribution activities.

**Financial Management.** While day-to-day operational management falls under the auspices of DISCO management teams in the country, implementation of the fiscal regime of the GOP, particularly with respect to allocation of GOP subsidy, was till recently being conducted by PEPCO. As of 2010, PEPCO was to be disbanded but remains in operation. However, on account of the operationalization of CPPA-G in June 2015, this role of PEPCO shall also be eliminated.

**DISCO Performance.** Performance of DISCOs is regulated by NEPRA and overseen by MWP. DISCO performance in Pakistan is threatened by unattended infrastructure, lack of financing for upgrades and poor governance. NEPRA has taken some actions to establish loss levels as part of the DISCOs performance standards; however, its ability to enforce these performance standards has not sufficiently emerged.

DISCO performance in Pakistan is monitored by at least two entities:

1. NEPRA through NEPRA Performance Standards Rules.
2. The Ministry of Water and Power through Performance Improvement Agreements.

Legally these management oversight mechanisms make sense. From an implementation view, there is room for conflict that should be carefully considered, notably, in how the performance improvement agreements are drafted.

## **DISCO Relations**

### **Pakistan Electric Power Company (PEPCO)**

Since 1998, despite legally becoming companies under Pakistan law, the Government continues to play a role in distribution activities of the 10 incorporated companies. Any subsidies to the customers in the form of reduced tariff is allocated for the DISCOs and channelled through PEPCO. Following the disbandment of PEPCO and operationalization of CPPA-G, it is expected that this role of PEPCO shall be eliminated. Each DISCO is responsible for its own financial affairs, including budgeting, and calculation of tariff.

### **National Transmission and Dispatch Company (NTDC)**

NTDC, often referred to as “The National Grid Company,” was incorporated in 1998. It was licensed to conduct transmission activities by NEPRA in 2002.



All power procured or purchased by the DISCOs until recently was to be through CPPA, a division of NTDC. Commencing in 2009, GOP anticipated transferring all business functions of the CPPA to a newly incorporated government-owned company, CPPA-G. Active support was and is being made available by the donor community, and the first phase of operationalization of CPPA-G has been achieved in June 2015. As a consequence, the market operations are now to be discharged by CPPA-G, and resultantly, the DISCO-related power procurement function from CPPA/NTDC shall now vest in and be administered by CPPA-G.

### **Federal Government**

- a. *Office of the President.* This office holds the issued share capital for the 10 DISCOs and has delegated custodial authority to the Ministry of Water and Power, as its Secretary is Chairman, PEPCO, to which the proxy has been issued by the President.
- b. *Ministry of Water and Power.* This Ministry plays a large role in DISCO operations and communications. Although technically responsible for policy development for the sector, in fact the MWP is a regular participant and at times the decision-maker on matters relevant to DISCO operations.
- c. *Ministry of Finance.* This Ministry oversees fiscal governance of state funds, including GOP subsidies for certain categories of customers of the DISCOs. DISCOs also interface with MoF as taxpaying businesses of Pakistan.

### **Provincial Governments**

Each provincial government has an Electric Inspector, appointed under the Electricity Act, who has also been conferred the function of Provincial office of Inspection (under the NEPRA Act) that also has interaction with the DISCOs.

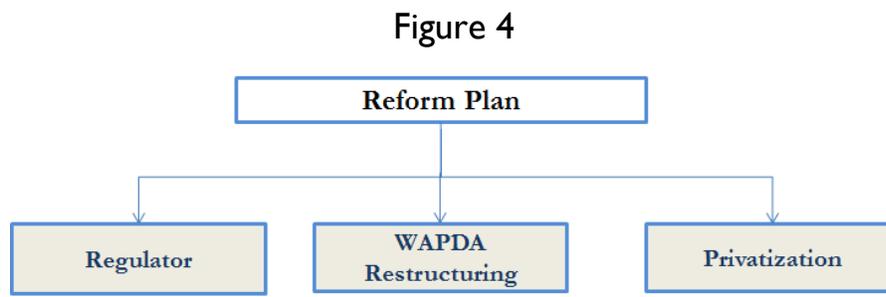
In addition, other provincial authorities, such as water & sanitation, irrigation & energy, building control, district administration etc., regularly interact with DISCOs concerning electricity matters. At times, a consumer can also approach provincial courts to address consumer complaints. Some provincial governments (or companies owned by them) have themselves been constructing and operating electricity generation projects – notably hydel/solar – in addition to awarding similar to work to the private sector.



## V. POWER SECTOR REFORM

In 1992/93, the GOP issued the Reform Plan for the Power Sector (Reform Plan). Its objectives included the attraction of private sector investment in the power sector, improved sector efficiency, and rationalization of electricity prices for full cost recovery.

The Reform Plan prescribed the transition from the vertically integrated monopoly structure under WAPDA to a competitive wholesale power market. This transition required the unbundling of the power wing of WAPDA (WAPDA's Power Wing) into separate and distinct business units for generation and distribution segments, while the transmission segment was to be housed under a government-owned entity with exclusive responsibility for the integrated operation of the electric power sector and wholesale market. Figure 4 illustrates the broad parameters of the Reform Plan.



(See text box for the envisaged four transition phases of the Reform Plan)

On the basis of the Reform Plan and after having obtained the constitutional mandate per Article 154 of the Constitution, the legislative framework

required to implement the intended power market transition was adopted in 1994 by amendment of the WAPDA Act. This amendment facilitated the restructuring and privatization of WAPDA's operations, excluding hydel generating power stations and the national transmission grid.

At that time, the 1994 Power Policy set out a policy framework of investment incentives specific to power generation projects in Pakistan. As a result, IPPs emerged as a dominant force in the market by making substantial investments; 15 IPPs added much-needed 3112 MW of installed generation capacity.<sup>5</sup>

The Reform Plan envisaged four transition phases:

1. Policy Formulation.
2. Decentralization and Corporatization.
3. Refinement of Competitive Structure and Operations.
4. Full Operation of Private, Competitive Sector Operations.

<sup>5</sup> 2850 MW was added to the national grid, and the remaining to the system operated by K-Electric.



In 1998, MWP prepared an Action Plan (1998 Action Plan) pursuant to which WAPDA's Power Wing was unbundled into the 12 limited liability companies that included: three generation companies, namely Jamshoro Power Generation Company Limited (JPGCL), Central Power Generation Company Limited (CPGCL) and Northern Power Generation Company Limited (NPGCL); NTDC as the transmission and despatch company; and eight DISCOs. PEPCO was established in 1998 to provide stewardship for the transition of the power functions of WAPDA to the 12 new companies.

#### **Policies of GOP pertaining to Power Sector**

- 1994 Power Policy.
- 1995 Hydel Power Policy.
- 1998 Power Policy.
- 2002 Power Policy.
- 2006 Renewable Energy Policy.
- 2013 National Power Policy.

In 1998, the business and assets of eight Area Electricity Boards (AEBs) of WAPDA were transferred and vested into newly incorporated distinct limited liability distribution companies, fully government-owned (DISCOs). Their respective distribution licenses were granted to them by NEPRA in 2001/02 for a term of 20 years, to operate within the service territory specified in their respective licenses. Since then, two additional DISCOs (SEPCO and TESCO) have been formed and currently a total of 10 government-owned DISCOs operate in today's market.

Except for areas falling within the domain of K-Electric and a minuscule area recently carved out of the service territory of IESCO in favour of Bahria Town (Pvt.) Limited (BTPL) (which matter is under dispute), these 10 DISCOs are conducting the distribution business for the entire country.

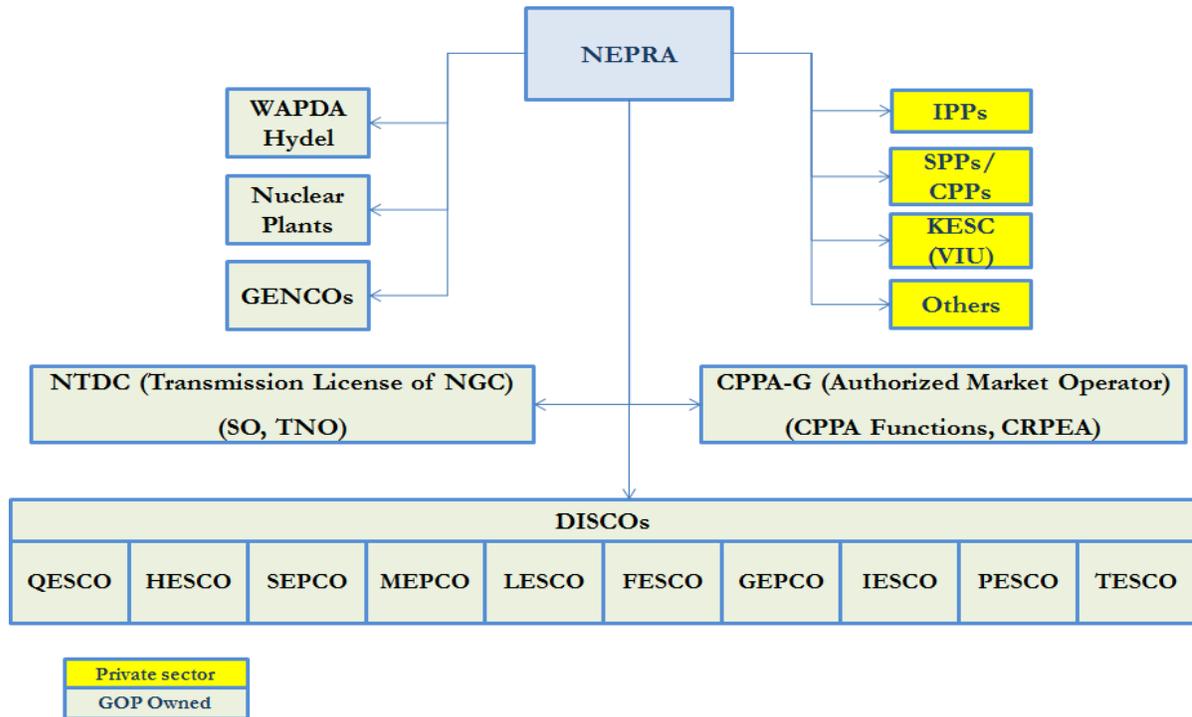
## **VI. REGULATORY FRAMEWORK**

In 1997, NEPRA was established under the Regulation of Generation, Transmission and Distribution of Electric Power Act, 1997 (NEPRA Act). NEPRA regulates entities engaged in the business of providing electric power services.

From 2002 to 2004, NEPRA worked with sector stakeholders and government agencies to prepare a legal framework conducive for the development and growth of a competitive power market. Presently, however, largely a single buyer market is in place. In this market, until recently, the CPPA, a division of the NTDC, served as the single buyer, which was procuring electricity on behalf of all the DISCOs. Now, this function is to be discharged and administered by CPPA-G under the Market Rules and the Commercial Code. Figure 5 illustrates the power sector entities regulated by NEPRA.



**Figure 5  
Regulated Entities**



## VII. DEVELOPMENT OF THE PAKISTAN POWER SECTOR

Keeping in view the Reform Plan and the developments being made to move the Pakistan power sector towards a competitive structure, the GOP commissioned a study by SyCip, Gorres, Velayo&Co, and Associates (SGV) in the year 1997-98, which resulted in what is referred to in this Report as the “SGV Work Program and Methodology”. The SGV report recommended that the transition of the power market be conducted in three phases. Annexure III provides analysis of the envisaged commercial arrangement and the phased transition of the Power Market.

In February 2002, the GOP committed to this transition plan to be implemented over the course of 10 years. During Phase 1, under the Single Buyer Arrangement, the DISCOs were not to directly negotiate with any power producers, and similarly, generation companies were not to deal directly with any DISCO/consumer, and these affairs were to be conducted through the Single Buyer.

Phase 1 was to be followed by Phase 2, the Single Buyer Plus Arrangement, for which certain pre-conditions were to be met. During this phase, the Single Buyer was to continue to perform its role, with the added option for generation companies to directly contract with DISCOs.



The Single Buyer Plus Arrangement was to be followed by Phase 3, the Competitive Trading Bilateral Contract Market (CTBCM), in which power producers / generators would directly sell power to DISCOs and any bulk power consumers (BPCs), and the role of Single Buyer would be eliminated. In this phase, NTDC would not then be allowed to procure or to purchase power for sale to third parties, except to the extent required to provide balancing services for the safe and reliable operation of the national transmission system.

These transition phases was also reflected in the NTDC Transmission License that envisaged that NTDC, through the CPPA, would operate as the Single Buyer to procure electric power on behalf of the DISCOs, followed by the next transition phases. In 2009, the GOP took active measures for the transition of market operations through the incorporation of the CPPA-G. Established as a separate government-owned company, not to be confused with CPPA of NTDC, CPPA-G is to conduct the market operation functions earlier being performed by the WAPDA Private Power Organization (WPPO) and NTDC (via CPPA), including the procurement of power on behalf of DISCOs from generation companies/power producers. The system operations and transmission network operations continue to be retained by NTDC.

NEPRA has notified the Market Rules and the function of the market operations is to be discharged and administered by CPPA-G per the Market Rules and the Commercial Code. The Market Rules have also revised and specified new benchmark dates for the transition of the Power Market. This transfer is intended to assist in paving the way toward a Competitive Bilateral Contract Market and Retail Market.

#### **Transition Phases of the Power Market**

- Single Buyer.
- Single Buyer Plus (intended to be in place from July 2016 to July 2020).
- Competitive Trading Bilateral Contract Market (intended to be in place by July, 2020 with no further postponement).

In today's market, the power sector functionally operates under the Single Buyer Arrangement and the DISCOs are supplied electric power from the "Power Pool", which is comprised of generation procured from various generation companies in Pakistan as approved by NEPRA.

The commercial arrangement for the supply of electric power to DISCOs was earlier based on Electricity Supply Agreement (ESA) novated with NTDC. This is presently based on the Power Purchase Agency Agreement (Agency Agreement) between the DISCOs and CPPA-G, which as the market operator per the Market Rules, is to conduct and administer the market operations according to the Commercial Code and the Administration Agreement. Currently, the allocation of electric power from the Power Pool to each DISCO is based on a formula developed by NTDC. The allocation formula requires a close review as it is



pre-dated, and is identified as a key pre-privatization action. A firm commitment of allocation from the Power Pool will safeguard the private investor from any unilateral action of curtailment of such allocation. It will also facilitate the private investor in making its plans and investments for its future power acquisition programs.

In order for the transition of the power sector to the Single Buyer Plus Arrangement and then to the competitive market, the NEPRA Act envisaged that NEPRA would prepare and implement standards and procedures for DISCO power acquisition programs, through which each DISCO would have individual approval of NEPRA for its own power acquisition. These standards and procedures have not been developed (but are under way). As a result, today’s DISCO power acquisition requests are addressed on a “case-to-case basis” in accordance with interim regulations issued by NEPRA in 2005.

### **VIII. PRIVATIZATION INITIATIVE**

To date, there have been several attempts to privatize some DISCOs (namely FESCO, PESCO and IESCO). Discussions about privatization as well as other models for mobilizing private investment in the distribution sector, including franchise agreements and management contracts, have been considered. Still, these and full privatization actions have stalled, with the exception of KESC.

In 2005, KESC now renamed as “K-Electric” was “privatized” to the extent of the GOP PPP model. As noted, K-Electric is not solely a distribution company but includes generation, which are important additional attributes to consider in privatization of DISCOs in Pakistan.

The following consents / approvals have been taken to implement the Reform Plan, including the privatization initiative:

<b>Period of Relevant Approval</b>	<b>Approving Body</b>	<b>Directive</b>
1993	CCI	Approval of Reform Plan including WAPDA Restructuring and Privatization.
1997	CCI	Re-affirmation of Reform Plan and WAPDA Restructuring and Privatization of the 8 government-owned DISCOs.
2011	CCI	In addition to reaffirming initiative for privatization of the distribution companies, it was also directed that Chief Secretaries of the Provinces would be members of the Privatization Board, and Chief Minister of the Provinces would be member of the CCoP, in respect of an item relating to privatization of a power sector entity



Period of Relevant Approval	Approving Body	Directive
		located in that Province.
2013	CCoP	Approval of the privatization program for early implementation. It was also indicated that the PPP Model with respect to FESCO, IESCO and HESCO may be adopted.
2014	CCoP	Approval to include LESCO, MEPCO, GEPCO, PESCO, QESCO, and SEPCO for early implementation
2014	Cabinet	Ratification of decisions taken by CCoP which included nine DISCOs (excluding TESCO) to be privatized.

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# CHAPTER – 2 REFORM PLAN AND WAPDA RESTRUCTURING

## I. BACKGROUND

The electricity industry includes three basic segments: generation, transmission, and distribution (which may also be further divided into supply and retail). Initially, the primary law guiding Pakistan’s electricity sector was the Electricity Act, 1910 (Electricity Act). The Electricity Act prescribes procedures for licensing, and guidelines for line placement (transmission) and supply of electrical energy. Under the Electricity Act, legal authority to grant licenses vests with the Provincial Government. Legal changes to the sector have impacted how this law presently functions in the current market context.

In 1958, WAPDA was established as a statutory corporation under the Pakistan Water and Power Development Authority Act, 1958 (WAPDA Act). WAPDA comprised of the “Water Wing” and the “Power Wing”. In the context of power sector, WAPDA was responsible for:

- a. All generation, transmission and distribution of power.
- b. The construction, maintenance and operation of all power plants and power grids.

For purposes of the Electricity Act, WAPDA was deemed to be a “licensee”, legally empowered to discharge all the functions of a licensee, including the supply of electric power.

The organizational structure of WAPDA specific to electric power included:

- a. “WAPDA’s Power Wing”, tasked with implementation and oversight of power generation, transmission and distribution of electric powers.
- b. Area Electricity Boards (AEBs) through which WAPDA implemented power distribution to all types of consumers (eight AEBs were in operation prior to the incorporation of eight DISCOs in 1998).

## II. POWER SECTOR REFORM PLAN

As early as 1985/86, the GOP issued a “private sector policy” for power generation. The GOP’s power sector reform plan sought to create a new sector framework in order to achieve the reform objectives that included:



- a. Attracting private sector investment without using sovereign guarantees.
- b. Improving sector efficiency through competition, accountability, managerial autonomy and profit incentives.
- c. Rationalizing electricity prices and social subsidies in order to eliminate inefficiencies, while maintaining socially important policies such as rural electrification and low-income “lifeline” rates.

In 1991/92, a consultant<sup>6</sup> was contracted to provide assistance to WAPDA in collaboration with MWP and other relevant agencies to evaluate power sector reform options. This resulted in a pivotal reform document, entitled ‘WAPDA’s Strategic Plan – Privatization of the Pakistan Power Sector’ referred to herein as the “Reform Plan”.

The Reform Plan prescribed that in order to achieve the proposed reform objectives to the largest extent possible, the framework for Pakistan’s power sector had to be based on private ownership and competitive market processes. The Reform Plan included the creation of an independent national regulatory authority. The salient features of the Reform Plan included:

- a. A number of private generation companies operating under free market conditions and selling power to both privatized area boards and large industrial users, and a sole national transmission and dispatch entity for integrated operation of electric power sector and wholesale electricity market (this feature was subject to the exception that large multi-purpose hydroelectric facilities were to remain with a government-owned corporatized entity).
- b. Market arrangements allowing end-use consumers, or at least large industrial users, to purchase power from generators or power merchants directly, with the transmission and distribution entities providing transportation and related supply services in a non-discriminatory manner.
- c. Private, regulated distribution companies to be responsible for providing reliable and affordable electric service to ultimate customers, including socially desirable subsidized services such as rural electrification and “lifeline” rate for financially disadvantaged customers. It was proposed that the GOP would provide subsidies in order to enable these private companies to provide these otherwise non-profitable services.

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<sup>6</sup> IRG



The 1992 Reform Plan was to be implemented in four phases (See Textbox):

1. Sector Policy Formulation: Policy formulation, improvements in WAPDA's power solicitation program (towards a competitive power solicitation process) and preparation for privatization of selected generation and distribution assets.

1992 Reform Plan Phases
1. Sector Policy Formulation.
2. Decentralization and Corporatization of Sector Operations.
3. Refinement of Competitive Structures and Operations.
4. Private and Fully Competitive Sector Operations.

2. Decentralization and Corporatization of Sector Operations: WAPDA's "Power Wing" was to be restructured and reorganized to include decentralized business centers and newly corporatized government-owned companies. Such companies, to the extent of the distribution segment, would be based on the AEBs and thereafter to the extent of whole or partial AEBs, would then be privatized.
  - a. This was the next step towards creating a market where sale and purchase of power was to be between independent distribution companies and power generators.
  - b. Retail rate reforms were to be designed and implemented by an independent regulator to eliminate cross-subsidies and to reflect the costs of providing electric service.
3. Refinement of Competitive Market Structures and Operations: WAPDA's core role would be limited to hydel facilities. With respect to distribution operations, it was envisaged that:
  - a. The regulatory authority established in Phase 2 would continue to develop, and that retail reforms would be completed.
  - b. The independent generation and distribution companies, some privately owned and some government-owned, would by then be responsible for planning for their individual systems, and to buy and sell power in the wholesale spot and contract markets.
  - c. The transmission sector would be divested from WAPDA and operations would be managed and operated through a government-owned transmission company, responsible for the management and operation of the transmission system and dispatch.
  - d. Electricity requirements and national energy policies would continue to be assessed / forecasted and formulated by the GOP with MWP as the sector policy-making body.
4. Private and Fully Operational Competitive Sector Operations: The power sector would be structured and operated on the basis of a long-term competitive market model, i.e., unbundling of WAPDA and



an electricity sector in which the scope for private ownership and competitive market processes to be as extensive as possible. It was understood that some details and features of the long-term model might be modified during the transition period in view of actual performance and market results.

To date, although significant changes have occurred leading the way to the present state where DISCOs as distinct and independent entities can be privatized, the entire vision envisaged under the 1992 Reform Plan has not, in full, materialized.

**NOTE:** As a result of the monopolistic structure of WAPDA controlling all aspects of the Pakistan power sector, two fundamental terms have emerged as “legacy references” and should be clarified and updated as the privatization process proceeds:

- a. WAPDA Restructuring – this refers to the divestiture and segregation of generation, transmission and distribution assets and business functions, but does not fully include all power sector restructuring. For the purposes of this Report, WAPDA Restructuring is highlighted for its importance in relation to DISCO operations only.
- b. Ex-WAPDA DISCOs – this refers to the eight AEBs that were subsequently incorporated to become eight stand-alone government-owned DISCOs. It is a term that should be removed from sector description and replaced with “government-owned DISCOs” or, as in this report, “DISCOs”.

### III.MANDATE FOR REFORM PLAN

On the basis of the consultative process between MWP, the Privatization Commission and also the CCoP, the MWP submitted a summary document entitled “Privatization of WAPDA and Amendments to the WAPDA Act” to the CCI (1993 MWP Summary). The MWP requested the CCI to:

- a. Approve proposed amendments to the WAPDA Act.
- b. Approve the privatization plan for restructured WAPDA’s Power Wing per the Privatization Commission recommendations.
- c. Provide assurance to the NWFP Government regarding the methodology to be used to determine hydel profits.

The CCI considered the 1993 MWP Summary and approved<sup>7</sup> the same for implementation (1993 CCI Approval).

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<sup>7</sup> September 12, 1993



In 1997, a further summary<sup>8</sup> was submitted by the Privatization Commission to the CCI entitled “Privatization of Utilities and other State-owned Entities”. The CCI granted post-facto approval<sup>9</sup> (the 1997 CCI Approval) to the work completed to date by the Privatization Commission and determined that sale proceeds from the privatization process should be used to pay down national debt rather than being utilized for budgetary support.

#### Approvals for Reform Plan

The 1993 and 1997 CCI approvals provided the requisite legal mandate for the GOP to undertake power sector reform – including privatization actions.

## IV. LEGISLATIVE FRAMEWORK FOR THE POWER SECTOR REFORM PLAN

The first tangible action taken by the GOP to implement the Reform Plan was enactment of the Pakistan Water and Power Development Authority (Amendment) Act, 1994 (Amendment Act) by Parliament.

#### WAPDA Amendment Act

The most significant legal amendment was made to Section 8(2) of the WAPDA Act, which authorized WAPDA to prepare a scheme for a province or part thereof, to “privatize or otherwise restructure any operation of WAPDA except hydel generating power stations and the national transmission grid”.

For this due diligence review, the most significant amendment was made to Section 8(2)

of the WAPDA Act, which authorized WAPDA to prepare a scheme for a province or part thereof, to “privatize or otherwise restructure any operation of WAPDA except hydel generating power stations and the national transmission grid”.

Per the Policy Formulation phase of the Reform Plan, the first policy framework stipulating various incentives for private investment in the Pakistan Power Sector was issued by the GOP in March 1994, entitled “the Policy Framework and Package of Incentives for Power Generation Projects in Pakistan”, referred to as the “1994 Power Policy”.

Consequently, IPPs made substantial private investment in Pakistan, and 15 IPPs added 3112 MW of installed capacity for electric power. Of this amount, 2850 MW of installed capacity produced by 13 IPPs was added in the national grid, and the remaining was added in the system being operated by KESC.

The 1997 CCI Approval provided official impetus for initiating the second phase of the Reform Plan, i.e., Decentralization and Corporatization. The first step for this phase was the promulgation of the NEPRA

<sup>8</sup> May 25, 1997

<sup>9</sup> May 29, 1997



Act, under which NEPRA was established as a statutory regulatory body for entities engaged in the electric power business.

## V. MANDATE FOR WAPDA RESTRUCTURING

In 1994, WAPDA established a team to implement “the Corporatization / Commercialization of WAPDA and its Existing Asset Blocks” (WAPDA-CCP). In 1997, a contract for consulting services to WAPDA-CCP was awarded to a consortium consisting of financial, legal and technical experts, namely M/s. SyCip. Gorres. Velayo & Co. & Co., and Associates (SGV).<sup>10</sup>

In 1998,<sup>11</sup> the MWP sought approval from the Economic Coordination Committee (ECC) for a list of actions to be taken in support of sector restructuring, referred to as the “1998 Action Plan”. The 1998 Action Plan was approved by the ECC.<sup>12</sup> Upon ECC approval, the Prime Minister Secretariat<sup>13</sup> issued an Executive Instruction (Federal Government Executive Instruction) that directed that the 1993 CCI Approval (whereby WAPDA Restructuring was also approved) be implemented and that PEPCO<sup>14</sup> should implement the process. The Federal Government Executive Instruction specified the parameters and basic guidelines for functioning and operations of the newly incorporated power companies that included:

- a. Facilitation of WAPDA restructuring; the Chairman WAPDA role would eventually only focus on “Water Wing”.<sup>15</sup>
- b. Share capital of the newly incorporated companies would be in the name of the President of Pakistan and would be voted by PEPCO.
- c. PEPCO would nominate members for the Boards of the newly incorporated companies.
- d. The Boards of Directors of the newly incorporated companies would independently exercise their powers and perform their functions, including appointing and determining the terms and conditions of their employees.

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<sup>10</sup> March 7, 1997. The contract contained well-defined terms of reference, which evolved at various subsequent stages on account of directives of WAPDA and the GOP (the WAPDA-CCP Services). In addition, the Chairman WAPDA issued “General Order No.1”<sup>10</sup>, which authorized the incorporation of companies (future DISCOs) to take over the functions of the AEBs, including authorization for WAPDA members (Finance and Power) to deliver all assets, documents and papers as transaction documents.

<sup>11</sup> June 17, 1998

<sup>12</sup> July 21, 1998

<sup>13</sup> Executive Order issued on 24-10-1998: no. 11(22) E&F-1/98

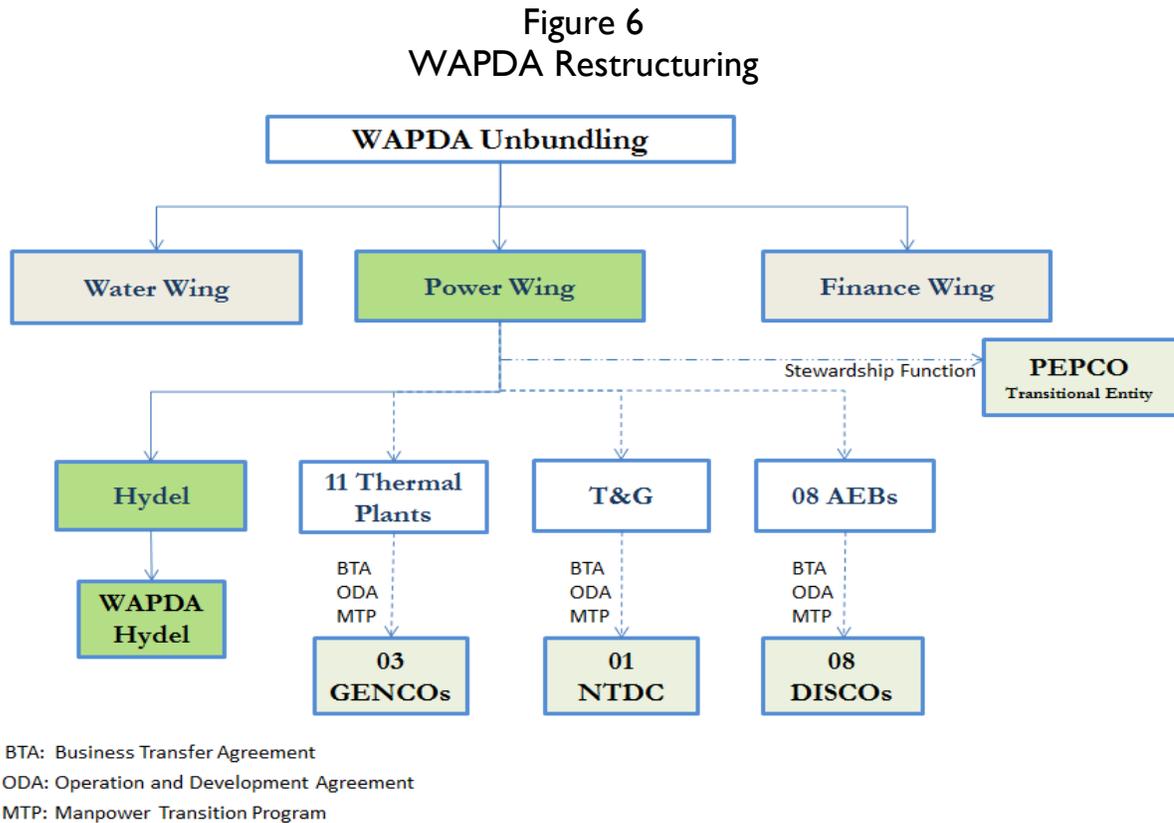
<sup>14</sup> GOP supported incorporation of a government-owned company, namely PEPCO, which was incorporated to provide stewardship functions for the transition of power functions of WAPDA’s Power Wing into 12 companies (generation, transmission and distribution) and to prepare them for privatization. PEPCO was intended to be a “transitional entity” to steward the reform in the sector.

<sup>15</sup> The Water Wing essentially consisted of and dealt with functions relating to water.



- e. The market structure design would be premised on principles of competition, whilst ensuring quality and affordable power to consumers; PEPCO was to ensure that the restructuring and reform of WAPDA's Power Wing secured this vision.

Figure 6 illustrates the entities formed as a consequence of the unbundling of WAPDA.



## VI. WAPDA RESTRUCTURING

Per the 1998 Action Plan and Federal Government Executive Instruction, the terms of reference of WAPDA-CCP Services were realigned and linked to two major dimensions of the reform process: (1) restructuring WAPDA's Power Wing; and (2) transitioning of WAPDA manpower. A number of interdependent activities requiring specific decisions to be made at various government levels and stages, involving not only WAPDA but also other government agencies and entities, encompassed the reform actions. WAPDA-CCP proposed the adoption of a single buyer arrangement, with a mandate for continued and dynamic reform measures that would result in more sophisticated pricing models (See Chapter 3).



The SGV Work Program and Methodology envisaged that the restructuring and corporatization of the AEBs should result in the incorporation of eight government-owned DISCOs following certain concepts:

- a. The AEBs should have greater influence over the formulation of power distribution expansion programs for their respective areas.
- b. The AEBs should have full control over electric power lines, equipment and facilities that are integral to their power distribution functions.
- c. Clearer delineation of responsibilities between distribution and transmission companies should be agreed upon.

In order to implement the restructuring of WAPDA, the following transaction arrangements were proposed:

- a. Preparation of legal documentation, i.e.: (a) Memorandum and Articles of Association; (b) Business Transfer Agreement; (c) Operation and Development Agreement; (d) Licenses for all the companies to be incorporated.
- b. Legal documents specific to the type of company, i.e., for DISCOs: (a) Electricity Supply Agreement and Novation Agreement; (b) Memorandum of Agreement; and (c) various correspondences<sup>16</sup>.
- c. With respect to financial aspects: (a) Opening balance sheets for the newly incorporated companies; and (b) feasibility studies including financial projections, particularly for the model DISCO, GENCO and NTDC.
- d. With respect to technical/engineering valuation: (a) Listing and classification of assets to be transferred to the model companies; and (b) Valuation methodology to be used and training of WAPDA staff on same.

## **VII. WAPDA RESTRUCTURING – IMPLEMENTATION STATUS**

In addition to the incorporation of PEPCO in 1998, actions taken under the Reform Plan included:

- a. Corporatization of WAPDA's Power Wing into eight DISCOs, three GENCOs and NTDC. The respective AEBs under WAPDA's Power Wing were corporatized in 1998 as limited liability

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<sup>16</sup> Contained letters pertaining to obtaining no objection certificate of Creditors, drafting of statutory regulatory orders for seeking exemptions from federal, provincial and local taxes and levies and putting up various position papers on CCP matters.



companies under the Companies Ordinance. Today, these government-owned DISCOs are fundamentally operating as limited liability entities with their own management and Board of Directors, which presently also include representatives from the private sector.

- b. Execution of legal documents, namely: (a) Business Transfer Agreement; (b) Operation and Development Agreement; (c) Electricity Supply Agreement (ESA); (d) Novation of ESA; and (e) Memorandum of Agreement.
- c. Distribution licenses issued to all government-owned DISCOs by NEPRA as a pre-requisite for carrying out distribution business within their respective licensed territory. Distribution tariffs are determined by NEPRA per the NEPRA Act, rules and regulations.
- d. Preparation of the opening balance sheet for each DISCO. The government-owned DISCOs operate as separate corporations, which maintain their own income statements and independent financial statements and accounts.

The process of incorporating AEB functions to be government-owned DISCOs is complete. The DISCOs are legally incorporated as distinct limited liability entities, and operate as licensed distribution companies within their service territory. However, significant matters are identified in this due diligence, which do not, in practice,

#### **Matters affecting / pertaining to operation of DISCOs**

- Intervention of GOP preventing DISCOs from functioning independently.
- Process for Issuance of Shares not complete.
- Many immovable properties not transferred to DISCOs.
- Outstanding employee issues, including Manpower Transition to the extent of “centralized seniority” for employees in BPS 18 and above, and Employee Benefits.

allow the DISCOs to properly operate as independent companies and require particular consideration:

- a. Intrusive DISCO oversight: The MWP and other government interventions continue to prevent DISCO senior management and Boards of Directors from functioning independently.
- b. Non-issuance of DISCO Shares: Primarily, the ownership of GOP in the incorporated companies is reflected by way of allotment of shares. The process of allotment and issuance of ordinary share capital by the DISCOs is not complete. With the exception of MEPCO, the DISCOs have not allotted the requisite share capital as per the arrangement, i.e., the Business Transfer Agreement and the Share Capital Allotment Agreement. The modality to be adopted for such process, as well as the modality adopted by MEPCO, needs to be examined and the



appropriate process under the Companies Ordinance is to be complied with while issuing shares (See Chapter 4).

- c. Legal Transfer of Immoveable Properties of WAPDA (forming part of AEBs) to DISCOs: Under the Business Transfer Agreement and the Supplementary Business Transfer Agreement, distribution assets were to be transferred and conveyance was to be effectuated in favor of the DISCOs by way of legal instruments, including sales deeds, transfer deeds, etc. These have been transferred to DISCOs and possession delivered. However, to the extent of immoveable properties, legal conveyance of a substantial number of immoveable properties of DISCOs has not been effectuated (See Chapter 7).
- d. Outstanding DISCO employee issues:
  - i. Manpower Transition: Under the Manpower Transition Program, the process for devolution of employees of WAPDA to DISCOs was developed and implemented in phases. While DISCO employees are now not linked to WAPDA, centralized seniority of such employees in Basic Pay Scale (BPS) 18 and above is presently being maintained by PEPCO and has yet to be “de-linked”. PEPCO is currently undertaking promotion board for such employees (See Chapter 7). Thus, in essence, employees in respective DISCOs in BPS 18 or above are on integrated seniority list maintained by PEPCO, and are promoted and in some cases inter-DISCOs posted/transferred, by PEPCO.
  - ii. Collective bargaining: The issue of collective bargaining, where a single agent represents employees of all incorporated companies, is pending adjudication at National Industrial Relations Commission and Islamabad High Court. The matter is sub-judice and its outcome should be monitored.
  - iii. Employee benefits: Aspects relating to employee benefits require closer assessment and resolution to facilitate and enable viable privatization (See Chapter 7).



# CHAPTER – 3 POWER POOL AND FUTURE POWER ACQUISITIONS

As noted, the Pakistan power market is operating as a “Single Buyer Market” with a very few transactions that may be further categorized as “Single Buyer Plus”. With the exception of some bulk power purchases, all power procurement transactions conducted between DISCOs and generation companies were conducted through CPPA, a department of NTDC, and are now to be through or administered by the government-owned CPPA-G.

## I. THE POWER POOL

The NTDC Transmission License described the process of power procurement by NTDC through CPPA for and on behalf of the DISCOs. The Power Pool comprises of power procured by NTDC from various generation sources approved by NEPRA, and its composition is reflected in the tariff determinations for NTDC by NEPRA.

The Power Pool specified in the 2004 NTDC tariff determination<sup>17</sup> prescribed that NTDC, through CPPA, would procure power on behalf of the DISCOs from:

- a. WAPDA Hydroelectric Stations.
- b. The nuclear power generating stations, namely Chashma.
- c. The 15 Independent Power Producers that have entered into Power Purchase Agreements (PPAs) with WAPDA, and which PPAs are backed by sovereign guarantee.
- d. The GENCOs, until the Competitive Market Operation Date (CMOD) determined by NEPRA.
- e. Other generation entities approved by NEPRA, from time to time, to provide power to NTDC for onward delivery to the DISCOs for a specified period.

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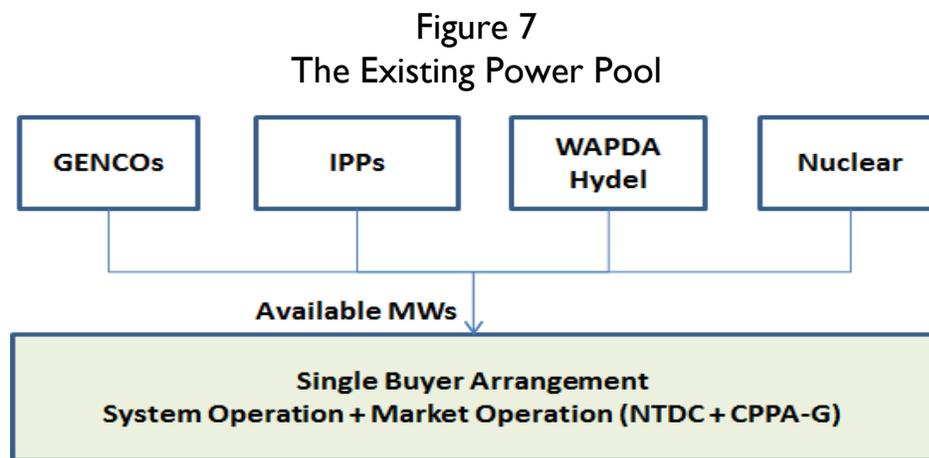
<sup>17</sup> April 14, 2004



- f. Sources of electricity imported from another country or territory of Azad Jammu & Kashmir (AJK) under the approval of the GOP so as to meet demands of the DISCOs, and as approved by NEPRA.

The above constitution of the Power Pool is still in place and additional sources of generation are included under items mentioned above, particularly under (e).<sup>18</sup> The 2013 NTDC tariff determination<sup>19</sup> indicated that electricity purchased by NTDC from any generation company within Pakistan via a PPA and in accordance with the NEPRA Interim Power Procurement Regulations 2005 would also be included in the composition of the Power Pool.<sup>20</sup>

The existing Power Pool under the Single Buyer Arrangement is illustrated in Figure 7.



As such, the commercial arrangements of NTDC as the Single Buyer of electric power are as follows:

- a. Power Purchase Agreement with: (a) WAPDA, for the procurement of electric power being generated through Hydroelectric Stations of WAPDA; and (b) government-owned GENCOs.
- b. Power Purchase Agreement with IPPs and administration arrangement with respect to Power Purchase Agreement with IPPs established prior to and under the 1994 Power Policy.

Presently, the PPAs of IPPs have been executed by and between IPPs and WAPDA or NTDC (through its CPPA) on behalf of DISCOs. Similarly, all the GENCOs owned by the GOP as well as WAPDA Hydel have PPAs with NTDC, and are delivering power to NTDC through CPPA on behalf of the DISCOs. Therefore, all power being procured under such Single Buyer arrangement forms part of the

<sup>18</sup> Tariff determination dated January 6, 2006 notified vide SRO No. 365(I)/2006 dated March 17, 2006, and tariff determination dated May 9, 2011 notified vide SRO No. 903(I)/2011 dated September 9, 2011.

<sup>19</sup> July 19, 2013, notified vide SRO No. 886(I)/2013 dated September 24, 2013.

<sup>20</sup> This addition is not reflected in the SRO No. 886(I)/2013 dated September 24, 2013.

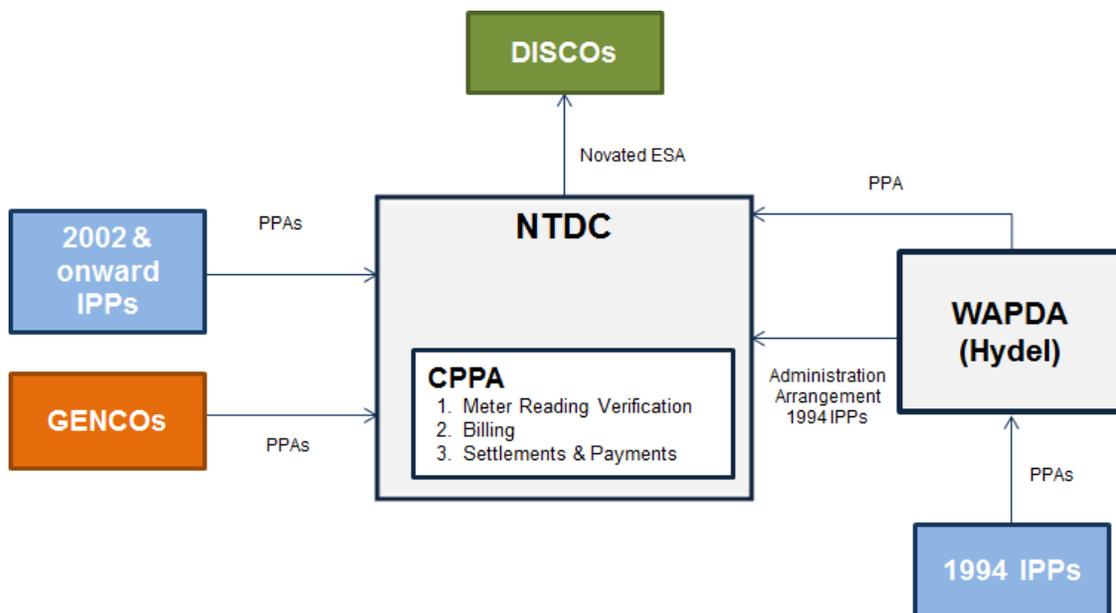


Power Pool. The latest development with respect to commercial arrangement of the Power Pool is also discussed below with reference to the CPPA-G authorized to undertake market operations per the Market Rules and the Commercial Code, pursuant to the modification of NTDC Transmission License by NEPRA.

## II. POWER SUPPLY AND ASSOCIATED COMMERCIAL ARRANGEMENTS

Prior to the operationalization of phase I of CPPA-G, the commercial arrangement between the DISCO and NTDC was based on an Electricity Supply Agreement (ESA), which was executed between WAPDA and each DISCO in 1998, following the incorporation of the DISCOs. Under the ESA, WAPDA was to sell electric power to the DISCOs and the DISCOs were to purchase the same on terms and conditions stated in the ESA. Subsequently, in February 1999, the ESAs were novated through a Novation of Electricity Supply Agreement between WAPDA, NTDC and each DISCO. Through the novation, NTDC was legally substituted for WAPDA and took on WAPDA's rights and obligations. The terms and conditions of the ESA define the commercial relationship between NTDC and the DISCOs, which are the same for each DISCO. Figure 8 below illustrate the above contractual arrangement of CPPA of NTDC.

Figure 8  
Contractual Arrangement of NTDC-CPPA and DISCOs



Some of the significant aspects of the commercial arrangement are discussed below, as the same shall equally be applicable in Phase I of the operationalization of CPPA-G.



### *Gap between Current Power Market Commercial Arrangements and Actual Operations*

Standard Operating Procedures (SOP) have been developed by PEPCO and issued by the MWP<sup>21</sup> to guide the commercial relationship between DISCOs and the CPPA vis-à-vis invoicing for power sale and purchase. The SOPs stipulate that the MWP has directed that all “gross collections”<sup>22</sup> made by the DISCOs from their consumers shall, on a daily basis, be remitted to the CPPA in order to meet the financial requirements of the overall power sector. This necessarily means that the DISCO revenue requirements to cover operations, maintenance, and other expenses are also to be routed through the CPPA.

DISCOs’ officials report that revenues collected are, daily, routed to the CPPA, subject to withholding of the DISCO’s “Distribution Margin”. The mechanism in place is not in line with the payment mechanism under the ESA, which provides for payment on a monthly basis.

### *Collection Shortfall of CPPA from DISCOs*

CPPA suffers cash shortfall in its collections from the DISCOs and is therefore not able to make timely or full payments to power producers. These shortfalls are the result of multiple factors that, inter alia, are described in detail in a complementary USAID report.<sup>23</sup>

What is clear is that the “ripple effect” of this cash shortfall cascades throughout the entire energy supply chain ranging from GENCOs/IPP’s to fuel suppliers, resulting in what has come to be described as “circular debt”. As a result, there is a shortage of fuel supply to the GENCOs / IPPs, leading to a reduction in power generation, and an increase in load shedding. The contributory factors of circular debt include:

- a. Poor governance; delays in tariff determination by NEPRA compounded by delay in notification by the GOP.
- b. Fuel price methodology that delays infusion of cash into the power sector; poor revenue collection by the DISCOs.
- c. Delay in payment of subsidies by MoF; delay in payments of dues by KESC.
- d. Prolonged stay orders / interim injunctions granted by the courts on fuel price adjustments.

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<sup>21</sup> May 12, 2007

<sup>22</sup> The term “gross collection” is ambiguous and does not account for the regulated components of tariff.

<sup>23</sup> See “Causes and impacts of Power Sector Circular Debt in Pakistan” USAID/IRG in collaboration with the Planning Commission of Pakistan, March, 2013 (Circular Debt Report).



- e. Transmission and distribution losses and theft; less than full pass through of generation cost and lesser recovery.
- f. Higher actual losses, less than 100% recoveries.
- g. Other contributory factors inclusive of, non-transfer of mark-up cost, and late payment surcharge non-inclusion as pass through back to the CPPA till 2015.

#### *Tariff Differential Subsidy (TDS) and Guidelines*

The Tariff Differential Subsidy (TDS) is a grant made available by GOP to provide relief to low-end consumers as well as to maintain a uniform national tariff. The mechanism used to determine the TDS is that following receipt of tariff determinations for all the DISCOs by NEPRA, the GOP conveys on a category-wise basis, the rate of subsidy to be incorporated into the tariff by NEPRA. This amount is communicated on the basis of quantum of subsidy allocated in the National Budget for the financial year as well as the ability of GOP to impose surcharge under Section 31(5) of the NEPRA Act. The principle aim is to provide targeted subsidy to low-end consumer and also to maintain uniform national tariff. This amount of subsidy is factored in by NEPRA and the Federal Government notifies the revised schedules of rates provided by NEPRA for all the DISCOs, including imposition of universal obligation fund / tariff rationalization surcharge to provide targeted subsidy and also maintain uniform national tariff.

The amount of TDS, after verification by MWP and its approval, is subsequently released by the GOP to the CPPA, which thereon allocates the share for each DISCO and adjusts amounts payable by each DISCO to CPPA. Currently, the TDS mechanism is subject to inclusion of the amount collected on the basis of universal obligation fund / tariff rationalization surcharge imposed by the GOP in terms of Section 31(5) of the NEPRA Act.

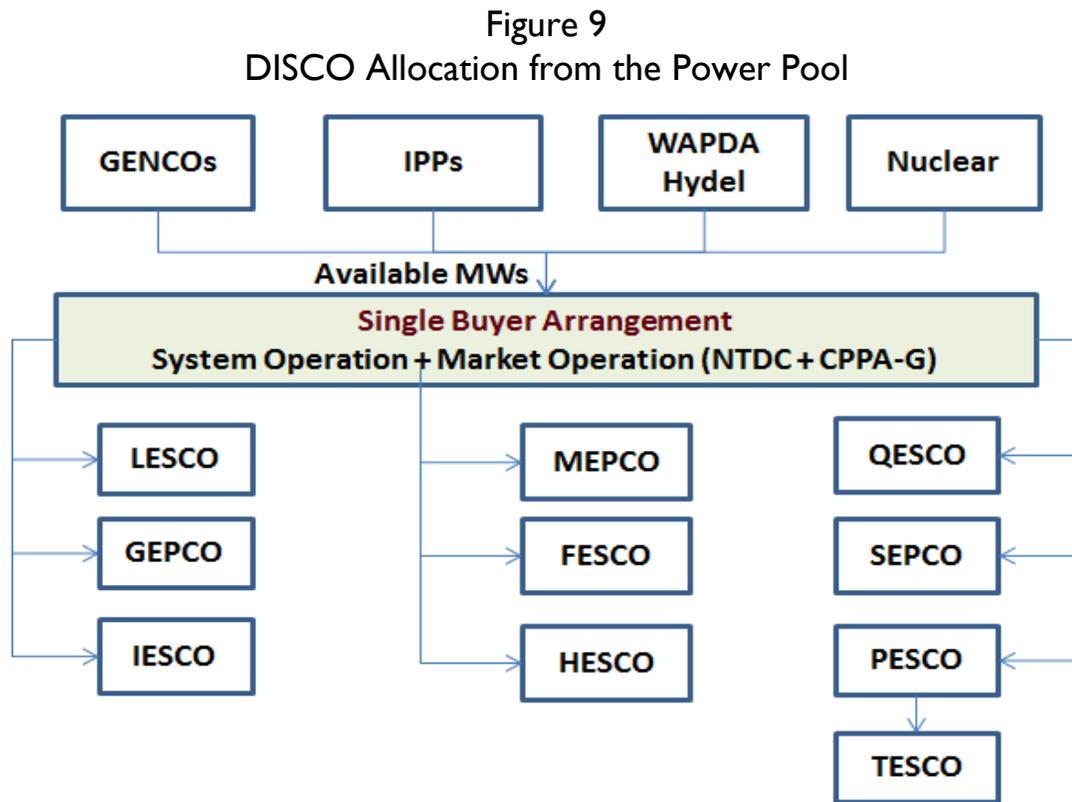
The procurement of electric power is fundamental to a DISCO's performance of its obligations, including the distribution of electric power to its consumer in its licensed service territory. Absent adequate power procurement, DISCOs cannot function. As stated above under the existing arrangement of Single Buyer, all power procurement forms part of the Power Pool. Thereafter, power is allocated by the System Operator, a division of NTDC, to the DISCOs out of the Power Pool for distribution to its consumers. In view of the fact that currently, due to shortfall in generation as compared to demand of the DISCOs, a substantial gap exists, the arrangement and mechanism of allocation out of the Power Pool is of paramount significance and discussed below.



### III. POWER POOL ALLOCATION

The NTDC Transmission License required establishment of the System Operator (SO), which is a division of NTDC, and besides dispatch of power plants, also manages the Power Pool. As discussed above, under the ESA, the SO is obligated to dispatch electric power to a DISCO in a manner sufficient to enable the DISCO to satisfy its license obligations. However, on account of gap between demand and supply, the entire demand for power of a DISCO is not satisfied – this directly impacts the DISCOs’ ability to meet their licensed obligations. Rather, the System Operator allocates electric power from the Power Pool to the DISCOs. This mechanism for allocation is based on formula developed by NTDC, on the basis of demand of each DISCO at a time when the Power Pool was sufficient to satisfy obligations of all DISCOs. It also results in a DISCO to carry out load management.

Figure 9 illustrates the existing DISCO allocation from the Power Pool:



#### *Methodology for Power Allocation*

The current power allocation mechanism is implemented as a necessary and an accepted business practice of NTDC by the DISCOs, but operates without any regulatory oversight or CCI approval. The methodology for allocation of power by NTDC to DISCOs, especially in light of the demand / supply



deficit, requires a supply/demand analysis. Such analysis may consider load growth in various DISCOs, projected changes in load growth, and other priority considerations to shape the allocation model. On the basis of such study, a methodology premised on an equitable allocation policy should be prepared by the MWP and submitted to CCI for approval. If the allocation mechanism is put in place pre-privatization, it would promote confidence of the investor with respect to a secured allocation from the Power Pool.

The allocation of the Power Pool may also be inclusive of the treatment of such allocation in juxtaposition with the collection and payment by a DISCO for the purposes of settlement of cost for providing electricity to such DISCO. An arrangement framed on such a basis would provide confidence to the private investor in the distribution sector.

#### *About K-Electric Limited*

Allocation of up to 650 MW for K-Electric Limited from the NTDC-managed Power Pool has been the subject matter of contentious litigation (See Chapter 6). The power purchase agreement between K-Electric Limited and NTDC expired in January 2015, but K-Electric Limited has already filed a suit in the High Court of Sindh at Karachi, claiming that it is entitled to electric power from NTDC beyond this recent expiry of the agreement. Proceedings are pending.

## **IV. POWER ACQUISITION AND WHEELING**

The National Electric Power Regulatory Authority Licensing (Distribution) Rules, 1999 (NEPRA Licensing Distribution Rules) allow DISCOs to submit their power acquisition programs to NEPRA. Under such approved power acquisition programs, DISCOs may procure power directly from any power entity, as per the terms of any power acquisition contracts entered into by the DISCO. However, DISCOs are required to procure/purchase all power from the NTDC until they have their power acquisition programs approved by NEPRA.

#### *Enabling Legal Framework for Power Acquisition*

Within 18 months from enactment of the NEPRA Act, which came into force in 1997, NEPRA was to prescribe procedures and standards for its approval of investment and power acquisition programs of the transmission companies (NTDC and K-Electric) and DISCOs.<sup>24</sup> The NEPRA Act further provided that any such procedures would advance the goal of minimizing regulatory oversight of contracts entered into by the national grid company and DISCOs, and take into account the national energy plans issued by the

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<sup>24</sup> Section 32 of the NEPRA Act.



Federal Government.<sup>25</sup> The essence of Section 32 of the NEPRA Act is to integrate the power market structure with the national energy plan, which would help achieve the reform objectives of GOP.

The prescribed procedures and standards under Section 32 of the NEPRA Act have not been notified to date.<sup>26</sup> As a consequence, it seems that to date, the methodology being adopted is that power acquisition contracts are made and sent to NEPRA for approval, which are decided on a case-to-case basis. Presently NEPRA is in the process of prescribing the procedures and standards under Section 32.

#### *Interim Framework for Power Acquisition*

In 2005, NEPRA notified the Interim Power Procurement (Procedures and Standards) Regulations 2005 (2005 IPPR Regulations), applicable to NTDC, all DISCOs, and GENCOs/IPPes seeking to sell power to NTDC or a DISCO under a power acquisition contract. The 2005 IPPR Regulations were framed and notified by NEPRA under Section 47 of the NEPRA Act, as an interim arrangement. The 2005 IPPR Regulations highlight the applicable procedure and framework for power acquisition contracts to be executed between the parties.

The request for power acquisition is to be filed with the Registrar NEPRA by a DISCO or a transmission company. The parameters for according the power acquisition permission have also been specified in the 2005 IPPR Regulations. In cases of procurement of power from a hydel/coal generation entity, including a foreign company, NEPRA may allow an advance tariff.

The 2005 IPPR Regulations were prepared to establish and set out procedures and standard for interim power procurement requests, and are limited to making of decision on a case-to-case basis after considering the prudence of the particular procurement or purchase. The 2005 IPPR Regulations neither envisage nor prescribe the modality for grant of NEPRA's approval with respect to DISCOs' investment and power acquisition programs. Intended as "temporary", these regulations still remain in practice 10 years later.

**NOTE:** The 2005 IPPR Regulations may not be considered as a substitute to the statutory obligation under Section 32 of the NEPRA Act to prescribe procedures and standards for NEPRA's prior approval of the NTDC/K-Electric (transmission) and DISCO investment and power acquisition programs.

It is recommended that the scope and essence of Section 32 of the NEPRA Act may be considered in its true perspective. Compliance with Section 32 of the NEPRA Act would facilitate the development of the

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<sup>25</sup> Section 32(2) of the NEPRA Act.

<sup>26</sup> Recently, NEPRA has circulated a draft for such rules in the context of investment programs.



integrated power market structure in line with the national energy plan, which would in turn lead to achieving the power sector reform objective of GOP. The 2005 IPPR Regulations, prescribing the approach on a case-to-case basis for an indefinite period, may be tantamount to defeating the statutory obligations cast under Section 32 read with Section 46 of the NEPRA Act. The Consultant understands that NEPRA has initiated the process of drafting the rules under section 32 of the NEPRA Act.

#### *Second Tier Supply Business/Wheeling*

The NEPRA Act (notwithstanding Section 21) legally permits a generation company or DISCO to sell electric power to BPCs located within the service territory of another DISCO for up to 15 years from the commencement of the NEPRA Act. NEPRA was to assess whether such permission was to be granted on a case-to-case basis on a written application from a generation company/DISCO, and if the BPC had not defaulted on previous charges of electric power to any other distribution company.

Thus, the NEPRA Act prescribes a time-bound provision by which NEPRA may permit the sale of electric power to a BPC for a period of 15 years from December 16, 1997,<sup>27</sup> i.e., until December 15, 2012. Thereafter, permission of NEPRA in this regard has not been envisaged.

The period of 15 years prescribed in the NEPRA Act, and the respective timeline for transition of power market as envisaged in the NTDC Transmission License, need to be considered and co-related. This time period has lapsed. During this time frame it was envisaged that the power industry would have moved towards the CTBCM, which would come into effect by CMOD, i.e. latest by 1 July 2012.

The CTBCM Implementation Plan would also have been devised by NTDC upon such directions of NEPRA in consultation with all authorized electricity operators and BPCs and NEPRA approval. The CTBCM Implementation Plan would also have set out steps to be taken by various stakeholders, including BPCs. However, these actions have not yet taken place. The time-bound provision correlates with the intended transition of the power market to a competitive market within the same time frame.

## **V. OPERATIONALIZATION OF CPPA-G**

To date, the CPPA has operated under the NTDC and served as the central power procurement and allocation agent for distribution company supply. In 2009, the CPPA-G was incorporated as a government-owned company. The GOP's main objectives for doing so were:

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<sup>27</sup> Date of enactment of NEPRA Act.



- a. The introduction of a new cash flow management system consistent with envisaged sector restructuring.
- b. Improved fiscal discipline, i.e., DISCOs’ ability to honor debts, especially those arising from new investments, and to attract further investments for the sector that will result in credibility of sector operations.
- c. The introduction of measures to improve the power supply-demand balance, while ensuring a reasonable quality of service.
- d. Paving the way toward the next phase of market reform, i.e., competitive trading bilateral contract power market and retail market.

As a consequence of the GOP Policy for reform of CPPA, NEPRA has notified the Market Rules that now recognize CPPA-G as the authorized power market operator. The Market Rules further provide that any entity: (a) approved by NEPRA as a generation company; (b) NTDC; (c) the DISCOs; or (d) any other entity enlisted by the market operator under the Commercial Code shall be considered as “Market Participants” (Market Participants). Operationalization of the CPPA-G is a critical aspect of the various actions included in Phase I of the GOP reform plan, various aspects are reviewed in the table below.

The 2015 ECC Approval reflects phased approach to be adopted. Phase I has been completed by way of the following regulatory and contractual framework. Thus, CPPA-G has been operationalized and is to be the market operator for the Market Participants, and undertake and discharge the market operations (discussed below) per the Market Rules and the Commercial Code.

<b>Description of Documents (Phase I)</b>	<b>Status</b>
Modification of NTDC License by NEPRA	Approved by NEPRA
Business Transfer Agreement (BTA) for transfer of the business and assets with respect to CPPA and WPPO, both divisions of NTDC	Executed between NTDC and CPPA-G
DISCOs to sign the Power Procurement Agency Agreement with CPPA-G	Executed between CPPA-G and all the DISCOs
Market Rules	Approved by Federal Government and Notified by NEPRA
Commercial Code	Approved and Notified by NEPRA
Administrative Agreement between NTDC and CPPA-G for all PPAs signed or administered by NTDC/CPPA with power producers	Executed between NTDC and CPPA-G



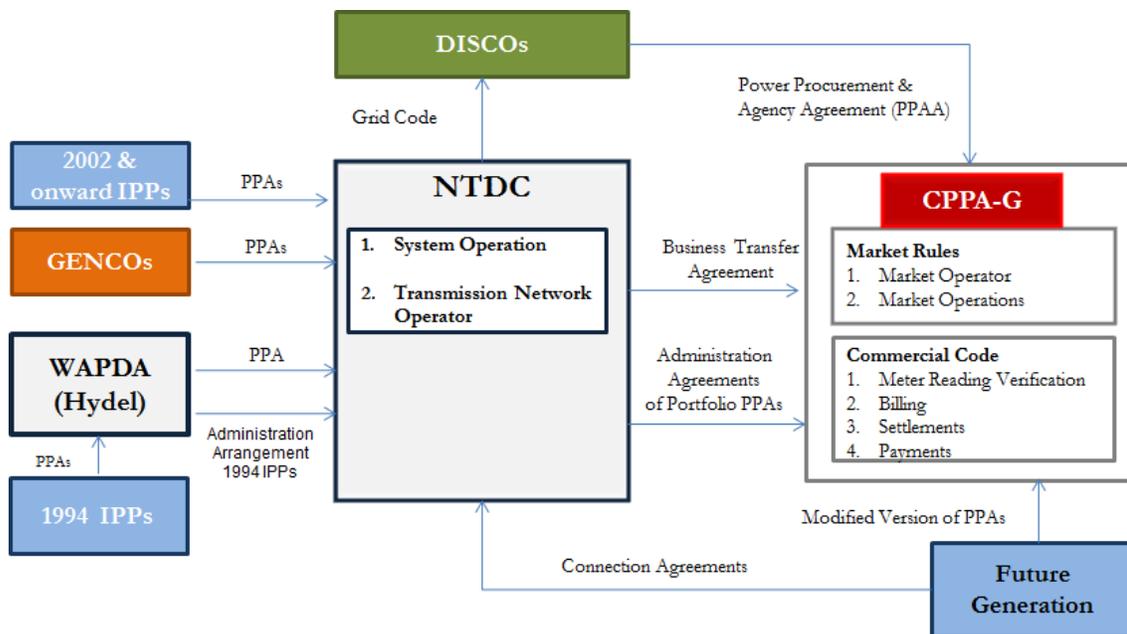
The functions, operations and responsibilities of CPPA-G assigned under the Market Rules may be further prescribed by NEPRA but presently include the following:

- a. in accordance with the Grid Code and the Commercial Code:
  - i. Settlement and development of competitive power market from CPPA of NTDC and to carry on these functions and business.
  - ii. Procurement of electric power on behalf of the DISCOs, including import of power from other countries.
  - iii. Generation invoice verification on the basis of meter reading or dispatch scheduling report and terms of the respective PPAs.
  - iv. Billing DISCOs based on the meter readings per delivery points procedures.
  - v. Payment from the DISCOs and settlement to the Market Participants.
  - vi. Management of cash flow, treasury management and other relevant banking functions for purposes of collection and disbursement.
- b. Administration, maintenance and implementation of the Market Rules and supervision of compliance by Market Participants, including the billing, settlement and payment procedures per the Commercial Code.
- c. Updating, implementing, administering and enforcing the Commercial Code in relation to the Market Rules.
- d. Collecting information and statistics and publishing reports and information relating to the performance of the Market Operator administered market.
- e. Administering the development of and amendments to the Commercial Code for submission to NEPRA for approval.
- f. Developing and implementing competitive power markets based on policies guidelines of the Federal Government and/or requirements of NEPRA.
- g. Liaising with other bodies having market functions similar to the Market Operator or administering competitive power markets.



In view of above, the commercial relationship between the DISCOs and NTDC, instead of the ESA, shall henceforth be based on the Power Procurement Agency Agreement under the Market Rules and the Commercial Code. In Phase I, the process of invoicing and settlement as in field at present has been adopted and shall continue to govern the commercial arrangement for power supply to the DISCOs. The significant additional aspect in the contractual arrangement is that the current mechanism of allocation from the Power Pool is reflected in the Power Procurement Agency Agreement. Figure 10 below illustrates the contractual arrangement of CPPA-G for Phase I of its operationalization.

**Figure 10**  
**CPPA-G Phase I Commercial Arrangement**



Per the 2015 ECC Approval, for continued implementation of the Phase II reform measures to develop Market Operations by CPPA-G, consultative processes with all stakeholders shall be used to implement key benchmarks as illustrated in the table below.

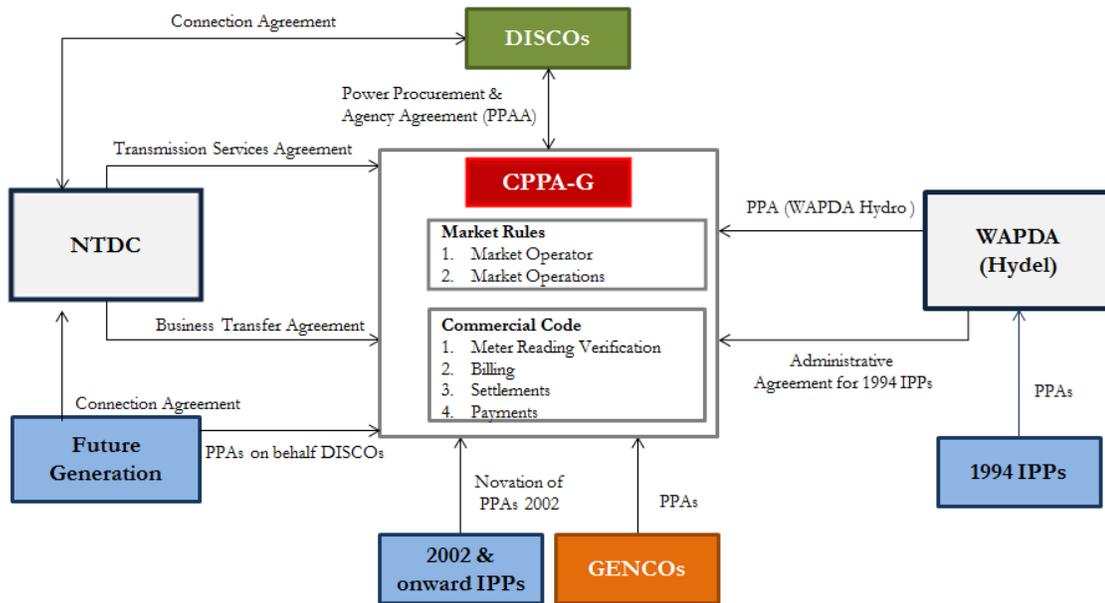
Illustrative Phase II Reform measures	Illustrative Benchmark
Novation of Power Purchase Agreement with IPPs under various Power Policies after 2002.	Within the time frame envisaged in the Rules/Commercial Code (Currently 2 Years from the date of notification of the Market Rules in May 2015).
Signing of new PPAs with public sector GENCOs	Within the time frame envisaged in the Rules/Commercial Code (Currently 2 Years



and WAPDA Hydel.	from the date of notification of the Market Rules in May 2015).
Preparation and submission of Competitive Trading Bilateral Contract Market (CTBCM) plan by CPPA-G.	Within two years of modification of NTDC License for bifurcation of Market Operation and System Operation functions and notification of Market Rules.
Connection Agreements / Transmission Service Purchase Agreement (if required).	Within the time frame envisaged in the Rules/Commercial Code (Currently 2 Years from the date of notification of the Market Rules in May 2015).
Modifications in the Grid Code.	As per the CPPA-G Reform Process. Time Period is not specified yet.

Figure 11 below illustrate the contractual arrangement of CPPA-G for Phase II.

Figure 11  
Phase 2 of CPPA-G





# CHAPTER – 4 CORPORATE STRUCTURE OF GOVERNMENT-OWNED DISCOS

## I. INCORPORATION OF DISCOS

Pursuant to the Reform Plan, including WAPDA Restructuring, the AEBs were corporatized into government-owned DISCOs. WAPDA approved the Memorandum and Articles of Association, which shaped the corporate structure of the DISCOs and is in the same form for each DISCO. General Order 1<sup>28</sup> authorized seven officers to hold one qualifying share each in the (to-be incorporated) DISCO, in trust for WAPDA. These officers were simultaneously appointed as the first Board Directors of the respective DISCO.

An initial act of business for the Directors was to subscribe to the Memorandum and Articles of Association of the DISCOs whereby the DISCOs were incorporated as limited liability public (unlisted) companies under the Companies Ordinance. The Companies Registration Office thereafter issued the Certificate of Incorporation and Certificate for Commencement of Business for each DISCO.

The DISCO Memorandum of Association clearly states that AEB functions would be transferred to DISCO management (See Chapter 7). The transition of AEBs to the DISCOs was to be managed by PEPCO. Therefore, at the outset, this section discusses the stewardship functions to be performed by PEPCO.

## II. THE ROLE OF PEPCO

The role of PEPCO as part of the corporate structure of the DISCOs is based on historic practices that in part, continue today. PEPCO was created in 1998 to steward and ensure the unbundling of WAPDA's Power Wing. The intent was that PEPCO would manage the transition of power functions from WAPDA's Power Wing into newly incorporated companies per the GOP sector restructuring plans. The GOP Reform Plan intended that PEPCO would assume responsibility for:

1. Accelerated implementation of corporatization and commercialization of WAPDA's Power Wing.
2. Overseeing the design and implementation of the Manpower Transition Program.

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<sup>28</sup> General Order No. 01 dated March 22, 1998 issued by Chairman WAPDA.



3. Stewardship of initial business operations by newly formed companies.
4. Privatization initiatives in the power sector.

#### *Objectives of PEPCO*

Draft documents proposed in support of establishing PEPCO were the: (1) Memorandum of Association of PEPCO; and (2) Memorandum of Agreement. As per the Memorandum of Association, the objectives for which PEPCO was established (as relevant to this Report) are specified in the text box.

#### *Timeframe for PEPCO Stewardship*

In 1999, a Memorandum of Agreement was executed between WAPDA and PEPCO<sup>29</sup> (the Memorandum of Agreement). The draft also included a signature page for the relevant companies, including the DISCOs. The Memorandum of Agreement had an effective term of two years, with the option to extend the term by written mutual agreement. Amendments were made to extend the term to up to December 31, 2002. After a period of about eight years, a letter by PEPCO<sup>30</sup> states that the Board of PEPCO had extended the Memorandum of Agreement for one year commencing from July 1, 2010. However, there is no evidence for extensions agreed between both signatories beyond 2002.

#### *GOP Assessment of Sector Reforms and Further Directives*

In 2007, the GOP assessed the status of power sector reform actions. As part of this assessment, the MWP prepared a summary entitled “Appointment of an Independent Chairman for Pakistan Electric Power Company (PEPCO)”. The summary noted that:

- a. The corporatization/commercialization process of WAPDA’s Power Wing had been achieved.
- b. The corporatized companies were maintaining their respective independent accounts.
- c. The assets and liabilities had been apportioned and the balance sheets were being maintained independently as required under the Companies Ordinance.

**PEPCO Objectives**

- To act as a managing agent in respect of all businesses, assets, properties and rights of WAPDA’s Power Wing.
- To carry on, expand, extend, privatize or restructure all or any of the WAPDA power businesses, assets, properties and rights.
- To prepare a schedule for all tariff rates applicable to the generation, transmission and distribution of electric power and petition the appropriate authority as required.
- To provide or procure the provision of such facilities and services as may be necessary or desirable to forecast electricity / energy demand and to satisfy such demand.

<sup>29</sup> April 14, 1999

<sup>30</sup> August 2, 2010



- d. The financial autonomy of the newly incorporated companies was still not in place as all revenues were being pooled up at the WAPDA level, and the newly incorporated companies had to approach WAPDA for their financial needs.
- e. Senior staff positions and common services remained centralized.
- f. Full implementation of the reform program had not been achieved and was required so that the newly incorporated companies could function on commercial principles in a competitive modern and dynamic power sector to ensure reliable and affordable power to the consumers.

The summary further stipulated that full implementation of the Reform Plan was required so that the newly incorporated companies function on commercial principles in a competitive, modern and dynamic power sector to ensure reliable and relatively cheap power to the consumers. In view of the individual tariff determination for all the newly incorporated companies having been made by NEPRA, and also having been notified by the GOP, it was proposed that the requisite framework had been established to effect the envisaged independence and financial autonomy to the newly incorporated companies. Therefore, it was recommended that the practice of having a common Chairman for both WAPDA and PEPCO could be discontinued.

In 2007, the Prime Minister issued an Executive Order<sup>31</sup> for the appointment of the Secretary of the MWP to serve as a member (of the Board of Directors) and as Chairman of PEPCO with immediate effect. It was also directed that WAPDA's Power Wing and all corporate entities would operate under the management of PEPCO.

As a consequence, PEPCO issued an office order<sup>32</sup> entitled, "WAPDA Power Wing Management and Reporting Lines". The reporting lines for WAPDA's Power Wing offices and the government-owned companies set out in this communication are at variance with the conceptual and legal framework for the companies.

*Example:* Reference is made to the reporting lines established for the Chief Executive Officer (CEO) of the DISCOs, who were directed to report to Managing Director of PEPCO, whereas, under the Companies Ordinance, a CEO is to function under the supervision of the Board of Directors of the entity.

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<sup>31</sup> October 10, 2007

<sup>32</sup> October 17, 2007



The status of power sector reform actions with respect to which the stewardship function was assigned to PEPCO, as well as the latest development having an impact on the functions being discharged by PEPCO, is succinctly stated below:

S. No.	PEPCO Responsibilities	Status
1.	Accelerated implementation of corporatization and commercialization of WPADA's Power Wing	Achieved
2.	Overseeing of the Design and Implementation of the Manpower Transition Program	Achieved. The only exception is continued maintenance of centralized seniority list for employees in BPS 18 and above (See Chapter 7)
3.	Stewardship of Initial Business Operations by Newly Formed Companies	Achieved, except the discharge of financial liability of the DISCOs with respect to the transfer charge of electricity procured by CPPA of NTDC for and on behalf of the DISCOs which till recently was still settled through PEPCO. Now this function is to be discharged, undertaken and administered by CPPA-G as the Market Operator per the Market Rules and the Commercial Code
4.	Privatization initiatives in the Power Sector	Function of Privatization Commission under the PC Ordinance

On the basis of letter dated January 8, 2015 of PEPCO,<sup>33</sup> it appears that PEPCO is to be dissolved as per the procedures of the Companies Ordinance, which is also reflected in a letter of the MWP<sup>34</sup> to implement the directive of the Cabinet. This dissolution is the logical step forward keeping in view the fact that the role assigned to PEPCO has substantially been achieved as indicated above.

### III. SHARE CAPITAL

The corporate structure of each DISCO includes structure for share capital. As stated above, seven designated officers of WAPDA subscribed to the formation/incorporation of the DISCOs. Of 1,000 shares, each of the seven officers as shareholders were issued one share each totalling seven shares for each DISCO, and 993 shares valued at Rs.10 each were issued to WAPDA. Per the Federal Government Executive Instruction, which directed that the shares in the companies being set up to control WAPDA's power assets would be in the name of the President of Pakistan, the 993 shares of DISCOs held by WAPDA were transferred in favor of the President of Pakistan.

<sup>33</sup> Provided to the Consultant by PEPCO

<sup>34</sup> October 28, 2011



The primary document for transfer of business and assets of AEBs to the DISCOs is the Business Transfer Agreement. The Business Transfer Agreement (See Chapter 7 for detailed terms and conditions) includes provisions that the DISCO was to pay the “Purchase Price” in consideration for the sale and transfer of the AEB Business and Assets from WAPDA to the DISCO. 30% of the Purchase Price had to be paid by issuance of ordinary shares, and 70% by issuance of Loan Notes. This arrangement was realigned, from time to time, and is identified in the text box and discussed below.

Background of Issuance of DISCOs Share Capital		
Period	Instrument	Description
1998	Business Transfer Agreement	Stipulates the Methodology for Transfer of Business and Assets in lieu of Purchase Price. 30% against issuance of shares and remaining in the form of Loan.
2003	SBTA	The entire Purchase Price to be paid by way of issuance of shares by DISCOs to WAPDA.
2004	Loan Liability Transfer Agreement	Assumption of certain identified liabilities by DISCOs in lieu whereof the Purchase Price to be reduced accordingly.
2008	Closing Date for Mutual Dealings	Shares to be issued by the DISCOs against the balance for deposit of shares as on June 30, 2008.
2010	Share Capital Allotment Agreement	The allotment by DISCOs of ordinary shares to WADPA subject to compliance with legal formalities, for such book value as would be reduced by the amounts of loans pertaining to such operating tangible assets taken over by DISCO categorized as “net worth”, annexed with Agreement.

The primary document for incorporation of the DISCOs and transfer of Business and Assets of AEBs to the DISCOs reflects that:

- a. In addition to each DISCO executing standard corporate start-up documents, the opening balance sheet for the DISCOs were issued<sup>35</sup> based on trial balances, accounting records and other record made available by the respective AEBs. The opening balance sheet for each DISCO contained methodology for the valuation of the net worth for each DISCO, classified into deposit for issuance of shares to WAPDA and long-term loans payable to WAPDA as per the terms of the Business Transfer Agreement.
- b. Following a consultative process, WAPDA determined that the DISCO portfolio would include assets and liabilities relating to 132kV and below, transmission lines and grid system for each AEB

<sup>35</sup> June 30, 1998



service area. The above arrangement is reflected in the opening balance sheet of each DISCO for the purposes of allocation of net worth.

*Change of Mode of Payment of Purchase Price*

In 2003, the “Purchase Price” structure relevant to DISCOs was revised by way of the Supplementary Business Transfer Agreement (SBTA) and executed between WAPDA and each DISCO. Under the SBTA, the DISCOs were required to pay 100% of the Purchase Price through the issuance of ordinary shares by the each DISCO to WAPDA.

In June 2004, WAPDA and each DISCO executed a Loan Liabilities Transfer Agreement that set out the process of corporatization and commercialization, including the transfer of certain WAPDA identified liabilities (i.e., loans) to the DISCOs, which liability was assumed by the DISCOs. The Agreement stated as follows:

- a. In consideration for assumption of the liabilities, the Purchase Price payable by the DISCOs to WAPDA under the Business Transfer Agreement would be reduced.
- b. The DISCO enter into contracts of novation or loan assumption agreements with the concerned lenders in order to effect the transfer of WAPDA’s rights and assume WAPDA’s obligations and liabilities.

*Closing Date of Mutual Dealing Accounted for Ascertaining Net Worth Under BTA/SBTA*

The DISCOs did not proceed with the process of issuance of shares; instead, the DISCOs and WAPDA continued additional mutual dealings with respect to assets as well as liabilities. In 2008, WAPDA informed the DISCOs<sup>36</sup> that WAPDA and PEPCO have granted approval for the following key steps:

- a. June 30, 2008 as the closing date for all dealings between the DISCOs and WAPDA.
- b. The issuance of shares by the DISCOs against the balance for deposit of shares as on June 30, 2008, after necessary reconciliation between the balances of WAPDA and the DISCOs for their respective mutual dealings.

A statement showing balances for deposit of shares as on June 30, 2008 as per WAPDA’s Books of Accounts, having transactions since incorporation of the DISCOs was also attached for reconciliation, reference and record.

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<sup>36</sup> July 18, 2008



### *Share Capital Allotment Agreement*

Thereafter, a Share Capital Allotment Agreement (Share Capital Allotment Agreement) was executed between WAPDA and the DISCOs in July 2010 confirming that WAPDA had transferred certain assets to the DISCOs and that WAPDA had agreed to the conversion of identified loan liabilities of DISCOs towards WAPDA into equity. However, neither the assets nor such liabilities are specified in the Share Capital Allotment Agreement. The Share Capital Allotment Agreement provided that the consideration for transfer of relevant operating tangible assets would be at an “agreed value”, the agreed value being in the aggregate the lower of the following:

- a. The value of the assets determined by a consulting engineer registered with the Pakistan Engineering Council and borne on the panel of at least two financial institutions as a valuer, and reduced by depreciation charged on a consistent basis.
- b. The historic cost of assets specified on the DISCO books, as reduced by depreciation charged on a consistent basis (book value), of such assets annexed to the Agreement.

The Share Capital Allotment Agreement provided that the DISCOs would allot to WAPDA ordinary shares subject to compliance with legal formalities, for such book value as would be reduced by the amounts of loans pertaining to such operating tangible assets taken over by DISCO categorized as “net worth”. The Share Capital Allotment Agreement provided that certain debts, loans and liabilities owed by the DISCO to WAPDA, as specified in the schedule, would also be converted into equity, in accordance with the advice of the GOP and the WAPDA.<sup>37</sup>

### *Allotment of Shares by DISCOs*

In conducting this review, copies of two share certificates by MEPCO, for 1,082,362,604 ordinary shares of Rs.10/- each amounting to Rs.10,823,626,048/- have been provided to the Consultant by MEPCO. These may be illustrative of the process for share allotment applicable to other DISCOs. These appear to have been issued and allotted in favor of WAPDA by MEPCO as a consequence of the Share Capital Allotment Agreement executed between MEPCO and WAPDA. To the extent of the remaining DISCOs, it appears that the process for allotting ordinary shares per the contractual arrangement discussed above is yet to be complied with, as no record in this regard has been provided to the Consultant.

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<sup>37</sup> The Schedule specified such net worth as on June 30, 2008, which was signed by WAPDA and the DISCO, which signified reconciliation by parties of their respective mutual dealings within this period.



While the Share Capital Allotment Agreement sets out the parties' mutual agreement with regard to assets and liabilities, specific information is lacking, and such assets and liabilities post-execution of the Loan Liabilities Transfer Agreement and the SBTA are merely given broad values without itemizing the same. As a result, it fails to provide sufficient information about which assets are transferred or which liabilities are assumed, and this may not be sufficient for the purposes of transfer of assets or assumption of liabilities during this period.

Under the Companies Ordinance, ordinary shares may only be issued in exchange for cash or "in-kind" payment. Under the Agreement, the exchange was "in-kind" and in this case, compliance with procedures specified in the Companies (Issue of Capital Rules), 1996 is required. While undertaking such compliance, deliverables for closing specified in Clause 2.5 of the BTA and Clause Nos. 4 and 7 of the SBTA may also be verified so as to remove shortcomings with respect to vesting of the assets (See Chapter 7 for shortcomings).

Further, the contractual arrangement provided that ordinary shares were to be issued by the DISCOs to WAPDA in consideration for the transfer of the Business and Assets under the BTA. On the other hand, the Federal Government Executive Instruction stipulated that the shares in the companies being set up to control WAPDA's power assets would be in the name of the President of Pakistan. As a consequence, the initial share capital, amounting to 993 shares of DISCOs held by WAPDA was transferred in favor of the President of Pakistan. The arrangement for such initial transfer of ordinary shares, as well as ordinary shares issued by MEPCO, requires consideration, and appropriate framework needs to be provided and implemented. Similar arrangement may also take account for ordinary share capital yet to be issued by the remaining DISCOs so as to comply with the arrangement reflected in the Federal Government Executive Instruction. Summarily, it may be noted that this is a procedural step which has to be taken: the DISCOs have to firstly issue the shares in favor of WAPDA under their contractual arrangements, and thereafter WAPDA has to transfer those shares in favor of the GOP pursuant to the Federal Government Executive Instruction.

#### *Representation in Meetings*

In accordance with the Companies Ordinance, where the GOP is a member of a company, the GOP can appoint a representative to attend meetings of that company. This provision is therefore also applicable on DISCOs.

In 1999, the President, as owner of the eight government-owned DISCOs, three GENCOs, NTDC and PEPCO, conferred voting rights to the Chairman PEPCO and its successors. For general meetings of the



DISCOs, the Chairman PEPCO confers proxy/authorization in terms of the Companies Ordinance to the chief executives of such entities to act as proxy and exercise the voting rights appertaining to the GOP for their respective companies.

*“Benazir Employees Stock Option Scheme”*

In 2009, the Federal Government announced a scheme named “Benazir Employees Stock Option Scheme” (BESOS), which provides that for the benefit of employees of public sector entities, 12% of the GOP shareholding in public sector entities be transferred in favor of a trust. The scheme requires the issuance of units by the trust to the employees in proportion to their entitlement on the basis of length of service. Unit certificates issued under BESOS may not be resold or transferred, and employees are required to surrender unit certificate to the trust on retirement, or otherwise ceasing to be employees in lieu of payments for surrendered units. Additional information is required for review to confirm level of compliance with BESOS by the DISCOs.

#### **IV. APPOINTMENT OF DIRECTORS**

Upon incorporation of the DISCOs, a critical corporate structure element was the establishment of independent Boards of Directors in accordance with the Companies Ordinance. As such, shareholders elect Directors and voting takes place in a general shareholders meeting. Reference to this legal requirement is made in the Articles of Association of the DISCOs (Article 69). Similarly, a Director may only be removed in accordance with the provisions of the Companies Ordinance, as per the requisite majority votes by the DISCO in shareholders.

However, the Companies Ordinance (Section 183(b)) also provides that nothing in Section 178, 180 or 181 shall apply to the Directors nominated by the Government on the Board of the company (i.e., the government-owned DISCO). And so, the Directors of the DISCOs are not elected, but rather nominated by the GOP and hold office at the pleasure of the Government.

For years the DISCOs operated without strong or independent Boards of Directors. Starting in/about 2010, active measures were taken to activate the Boards. Initially, the Federal Government Executive Instruction directed that Directors of DISCOs were to be appointed by PEPCO as a GOP agent, and this procedure continued till 2010. Under the Rules of Business, a “Cabinet Committee on Restructuring of Public Sector Enterprises” was constituted, comprising five members, with a mandate that included:

- a. Restructuring the Boards of Directors of identified entities (which included the DISCOs).



- b. Restructuring DISCO management.
- c. The reconstituted Boards were to prepare restructuring plans to be reviewed by the Cabinet Committee on a quarterly basis.

#### *Roadmap for Management Reform of Government-Owned Companies*

In 2010,<sup>38</sup> a summary prepared by Finance Division entitled “Approval of the Decisions of Cabinet Committee on Restructuring (CCoR) of Public Sector Enterprises” was moved to the Cabinet, and the Cabinet approved the road map for the re-organization of the DISCO Boards. The fundamental premise of the restructuring was to establish corporate independence of public sector entities, including the DISCOs.

Following the summary approval, relevant Ministries/Divisions were directed to submit candidates for Director positions to the Prime Minister, through the Cabinet Committee, for approval so as to complete the process by April 30, 2010. The reconstituted Boards were to then recommend a panel of qualified professionals for appointment as CEOs, and to recommend the terms and conditions for such officers to be approved by the Prime Minister. The final restructuring of the DISCOs was to be completed by October 2010, and included recommendation of each CEO candidate for consideration by the respective Boards of Directors and Cabinet Committee on Restructuring of Public Sector Entities (CCoR-PSE), for final Cabinet approval.

In October 2011, the Cabinet reviewed a “Briefing by the Committee on Energy”,<sup>39</sup> which identified critical power sector issues with the primary aim of addressing power shortages on a long-term basis. Based on this briefing, the Cabinet directed that management of power generation and distribution recovery be improved and that professional management teams be installed.

The reconstituted DISCO Boards were in place in 2011. At present, the members of the Board of Directors of all DISCOs are nominees of the Federal Government, although such nominees also include private sector representatives.

## **V. POWERS OF DIRECTORS**

The Federal Government Executive Instruction stipulated that the Boards of Directors of the incorporated government companies (NTDC, GENCOs and DISCOs) would be autonomous bodies, free to exercise the powers given to them by the Companies Ordinance. It further confirmed that the Boards

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<sup>38</sup> March 10, 2010

<sup>39</sup> Case No.211/21/2011



would have the power to appoint and determine the terms and conditions of their employees, without the necessity of GOP approvals.

The legal guidance on the general powers of the Board of Directors is provided in the Companies Ordinance. This legal guidance is reflected in the DISCOs Articles of Association, which provides that the Board of Directors may exercise all such powers as are not required to be exercised by the DISCO in general meeting of shareholders.

The Securities and Exchange Commission of Pakistan (SECP) has notified the Public Sector Companies (Corporate Governance) Rules, 2013 (Public Sector Corporate Governance Rules), which provide the framework and methodology for corporate governance of public sector companies (discussed below).

## VI. OPERATIONAL AUDIT REPORT

In 2011, assessment of the DISCO corporate structure included an Operational Audit Report of the then eight<sup>40</sup> government-owned DISCOs by a consultant.<sup>41</sup> The Audit Report highlighted various findings in relation to DISCO operations and governance system.

### Operational Audit Report

It concluded that there had not been a complete transition of DISCOs to a corporate governance framework and that establishing the new Boards of Directors was a critical step to taken toward strengthened good governance, professionalism, and independence and company autonomy.

The Audit Report emphasized the need for the selection of experienced professionals who were able to govern the DISCOs with autonomy, integrity and impartiality as essential to create viable DISCO operations. Key findings of the organizational structure of DISCO included:

- a. The DISCO CEOs managed all headquarters functions and were also responsible for overseeing field operations, and therefore had excessive duties with managers directly reporting to the CEOs that should be streamlined.
- b. A revised organizational structure for the DISCOs at the DISCO and inter-agency level where the reporting lines were clearly defined was needed, as well as a revised structure for operational management and efficiency.

<sup>40</sup> The additional two DISCOs, SEPCO and TESCO portfolios were included under other DISCOs at the time.

<sup>41</sup> Conducted by International Resources Group (IRG) under the USAID technical assistance Power Distribution Program (PDP).



The corporate governance and operational structure of the DISCOs have not been revised. As recently as 2013, NEPRA identified the absence of independence of the DISCOs in certain operational matters as an impediment to sound DISCO operations (NEPRA State of Industry Report, 2013 and 2014).

## VII. PUBLIC SECTOR CORPORATE GOVERNANCE RULES

The Public Sector Corporate Governance Rules (2013) issued by the SECP set out the framework and methodology for corporate governance of public sector (includes government-owned) companies. The Rules are applicable to all “Public Sector Companies”.

The status of a DISCO’s compliance with the Public Sector Corporate Governance Rules is to be addressed, published and circulated with its annual report, which is also, per these rules, to be verified by an independent auditor. In the case of non-compliance, penalty provisions may be legally applied per the Rules.

Under the Public Sector Corporate Governance Rules, the Boards of Directors are to consist of executive and non-executive Directors, and are also to include

independent Directors. An “independent Director” is defined in detail, with the test of independence being based on whether such a person can be reasonably perceived as being able to exercise independent judgment without being subservient to any form of conflict of interest.

Within two years of notification of the Rules, 40% of the Directors are to be independent, which is to be increased to a majority of independent Directors within the next two years. This two-year period will lapse in August 2015 and if required, compliance status can be verified from the SECP.

Some of the highlights of the Rules as applied to DISCOs include the following.

- a. While appointing or nominating Directors, the GOP is to apply the “fit and proper” criteria, which hinges on meeting educational standards, integrity, honesty and no conflict of interest. The same criterion is also to be applied for the appointment of the CEO.

### Public Sector Company

It is defined in the Rules to include a company, whether public or private, which is directly or indirectly controlled, beneficially owned or not less than 50% of the voting securities or voting power of which are held by the Government, or in respect of which the Government has otherwise power to elect, nominate or appoint majority of its Directors.

- DISCOs therefore fall within the ambit of a Public Sector Company, and the Public Sector Corporate Governance Rules are applicable on them.
- The applicability of these rules post-privatization would depend on whether the DISCOs fall within the above definition of “Public Sector Company” after privatization.



- b. The office of the Chairman and Chief Executive is to be separate and their responsibilities distinct from each other. The Chairman is to be from amongst the independent Directors, so as to achieve an appropriate balance of power, increasing accountability, and improving the Board of Directors' capacity to exercise independent judgment.
- c. The Board of Directors is to establish a system of sound internal control to ensure compliance with principles of probity and propriety, objectivity, integrity and honesty, and to establish a sound relationship with the shareholders.
- d. The Board of Directors is to meet at least once in each quarter. A list of the key information and significant issues to be placed before the Board of Directors for decision is also provided. Performance evaluation of the Directors is to be undertaken, for which the Board of Directors is to establish a process based on specified criteria.
- e. The company is to, within one month of the close of first, second and third quarters of its year of accounts, prepare a profit and loss account for, and balance sheet at the end of, the quarter, for the approval of the Board of Directors. Monthly accounts are also to be prepared for circulation among the members of the Board of Directors.
- f. The Board is to constitute/form five (5) committees to support the Board in performing its functions efficiently, and for seeking assistance in the decision making process, namely:
  - i. An audit committee, for an efficient and effective internal and external financial reporting mechanism.
  - ii. A risk management committee, in case of Public Sector Companies either in the financial sector or those having assets of five billion rupees or more, to effectively review the risk function.
  - iii. A human resource committee, to deal with all employee-related matters, including recruitment, training, remuneration, performance evaluation, succession planning, and measures for effective utilization of the employees of the Public Sector Company.
  - iv. A procurement committee, to ensure transparency in procurement transactions and in dealing with the suppliers.



- v. A nomination committee to identify and recommend the candidates for the Board for the consideration of shareholders after examining the skills and characteristics that are needed in such candidates.

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# CHAPTER – 5 DISCO PROCUREMENT

## I. BACKGROUND

In the normal course of conducting distribution operations, as part of its business, each DISCO procures goods, services and electric power. It is important that the different procurement rules as are presently applied, and may be implied post-privatization, are distinguished (see text box).

Legal procurement guidance includes public procurement laws and, to the extent of procurement of power, the NEPRA Interim Power Procurement Regulations, 2005 (2005 IPPR Regulations). Applicability of the public procurement laws, relevant to goods and services, will depend on the mode adopted for privatization; power procurement rules will apply to both public and private investors.

### Illustrative Procurement Rules applicable to DISCOs

1. Goods and Services
  - Public Procurement Regulatory Authority Ordinance, 2002
  - Public Procurement Rules, 2004
  - WAPDA Purchase Manual, 1998
  - Import and Exports Control Act, 1950
2. Power
  - NEPRA Interim Power Procurement Rules, 2005

### *Uniform Design and Standards*

Prior to the incorporation of DISCOs, all procurements were centrally made by WAPDA. In order to maintain uniformity, the design and standards (for technical items like grid stations, towers, transformers, etc.) were also approved centrally by WAPDA. After the restructuring of WAPDA, in addition to the various other functions being performed by NTDC, the function of design and standards, material inspection, and power flow studies was also attributed to NTDC and is being performed by its Services Division.

Today, the continued intent of having common design and standards appears to be to ensure that the bids are considered in light of the existing system, and suitability and compatibility of the product with the same. However, this aspect is to be considered by MWP and PC, as an investor may consider such restriction to be an impediment in procurement.



In today's market, the NTDC provides consultative services to DISCOs to develop technical specifications for procurement including the purchase of materials required for their core business (such as grid stations, transmission lines, transformers, cables, poles, towers, meters, etc.). The DISCOs have typically adopted the NTDC specifications for procurement of material and equipment, and have also taken on board some parameters provided by PEPCO. As private investors enter the market, review and possible modification of these specifications may enhance the system and legal basis to facilitate such improvement should be considered.

Two departments of NTDC are performing procurement functions relevant to DISCOs:

- a. Design and Standards (D&S) Department – Responsible for the preparation and upgrading of procurement specifications and approval of prototypes of equipment after independent testing, following which manufacturers are able to participate in DISCO tenders.
- b. Material Inspection (M/I) Department – Responsible for testing of electrical goods, such as distribution transformers, power transformers, etc., per prototype approved drawings and specifications. After testing, the M/I department issues the inspection certificate following which manufacturers are able to dispatch the equipment to the respective DISCO.

The D&S Department is at times engaged in the tender process for DISCO procurements. This engagement involves providing the DISCOs assistance in preparing bidding documents and reviewing technical specifications in the bidding documents prepared by the relevant DISCO. These procurement arrangements are not codified in any legal document, but rather, are implemented through detailed bidding documents.

Similarly, the process to register suppliers is implemented by the DISCOs with reference to the registration procedures followed by WAPDA (the Suppliers Registration Process). The Suppliers Registration Process prescribes that once the suppliers are registered, a process of renewal is adopted on an annual basis.

What emerges is that a series of entrenched business practices relevant to procurement have taken hold relevant to DISCO operations, and in the wake of privatization, will require more legal certainty and clarity in application. It is not likely that private investors will agree to apply public procurement rules, but will, as is international practice, expect to abide by standard transparency and reporting requirements relevant to procurements and business operations in general.



## II. LEGAL FRAMEWORK

Subsequent to unbundling of WAPDA’s Power Wing, the DISCOs adopted the WAPDA Purchase Manual as part of their business procurement regime, and the WAPDA process of procurement continued until 2004, at which time the Public Procurement Regulatory Authority Ordinance, 2002 (the PPRA Ordinance), and the Public Procurement Rules, 2004 (the PPRA Rules) were put in place. These rules apply to goods and services.

The procedures under the WAPDA Purchase Manual were still kept intact, save to the extent that precedence was attributed to the provisions of the PPRA Ordinance and the PPRA Rules. Thus, presently, for the purpose of procurement, the DISCOs follow procedure prescribed for public procurement under the PPRA Ordinance and the PPRA Rules, in addition to procedures prescribed in WAPDA Purchase Manual adopted by DISCOs.

The PPRA Ordinance and PPRA Rules apply to any “procuring agency”, which is defined as:

- a. Any Ministry, Division, Department, or any office of the Federal Government.
- b. Any authority, corporation, body or organization established by or under a Federal law or which is owned or controlled by the Federal Government.

### Procuring Agency

Importantly, in the current market context, the DISCOs are included under the term “procuring agency”.

The PPRA Rules apply to all procurements made by procuring agencies, whether within or outside Pakistan. The broad principle of public procurement is that procuring agencies have to ensure that the procurements are conducted in a fair and transparent manner, the object being that the procurement brings value for money, and the process is efficient and economical.

All procuring agencies are legally required to devise a mechanism for planning the proposed procurements, including completion date, delivery time, and benefits the procuring agency would gain in the future. The PPRA Rules provide that specifications should allow for the widest possible competition, without favor to any single contractor or supplier. In order to achieve these objective, it is legally indicated that specific brand names, model numbers, catalogue numbers or similar classifications should not be included in specifications unless the procuring agency is convinced that the use of the said name etc. is essential to complete an otherwise incomplete specification, and even in such case, the use of such specification is to be qualified with the words “or equivalent”. Where a DISCO tender does need to specify a particular brand or classification, the phrase “or equivalent” is also adopted.



### **III. SPECIAL PROCUREMENT RULES FOR ENGINEERING GOODS**

Under Section 3 of the Import and Exports (Control) Act, 1950, the GOP has notified S.R.O. No. 827(I)/2001 (SRO 827) so as to provide a level of protection to the local engineering industry. This protection is provided in three ways:

- a. Firstly, where possible, public sector agencies (defined to include DISCOs as “all the statutory or autonomous corporations and other agencies or bodies under the administrative control of the Federal Government and the Provincial Governments including private or public companies with the government shareholding”) were directed to procure their engineering goods from within the country.
- b. Secondly, in cases where international bidding is a requirement, a price preference of 15% to 25% of landed cost<sup>42</sup> was to be given to local manufacturers.
- c. Thirdly, in order to enable a proper and fair comparison to be made between foreign and local suppliers, it was the requirement of SRO 827 to compare “landed cost”. It is for this reason that SRO 827 stipulates that where an international tender is floated, FOR prices will be asked for. “FOR” means Free on Rail and is basically the landed cost (including customs duty) of the relevant foreign supplied item. SRO 827 goes on to state that if FOB prices are asked for (i.e. Free on Board prices), then a committee, as specified in SRO 827, will be formed to determine the landed cost of the foreign supplied item.

It appears that in the event of procurement from “own source”<sup>43</sup> of funding, DISCOs comply with the provisions of the SRO 827, in addition to the requirements applicable under the PPRA Ordinance and the PPRA Rules.

### **IV. APPLICABILITY OF PROCUREMENT RULES POST-PRIVATIZATION**

The applicability of the PPRA Ordinance and PPRA Rules, as well as SRO 827, for private investors in DISCOs post-privatization will depend on the methodology adopted for privatization; whether once privatized, a DISCO falls within the definition of the term “procuring agency” under the PPRA Ordinance or “public sector company” under SRO 827. It should be noted that application of these rules to private

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<sup>42</sup> Total cost of a product once it has arrived at a buyer’s door.

<sup>43</sup> Procurement from funds of the public sector entity and not on the basis of finance by international donor/agencies. Procurement from funds of international donor agencies on account of Rule 5 of PPRA Rules is undertaken as per their respective guidelines.



investment has potential to jeopardize technical quality and expediency in quality, and should be reviewed through consultation with private sector before application; some legal guidance is likely required.

In addition, the PPRA Ordinance provides that the Ordinance shall not apply to an entity specified in the Schedule, which has been privatized pursuant to the Privatization Commission Ordinance, 2000. In this regard, the Federal Government is empowered to add any entry to the Schedule.

## **V. INTERIM POWER PROCUREMENT REGULATIONS**

In 2005, NEPRA issued the Interim Power Procurement (Procedures and Standards) Regulations (2005 IPPR Regulations), which provisions apply to the DISCOs, specifically in the context of power acquisition contracts between intending generation companies and DISCOs.

Under the 2005 IPPR Regulations, where a generation company submits its offer for sale to the DISCO, and the DISCO is satisfied that the same is in accordance with its obligation to procure electric power at the best effective price obtainable, the DISCO is to file a request for power acquisition with the Registrar of NEPRA.

- a. This request is to include details of the firm capacity expected, technology (primary fuel, alternate primary fuel and back up fuel), expected time of commercial operation of the generation facility, expected rate of power to be acquired, the demand which is going to be met under the proposed procurement, and adequacy of the sub-transmission system and cost of inter connection involved.
- b. Within 14 days of the request, the same is to be presented before NEPRA for admission. NEPRA is to satisfy itself as to the prudence of the procurement, after which it will grant power acquisition permission to the DISCOs for negotiating a power acquisition contract (to meet its load growth, or reduction in power purchase cost), or grant permission to NTDC to initiate negotiations for procurement on behalf of the DISCO or a group of DISCOs.
- c. The DISCO is to file the power acquisition contract with NEPRA for approval before its execution, accompanied by justification of the rates, terms and conditions thereof. Thereafter, NEPRA is to provide its decision within 60 days.

The 2005 IPPR Regulations were intended as temporary regulations and issued on an interim basis, however, to date, the requisite rules pursuant to Section 32 of NEPRA Act to regulate procedure for power acquisition programs have not been framed, and the 2005 IPPR Regulations remain in force.



# CHAPTER – 6 DISPUTES AND LITIGATION

## I. BACKGROUND

There are various disputes and litigation pertaining to the distribution sector, which also have financial impact on DISCOs. Resolution of disputes relevant to distribution is conducted by: (1) NEPRA Tribunals; (2) Courts with applicable jurisdiction; and (3) DISCO Customer Complaint Centers. Some key matters illustrative of topics of dispute and litigation in the current Pakistan power market context are highlighted below.

### Illustrative Key Areas of Dispute / Litigation in the Power Distribution Sector

- End-use tariff and modality of tariff determinations, including adjustments.
- Imposition of surcharges pursuant to the NEPRA Act.
- Load management requirements.
- Levy / charge of Fixed Charges during load management.
- Power Pool allocation.
- Appointments to Boards of DISCOs, and appointments of CEOs.
- Taxation disputes with FBR.
- Modification of the IESCO License.

## II. TARIFF DISPUTES

At various times, consumers of distribution companies have challenged the consumer-end tariff as well as the methodology of tariff determination before the Superior Courts. The principles enunciated in various judicial decisions on the matter may be summarized as follows:

- a. Judicial recognition is given to the power and authority of NEPRA to determine and recommend tariff. It is also recognized and validated that the tariff of each segment, i.e., generation, transmission and distribution, is to be determined and distinctly notified.
- b. Though the NEPRA Act did not necessarily prescribe public notice prior to undertaking fuel adjustments, judicial support is given to public notice for hearings and that it be given before any fuel adjustment is made by NEPRA. Judicial determinations further confirm that the scope of such hearing should be limited to examining and testing the veracity and accuracy of the change in the components of the fuel adjustment formula already determined. The interveners (if any) should not be permitted to reopen the matters settled through the previous determination.



- c. Judicial recognition of NEPRA’s power under Section 31(4) of the NEPRA Act to issue notifications for fuel cost adjustments.

At times during litigation proceedings, in some instances, restraining orders have been issued by the Superior Courts against DISCOs. As a consequence, tariff recovery or recovery of tariff components (i.e., recovery of fuel adjustment charge from the consumers) has been restricted.

- a. Such restraining orders have resulted in a shortfall in the recovery of electricity costs, affecting payment of the same by DISCOs to NTDC/CPPA and onwards to the power producers.

*Example:* As an illustration, reference is made to the dispute initiated by the consumers against recovery of fuel adjustment charges for the period from April 2011 onwards, with respect to which various civil appeals are pending adjudication before the Supreme Court of Pakistan.

- b. At present, no restraining order is in place with respect to recovery of fuel adjustment charges and such amounts are being recovered from the consumers as per Section 31(4) of the NEPRA Act.

### III. SURCHARGE DISPUTES

In line with GOP policies, certain surcharges are levied by the GOP under section 31(5) of the NEPRA Act and collected from time to time through electricity bills from the end consumers. Currently, these include the Neelum Jehlum Surcharge,<sup>44</sup> Debt Servicing Surcharge (now renamed as “Financing Cost Surcharge”),<sup>45</sup> and Uniform Obligation Fund Surcharge (now renamed as Tariff Rationalization Surcharge),<sup>46</sup> which are charged at notified rates from different categories of consumers.

Illustrative Surcharges
▪ Neelum Jehlum Surcharge – to recover cost for generation project.
▪ Financing Cost Surcharge – to recover service costs for loan obtained to discharge determined costs of power producers.
▪ Tariff Rationalization Surcharge – to recover cost to maintain uniform tariff and provide lifeline tariff support.

The levy of surcharges has been legally challenged, and currently, the matter is pending adjudication before the Supreme Court of Pakistan.

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<sup>44</sup> Surcharge imposed to recover a portion of the cost for setting up Neelum Jhelum Dam for generation of electric power through hydel source.  
<sup>45</sup> Surcharge imposed to recover servicing of loan arranged through Power Holding (Pvt.) Limited for bridging the shortfall in collection by DISCOs and payable to power producers.  
<sup>46</sup> Surcharge imposed to recover cost within the revenue requirement of DISCOs so as to maintain uniform national tariff and provide subsidy to low-end consumers.



- a. The Division Bench of the Lahore High Court has declared section 31(5) of the NEPRA Act to be *ultra vires* the Constitution and on that basis struck it down. Further, NEPRA has been directed to devise a scheme for refund of such amounts. The Supreme Court of Pakistan has suspended this Judgment.
- b. The Division Bench of the Quetta High Court has validated the debt service surcharge.

#### **IV. LOAD MANAGEMENT DISPUTES**

Recent electricity shortages have resulted in load management,<sup>47</sup> which has triggered *suo moto* proceedings before the Supreme Court of Pakistan, as well as constitutional proceeding in the Lahore High Court. The authoritative pronouncements of the superior courts have stated the following:

- a. Increased power demands in Pakistan require unprecedented levels of investment and pursuit of all sources of energy. To reignite, sustain and expand economic growth, the availability of energy at reasonable price is required.
- b. The GOP and all concerned entities should make every effort to eliminate the practice of load management. However, in the event load management is required due to a shortfall in supply, then load management must be administered on an equitable basis. The modality for such load management should be based on a formula put in place so as to ensure that the curtailment of electric power is on equitable basis.
- c. Modern technology such as smart meters should be utilized to control the effect of line losses, theft, etc.; billing and collection mechanisms should be improved and legal action against non-payment. A policy may be framed to differentiate in supply of electric power between paying consumers and defaulters.
- d. It was further observed that increase in generation capacity is a long-term measure. However, in the short term, a power supply rationing system that classifies its consumers may be devised. This system should encourage best practices, conducive lifestyle and role modelling for suitable consumption patterns.

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<sup>47</sup> Load Management means a schedule to be made and announced by the DISCOs during which period supply of electric power shall be curtailed.



It may be noted that NEPRA has prescribed performance standards rules applicable to the distribution sector (NEPRA Performance Standards Distribution Rules), in which it has provided a priority list, which is to be followed in the case of load management. The load is to be shed / managed in the manner indicated in the text box.

Further, DISCOs are to prepare schedules of load disconnection in this priority, and are to ensure that load management within the above groups is done in a non-discriminatory manner.

<b>NEPRA-prescribed load management order</b>
<ol style="list-style-type: none"><li>1. Consumers in rural areas, and residential consumers in urban areas where separate feeders exist.</li><li>2. Consumers, other than industrial, in urban areas.</li><li>3. Agricultural consumers where there is a dedicated power supply.</li><li>4. Industrial consumers.</li><li>5. Schools and hospitals.</li><li>6. Defence and strategic installations.</li></ol>

## **V. FIXED CHARGES DURING LOAD MANAGEMENT**

A “Fixed Charge” is that part of the sale rate in a two-part tariff which is recovered on the basis of billing demand in kilo watt on monthly basis.

Industrial consumers have challenged the recovery of fixed charges during periods of load management. The details are:

- a. In 1999, the Supreme Court adjudicated the applicability of fixed charges during load management<sup>48</sup> periods. The rationale for fixed charges at that time led to the finding that proportionate reduction to the extent of 50% of amount calculated for the period during which load shedding remains operative, be allowed to industrial consumers. This was based on account of WAPDA's inability to “preserve power” for meeting with “maximum demand”.
- b. The issue of fixed charges was raised by industrial consumers in the hearing of DISCOs tariff determination pertaining to Financial Year 2008-09. NEPRA, after distinguishing the rationale of fixed charges in post-NEPRA regime, declined to grant relief. This determination was not challenged any further and attained finality.
- c. Subsequently, in 2012, various industrial consumers again raised this issue directly before the High Court at Lahore and Islamabad. Summarily, the grievance was that the industrial consumers were not being supplied continuous electric power due to load shedding, yet fixed charges were being recovered on the basis of 24-hour supply. The DISCOs and NEPRA, on the basis of rationale

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<sup>48</sup> 1999 SCMR 494 (also see 1999 SCMR 472)



stated in the 2008-09 DISCO tariff determination submitted that the contentions of the consumers were without merit.

- d. The cases at the Islamabad courts have been dismissed. However, the same matter before the Lahore High Court has been referred to the DISCOs to pass a speaking order on the same.

## **VI. POWER POOL ALLOCATION**

With respect to distribution under the KESC, in an attempt to address the gap between power supply and demand in Pakistan, in 2012, the CCI determined that the distribution of electric power should be “equitable” and as a consequence directed that a methodology be framed for curtailing the electric power being transmitted to KESC from the Power Pool to 300MW from 650MW.

Under the NTDC-KESC power purchase agreement, up to 650 MW was supplied by NTDC to KESC on terms and conditions stated therein. However, KESC consumers and the utility itself impugned the CCI decision on various grounds. Proceedings are currently pending before the Sindh High Court. In the meantime, the power purchase agreement between NTDC and KESC has expired. The GOP is considering various aspects with respect to such power supply, and it is not clear as to what course of action shall be adopted by the GOP with respect to this arrangement.

## **VII. APPOINTMENTS TO BOARDS AND CEOS**

The modality for the appointment of members on the Board of Directors and Chief Executive Officers of the DISCOs has been the subject of legal challenge, and the superior courts have laid down the following principles:<sup>49</sup>

- a. The Chief Executive Officer of the DISCOs may be appointed either through fresh recruitment or internal promotion.
- b. The Board of Directors of the DISCOs is meant to be independent in the exercise of powers under the Companies Ordinance. Further, the constitutive documents confer the management with the power to appoint employees without reference or recourse to the Federal Government.
- c. The Public Sector Corporate Governance Rules are applicable on the DISCOs; the criteria of “fit and proper” person as required under the Public Sector Corporate Governance Rules guide the appointment of CEOs, the Board of Directors may recommend at least three persons to the

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<sup>49</sup> Leading case reported as 2014 CLD 664.



Federal Government, and the nominee concurred by the Federal Government may then be appointed as CEO of DISCO.

- d. Judicial determinations have stated that:
  - i. The Board of Directors and CEOs should be professional, competent, independent and meritorious.
  - ii. The process of selection of CEO directly, without recommendation by the Board of Directors was improper.
  - iii. The existing DISCO Board of Directors should be reviewed, and reconstituted where necessary in accordance with the Public Sector Corporate Governance Rules. The reconstituted Board should commence proceedings for appointment of CEO, as contemplated in the Public Sector Corporate Governance Rules, supplemented by additional qualifications specified by the Federal Government.

The transfer and posting of senior management of the DISCOs by PEPCO has resulted in some litigation. Such PEPCO transfer orders are usually suspended by the superior courts in that the superior courts have found that since the DISCOs are legally incorporated, they may operate in terms of the Companies Ordinance. The Companies Ordinance allows for companies to determine transfer and other operational matters.

## **VIII. TAXATION ISSUES**

A number of unresolved issues concerning DISCO tax matters have resulted in contentious litigation, some of which remains pending before various departmental forums as well as the superior courts.

- a. Federal Board of Revenue Issues
  - i. Tax on Subsidies

There are divergent views of DISCOs and the Federal Board of Revenue (FBR) on the applicability of sales tax on GOP subsidies. FBR is of the view that sales tax should also be levied on such subsidy. The DISCOs are not in agreement with this interpretation, which has led to litigation between FBR and the DISCOs now pending adjudication before various forums including the ECC.



ii. Tax relevance of Line Losses

There are also divergent interpretations of the FBR and DISCOs with respect to taxes on line-losses, as FBR disallows claims of input tax for any line losses exceeding the line losses permitted by NEPRA. On the other hand, the DISCOs are of the view that they are unable to recover the cost of such losses during transmission and distribution, regardless of NEPRA's determination, hence that the disallowance of input tax is not valid. This issue is pending adjudication at various forums.

iii. Application of Sales Tax

- a) Some DISCOs (i.e., IESCO, PESCO and GEPCO) supply electricity to the territory of Azad Jammu & Kashmir. Per a 2002 Policy Statement, sales tax was not being charged on such supply<sup>50</sup>. Tax authorities disagreed with this stance, which has resulted in litigation. When the matter came up before a competent tribunal in Islamabad, the tribunal held that the supply was exempt from sales tax. However, following this, Tax authorities have commenced legal action against the DISCOs on the basis that in case of exempt supply, a proportionate input tax adjustment is not admissible. This issue is also pending adjudication.
- b) The consumers of the Federally Administered Tribal Areas (FATA) challenged sales tax charged by PESCO on their bills before the local courts. Resultantly, the local courts restrained PESCO from collecting sales tax. The appellate forum in Swat upheld this decision. PESCO has approached the Peshawar High Court. However, the matter is pending adjudication. In the meantime, tax authorities have commenced litigation against PESCO for evasion of sales tax.

iv. Development Works

DISCOs are also undertaking development activities for installation of distribution network. Tax authorities require that sales tax is due on these development works, and litigation has been initiated in this respect, which is pending adjudication.

Resolution of the above issues would be of critical importance at the time of privatization, in order to enable potential private investors to assess their costs of doing business.

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<sup>50</sup> Policy statement by the President/Chief Executive of Pakistan on September 26, 2002



b. Actions taken to Resolve Tax Issues

- i. In order to address outstanding tax issues, a committee was constituted in March 2013, comprising of all the relevant stakeholders, including GOP representatives and the DISCOs; various meetings have been held.
- ii. The dispute regarding chargeability of sales tax on subsidy provided by the GOP has been referred to the ECC. On November 11, 2014, the GOP issued an office memorandum (although only specific to chargeability of sales tax on subsidy by GOP), quoting a decision of the Cabinet in 1984/85 which stated that all disputes should be resolved through inter-Ministerial consultation, and that unresolved matters should be referred to the Ministry of Law, Justice and Human Rights for a final, binding decision. No final outcome has materialized.

It is recommended that the issues between the DISCOs and FBR be resolved by way of inter-ministerial consultation, as this option may be the most feasible way forward to determine all such outstanding issues between the parties.

c. Other Aspects

Other issues to be resolved between the DISCOs and FBR, which are impeding effective operations of the DISCOs, include:

- i. Instances where DISCO bank accounts have been frozen and/or attached by the FBR on account of FBR-perceived tax liabilities, and at times funds have been routed to FBR on account of such claims.
- ii. Instances where input tax paid by the DISCOs is in excess of the output tax due, which has resulted in a refund claim in favour of the DISCOs. However, these refunds have not been timely made by FBR, leading to further litigation.
- iii. Since July 2006, sales tax has been made payable on accrual of billing basis rather than revenue received basis (amount recovered from consumers). As a result, DISCOs have to pay sales tax on behalf of all consumers upon billing – even those who fail to pay their electricity bills. The DISCOs are of the view that this mechanism should be revised to the previous model when payment of sales tax was on the basis of actual collection.



Under the Income Tax Ordinance, 2001, a minimum tax is payable by the DISCOs. The provision states that “Where corporatized entities of WAPDA (DISCOs) and NTDC are required to pay minimum tax under Section 113, the purchase price of electricity shall be excluded from the turnover liable to minimum tax up to the tax year 2013”. The DISCOs are of the view that this clause should be extended up to the completion of the privatization process of the DISCOs.

## **IX. SERVICE TERRITORY DISPUTES**

A recent dispute between IESCO and Bahria Town (Pvt.) Limited (BTPL) may provide lessons to be learned.

- a. BTPL’s businesses include developing and operating housing colonies in Pakistan. In this regard, it has developed certain areas, which were within the licensed jurisdiction of IESCO. However, BTPL was granted a Distribution License on November 24, 2010 by NEPRA, and the license of IESCO was modified by NEPRA by carving out an area under BTPL from the service territory of IESCO. The rationale of NEPRA was that it was in the public interest to make the modification to the distribution license of IESCO, as consumers may be served better by BTPL and that BTPL had been involved in providing the services in the area for which many consumers had expressed their satisfaction. NEPRA was of the view that in the concerned area, no distribution services were being provided by IESCO, and the dedicated distribution system was laid by IESCO for BTPL, which was thereafter owned, operated and maintained by BTPL.
- b. IESCO was aggrieved of NEPRA’s determination leading to modification of its license and carving out of some of its service territory, which was to be covered by BTPL’s license. Resultantly, IESCO filed a writ petition in the Honorable Islamabad High Court, which is pending adjudication. In the writ petition, IESCO’s contentions include that modification of its license, and grant of license to BTPL, are contrary to public interest hence null and void.

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# CHAPTER – 7 DISCO ASSETS AND EMPLOYEES

The contractual framework established to legally divest the business functions and assets of the eight Area Electricity Boards from WAPDA, in the year 1998, included the transfer of all relevant AEB assets, business functions and employees. Later on, TESCO and SEPCO were divested from PESCO and HESCO in 2002 and 2010 respectively.

## I. SALE AND TRANSFER OF DISTRIBUTION ASSETS

In order to effectuate the sale and transfer of assets and business functions, including transfer of employees, from the AEBs to the newly incorporated DISCOs, WAPDA and each of the DISCOs executed the following legal documents:

- a. Business Transfer Agreement (BTA).
- b. Supplementary BTA (SBTA).
- c. Contract of Sale of immovable properties (the Contract of Sale), specified in the list attached as an annexure to the Contract of Sale.
- d. Sales Deed dated June 30, 2004 for moveable properties (the Sale Deed), specified in the list attached to the Sales Deed.
- e. Operation and Development Agreement (Operation and Development Agreement).

### Transfer Documents

- Business Transfer Agreement (BTA).
- Supplementary BTA.
- Contract of Sale for immovable properties.
- Sales Deed.
- Operation and Development Agreement.

Through the BTA, WAPDA sold and transferred to each DISCO, and each DISCO purchased and acquired from WAPDA, the business and assets set forth in the BTA. Some pertinent BTA provisions are as follows:

- a. In consideration of the transfer of Business and Assets, each DISCO was to pay a Purchase Price to WAPDA.
- b. WAPDA was to deliver to the DISCO the Transfer Deed, the Sales Deeds and the Assignment Agreement. Business is defined as the ownership, operation, management or control by WAPDA



of distribution and supply facilities for the movement, delivery or sale to bulk or other consumers of electric power throughout the area of operation of the corresponding AEB, including but not limited to the 132 KV and below grid stations and lines servicing the said divisions.

- c. The following actions were to be taken on Closing (to occur on or before July 1, 1998) so as to transfer the Business and Assets from WAPDA to the DISCO:
  - i. WAPDA was to deliver to the DISCO duly signed and executed copy of the Transfer Deed, the Sale Deeds and the Assignment Deeds.
  - ii. The DISCO was to deliver to the WAPDA all the share certificates issued in favour of WAPDA, and the Loan Notes.

In 2004, in order to complete the objectives of corporatization and commercialization of WAPDA's Power Wing, WAPDA and the DISCOs executed an SBTA which provided that, notwithstanding that the closing contemplated in the BTA had not occurred, WAPDA would proceed to effect completion of the legal transfer of the business and assets per the following legal tools:

- a. Memorandum of Transfer of Assets, which is a general agreement in relation to the transfer of WAPDA assets to the DISCO and provides the summary of moveable and immoveable properties transferred by WAPDA and NTDC as on July 1, 1998. The summary did not provide the description of assets; rather, it merely stipulated the aggregate quantum of worth of such assets.

SBTA Transfer Documents
<ul style="list-style-type: none"><li>▪ Memorandum of Transfer of Assets</li><li>▪ Contract of Sale</li><li>▪ Sales Deed</li><li>▪ Assignment Agreement</li></ul>

- b. Contract of Sale, which is a specific contract of sale and transfer of certain immoveable properties of WAPDA to the DISCO that stipulates the terms and conditions for the sale of the immoveable properties. It detailed all immoveable properties at the book value as on July 1, 1998 to be vested with each DISCO. The mode and manner for execution of the conveyance documents for the immoveable properties was also included.
- c. Sales Deed, which is a specific contract for the sale and transfer of certain moveable properties of WAPDA to the DISCO that stipulates the terms and conditions for the sale of the moveable properties. It detailed all moveable properties at the book value as on July 1, 1998 to be vested with each DISCO. The Sales Deed also included moveable assets.



- d. Assignment Agreement, which is a specific contract for the sale and assignment of certain intangible properties of WAPDA to each DISCO that stipulates the terms and conditions for the sale of intangible properties; its annexure particularized the intangible properties to be vested with the DISCO as NIL.

With respect to the immovable properties of WAPDA relevant to today's DISCOs, the following aspects should be reviewed for each DISCO pre-privatization:

- a. The legal instruments that were required to convey immovable properties have not been effectuated and should be.
- b. Some immovable properties continue to be legally titled in the name of WAPDA or even its predecessor. The detail of such properties not vesting in the DISCOs should be addressed in individual due diligence of each DISCO.
- c. The SGV Work Program and Methodology suggested a way forward so as to avoid duties and fees for effectuating such conveyance. This primarily required the issuance of a notification for exemption from the levy of stamp duty, etc. It appears that these exemptions were obtained but that they were time-bound, and will have to be re-validated.

## II. INCORPORATION OF SEPCO AND TESCO

While actions taken pursuant to the Reform Plan and the GOP's objectives resulted in the incorporation of eight government-owned DISCOs, subsequently, two additional DISCOs were incorporated:

1. Sukkur Electric Power Company Limited (SEPCO) (2010).<sup>51</sup>
2. Tribal Areas Electric Supply Company Limited (TESCO) (2002).

SEPCO's distribution territory covers an area that was bifurcated from Hyderabad Electric Supply Company Limited (HESCO), whereas TESCO service territory was bifurcated from Peshawar Electric Supply Company Limited (PESCO).

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<sup>51</sup> In 2002, NEPRA granted a Distribution License to HESCO to provide electric power distribution services in Sindh Province, exclusive of areas already serviced by KESC (now K-Electric). Due to the vast service area of HESCO, the utility was challenged by considerable operational and managerial problems. NEPRA therefore advised PEPCO to bifurcate HESCO, as a result of which certain areas of HESCO were bifurcated and vested in SEPCO. NEPRA approved the Distribution License of SEPCO in 2011.



Before privatization, some issues with respect to SEPCO (and similarly for TESCO) to be considered include the following.

- a. At the time of restructuring of WAPDA and conversion of the AEBs into DISCOs, HESCO entered into a BTA and other agreements as discussed above, with WAPDA. By virtue of the BTA, relevant business functions and assets were to be sold and transferred to HESCO.
- b. With respect to SEPCO, no such agreement or arrangements are in place either with WAPDA or with HESCO. It is unclear as to how the relevant business functions and assets are to be legally transferred to SEPCO. This arrangement is further complicated by the fact that all the relevant assets have also not yet been transferred from WAPDA to HESCO. It appears that despite the SEPCO Distribution License being granted more than three years ago, no progress regarding transfer of business functions and assets from HESCO has been made.
- c. Similar issues arise with respect to the employees and overall transfer of employees from HESCO to SEPCO. In the absence of any legal evidence of the transfers, it appears that there is no requisite contractual arrangement for such transfers.

With regard to SEPCO, various steps remain to be taken in order to give legal and contractual sanctity to its legal standing (i.e., to legally solidify its envisaged bifurcation from HESCO). This becomes especially important in light of the fact that recently, an advertisement was floated for the proposed privatization of SEPCO. In such a case, any private investor may be apprehensive, if the relevant assets, personnel and contractual arrangements and approvals are not in place. It may be noted that the same issues may also arise in the case of TESCO.

### **III.EMPLOYMENT ISSUES**

After the incorporation of the DISCOs, WAPDA and each DISCO executed an “Operation and Development Agreement” (O&D Agreement). The intent of the O&D Agreement was that, following the transfer of the business functions and assets from WAPDA to each DISCO, the DISCO would require an operator to supply manpower and to provide development assistance to maintain reliable, quality power supply at affordable prices. It was agreed in the O&D Agreement that WAPDA would take on this responsibility, and provide the services detailed therein to the DISCO through seconded WAPDA personnel.



In consideration of the services to be provided by WAPDA under the O&D Agreement, each DISCO was responsible for payment to the seconded WAPDA personnel (i.e., salaries and allowances), and such payments were deemed as if having been made by WAPDA.

The O&D Agreement was to be valid for three years commencing from the effective date.

*Manpower<sup>52</sup> (Employee) Transition*

Pursuant to the O&D Agreement, various actions were taken to facilitate the transition of manpower from WAPDA to the DISCOs. Per an office order,<sup>53</sup> the services of relevant WAPDA employees were immediately made available to the DISCOs upon legal establishment of the DISCOs. The “Manpower Transition Program” was established and supported secondment, initially for three years, after which employees could opt for full time employment at the DISCOs.

- a. For employees opting to join DISCOs, they were issued new employment contracts executed between them and the respective DISCO, with the specific provisions regarding severance of their employment with WAPDA.
- b. Importantly, the terms and conditions of employment of such opting employees were not less favorable than the terms of employment in WAPDA for such employees. PEPCO also stipulated that after permanent employment in respective DISCOs and the finalization of new employment contracts, all such employees would cease to be WAPDA employees from the date so notified by the company (DISCO).<sup>54</sup>
- c. As part of the Manpower Transition Program, PEPCO issued “Guidelines for Inter-Company Transfers of Officers in Post Corporatization Scenario”,<sup>55</sup> which provided that once the DISCOs notified the officers recruited from WAPDA (with consent of WAPDA), they would cease to be WAPDA employees. This was subject to a limited period until a specified cut-off date, which was to be fixed, during which the employees had an opportunity to return to WAPDA employ. For inter-company transfers, PEPCO issued certain principles for implementation which included:

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<sup>52</sup> Manpower has been a typically used term to refer to “employees” in the WAPDA context.

<sup>53</sup> Office Order dated June 17, 1999. In furtherance, various other letters/instructions were also issued by WAPDA including letters dated January 29 / 31, 2001, and January 1, 2002.

<sup>54</sup> Notification dated April 8, 2002

<sup>55</sup> Letter issued March 31, 2003.



- i. Inter-company transfer, as well as transfer from a DISCO to WAPDA, would be done on secondment basis for a specified period, and the transfer would not by itself result in cessation of the employment with the employing company.
- ii. Contractual rights of individual employees as contained in the new contract of employment would continue to be protected.
- iii. The employing company would issue employee Transfer Orders with the concurrence of the concerned corporatized entity, where the officer was to be posted on secondment basis for a specified period.
- iv. Transferred officers would be obligated to revert to the parent company on completion of the period of secondment (or any extension or earlier termination thereof).

Thereafter, in 2004, WAPDA issued an office order for clarification regarding the conversion of contract employees to regular employees, in which it was stated that contract service would be regularized with immediate effect.<sup>56</sup> This was followed by an office order issued in 2005 by PEPCO,<sup>57</sup> which authorized the newly incorporated companies to convert the contract of any officer in BPS 17 into regular service<sup>58</sup>.

Thereafter, WAPDA authorized the newly incorporated DISCOs to notify all regular WAPDA Officers (BPS 17 and above) who had opted to become employees of the DISCO.<sup>59</sup> Such employees were to cease to be WAPDA employees on December 31, 2004 and to become employees of the relevant DISCO on January 1, 2005. It appears that such employment letters were actually issued in 2010, and that respective DISCO employees accepted them.

#### *BPS 18 Employees – Retention of Centralized Seniority with PEPCO*

PEPCO issued a letter<sup>60</sup> which recognized that pursuant to the above steps, WAPDA employees had been assigned to the companies for commencement of company employment under the respective companies, letters of employment had been issued to them and their lien with WAPDA stood severed. PEPCO also stated that the DISCOs had been given legal authority to implement requisite human resource and administrative powers.<sup>61</sup>

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<sup>56</sup> July 10, 2004

<sup>57</sup> March 24, 2005

<sup>58</sup> Means permanent employment with incorporated DISCO.

<sup>59</sup> Letter dated December 15, 2004.

<sup>60</sup> December 12, 2009

<sup>61</sup> Through earlier Office Orders dated May 31, 2005 and September 5, 2005.



In an attempt to ensure fair treatment of WAPDA professionals, an exception was created with respect to the devolution in the career progression of officers in BPS 18 and above. It was also directed that for employees up to BPS 17, the respective DISCO would give employees inter-se seniority. However, officers in BPS 18 and above would remain on “centralized seniority”, i.e., jointly common at all DISCOs level.

*Pension and Provident Funds*

With respect to DISCO Employee Benefits, the WAPDA-DISCO Business Transfer Agreement sets out that:

- a. WAPDA would take action so that not later than ninety (90) days after the Closing Date,<sup>62</sup> all employer contributions to the WAPDA Provident Fund and to the WAPDA Pension Fund payable as of the Closing Date with respect to seconded employees, had been paid in full or were fully provided for in the financial statements of WAPDA and were paid to the DISCO.
- b. Not later than thirty (30) days before the expiry of the O&D Agreement (the “Fund Transfer Date”) WAPDA would make, or cause each fund to make, transfers from each of the WAPDA Pension Fund and the WAPDA Provident Fund to the respective DISCO Pension Fund and DISCO Provident Fund established in accordance with the DISCO’s Memorandum of Association.
  - i. The amounts of such transfer would be equal to the actuarial present value of all accrued benefits attributable to the Seconded Personnel under each of the WAPDA Pension Fund and the WAPDA Provident Fund (the “Fund Transfer Amount”).
  - ii. (“Accrued Benefits” was defined to mean all benefits that would have accrued under the WAPDA Provident Fund or the WAPDA Pension Fund (whether or not subject to forfeiture) until such time that the fund-to-fund transfer was actually affected.)

WAPDA was required to provide each DISCO with the names and relevant information of all Seconded Personnel, including the benefits vested and accrued for each employee under the funds. In this regard:

- a. WAPDA was required to pay the employer’s contribution to these funds through the Closing Date and such funds would be transferred to each DISCO’s respective Pension Fund and Provident Fund.

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<sup>62</sup> July 1, 1998 or such later date as parties may mutually agree per the BTA.



- b. Thereafter, contribution to the funds was to be the responsibility of each DISCO, which would be an allowable cost to be claimed by each DISCO in its respective tariff determination from NEPRA.
- c. It appears that the DISCOs, as envisaged in the WAPDA-DISCO Business Transfer Agreement, have not created the corresponding funds.

In 2004 and 2007, when the first tariff determinations were made by NEPRA for the DISCOs, NEPRA allowed pension liability as a calculated cost included in tariff determinations to be claimed by DISCOs on the basis of actuarial evaluation. However, due to DISCO non-compliance to establish pension funds, NEPRA now only allows those amounts that are actually paid by a DISCO, and that are based on cost projections.

With respect to pension benefits for WAPDA employees that retired before July 1, 1998, (this date is the cut-off date prescribed in the Business Transfer Agreement), it appears that the issue with respect to payment of these benefits is still not resolved. The BTA provided that “The Parties acknowledge that, except for the liabilities expressly assumed by the Company [DISCO] in Clauses 2.3 and 2.4 hereof, the Company [DISCO] is not assuming pursuant to this Agreement any liability or obligation of WAPDA currently in existence or hereafter arising, including liabilities or obligations under existing financing arrangements related to the Business and Assets”.

A review of the provisions indicates that there is no mention of the DISCO taking over pension benefit liability of WAPDA employees who had retired prior to the “Closing Date” (July 1, 1998). In fact, with respect to the consideration paid for transfer of Business and Assets, the BTA provides that “if WAPDA fails to make or cause each fund to make the fund-to-fund transfers described in Clause 5.7(h) and 7.6(d), then the Purchase Price shall be reduced in an amount equal to the difference between the amounts actually transferred and the Fund Transfer Amounts”.

Financial liability for such retired WAPDA employees has not in fact been transferred to the DISCOs and remains with WAPDA. Further, the transfer of funds is limited to the Seconded Personnel. When read in light of Clause 2.6 of the BTA, restricting the DISCO assumption of liabilities, it is found that DISCO has not assumed liability of payment of retirement benefits to employees who had already retired before July 1, 1998 and who had never been seconded to the DISCO.



Contrary to the aforesaid, it is the position of WAPDA that the pension claims of its retired/deceased employees etc. will be settled at the level of corporate entities – i.e., the DISCOs (as well as the GENCOs, NTDC).

The aforementioned aspects require closer review and resolution, particularly keeping in view the extent of financial exposure.

#### **IV. OTHER ASPECTS**

Employee benefits also include the General Group Life Insurance and the Workers Welfare Fund. These matters are still being dealt with at consolidated WAPDA level, which should be devolved to the respective companies on account of corporatization/commercialization. Its impact in the post-privatization scenario also requires consideration.

##### *Union issues*

To the extent of union matters, PEPCO issued an office order<sup>63</sup> to all newly incorporated companies in which they were informed that All Pakistan WAPDA Hydro Electric Workers Union had been declared as the Collective Bargaining Agent by the National Industrial Relations Commission, for WAPDA/newly incorporated companies.

The office order stated that the workers' trade union could raise their demands to PEPCO level, but that in such instance, could not raise such demands before a higher forum. (Note: the Consultant has been informed by PEPCO that this issue is pending adjudication).

This aspect needs to be resolved by way of consultative discussion process between the centralized union, WAPDA, management and employees of the DISCOs, and in this process MWP as well as PC should take the lead so that the privatization initiative may not be stalled.

#### **V. EMPLOYEES' OLD-AGE BENEFITS**

With respect to whether the provisions of the Employees' Old-Age Benefits Act, 1976 (the 1976 Act) are applicable to DISCO employees needs to be resolved prior to privatization in order to properly assess DISCO liabilities. The 1976 Act was promulgated so as to provide old-age benefits to the persons employed in the industrial, commercial and other organizations. The provisions of the 1976 Act apply to every industry or establishment, and all employees in an industry or establishment are to be insured in the manner prescribed by or under the 1976 Act.

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<sup>63</sup> Dated December 11, 2013



The scope the 1976 Act (Section 47) has been reviewed by the superior courts. The courts have found that Section 46 of the 1976 Act pertains to exemption to be granted by the Federal Government to an “establishment” or “industry”. Similarly, it has also been observed that a company incorporated under the Companies Ordinance cannot be considered as a statutory corporation and it would not fall outside the ambit of 1976 Act.

Presently, DISCOs provide similar benefits to their employees as had WAPDA, i.e., pension, various benefits. In addition, the DISCOs have adopted the WAPDA employee service rules and assert that applicability of provisions of 1976 Act would tantamount to provide a double benefit. IESCO has initiated a constitutional petition in this regard, which is pending adjudication.

It shall be appropriate that the matter is addressed by way of representation to Ministry of Law, Justice and Parliamentary Affairs, through MWP as per Rules of Business, and resolved prior to privatization.

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# CHAPTER – 8 CONSENTS AND APPROVALS FOR PRIVATIZATION

## I. CONSTITUTIONAL REQUIREMENTS

Article 153, read with Article 154 of the Constitution, provides that the CCI is constitutionally empowered to determine, formulate and regulate policies relating to matters enumerated in Part II of the Federal Legislative List and exercise supervision and control of related institution. Electricity is specifically cited as a matter of federal oversight in Entry 4 in Part II of Schedule 4 of the Constitution.

Recent judgments of the Supreme Court have alluded that in cases of privatization where public and provincial interests are at stake, CCI's approval would be essential for lending legal sanction to any such initiative.

As early as 1993, the GOP's Reform Plan was approved by CCI, and was further reaffirmed in 1997. Read together, the 1993 and 1997 CCI Approvals provide the requisite mandate to the GOP for undertaking power sector reform, including WAPDA Restructuring and subsequent privatization of newly incorporated companies in generation and distribution of power according to a phased program.

In 2010, the 18th Amendment was made to the Constitution of Pakistan. The amendment primarily modified roles of federal and provincial governments by introducing changes in the two lists of topics for which these levels of government were responsible. These lists in the Constitution (prior to the 18<sup>th</sup> Amendment) included:

- a. Federal Legislative List, providing topics that for which legislation would be the exclusive domain of the Federal Government.
- b. Concurrent List, providing topics that could be legislated by either/both the Federal and the Provincial Governments.

The 18<sup>th</sup> Amendment abolished the Concurrent List leaving a single legislative list. "Electricity", which was previously included in the Concurrent List, was completely shifted to be part of the Federal Legislative List; hence jurisdiction for electricity is vested with the Federal Government and CCI.



Following adoption of the 18th Amendment, the Privatization Division presented a summary to the CCI,<sup>64</sup> stating that the groundwork was in place to refine the GOP concept for tendering DISCO operations including outsourcing management. The summary proposed that IESCO shares be listed on the stock exchanges and that outsourcing of management be outsourced as a pilot project based on the GOP's model for PPP (Public Private Partnership),<sup>65</sup> with the expectation that such experience, based on lessons learned, could be replicated in other DISCOs and GENCOs. The CCI<sup>66</sup> deferred its consideration and directed that the summary be revised following consultation with Provincial Governments for subsequent CCI discussion.

In 2011, the Privatization Division issued a new summary<sup>67</sup> stating that per the CCI February 1, 2011 decision, the matter was taken up with the Provincial Governments, MWP and the Planning & Development Division. Provincial Governments had demanded expanded involvement in privatization process of power sector

Illustrative Privatization Approvals by CCI	
Year	Description
1993	Power Sector Reform, including WAPDA Restructuring and privatization approved.
1997	Above decision reinforced.
2011	Subsequent to 18th Amendment, privatization of DISCOs again approved by CCI. Further, directed that the Provincial Chief Secretaries would be members of the Privatization Board while the Provincial Chief Ministers would be members of the CCoP, with respect to power sector privatization issues pertaining to that Province.

entities located in their respective provinces and were consulted. The Provincial Governments of Punjab, Khyber Pakhtunkhwa and Sindh had not opposed the proposed privatization of power sector entities, while comments from P&D Department and Government of Balochistan were not received.

The summary further stated that private investment and managerial talent was essential to have a robust and sustainable power sector that ensured affordable and reliable energy to a growing economy. It was stated that private sector investment should be attracted to address the sector's operational inefficiencies, to deploy modern technology and to provide much-needed capital.

<sup>64</sup> January 29, 2011

<sup>65</sup> The GOP PPP Mode specifically envisages sale of 26% equity stake along with management control.

<sup>66</sup> In a meeting held on February 1, 2011.

<sup>67</sup> April 16, 2011



Per CCI approvals for privatization it was proposed that privatization would proceed on a case-to-case basis and that marketing, optimal transaction structure, and the appropriate mode of privatization of each entity would be decided by the CCoP. The manner in which privatization would be formulated would be based on the level of investor interest, the investment climate and overall sector dynamics.

The CCI<sup>68</sup> approved the privatization of three GENCOs and nine DISCOs (the 2011 CCI Approval) and that the privatization model should ensure inputs from the relevant Provinces for continued review by the CCI.

Thereafter, later in 2011, the Privatization Division issued another summary<sup>69</sup> to CCI, which detailed the entire privatization process, relevant to any entity, including DISCOs:

- a. Identification of the entity to be privatized and previous approval(s) by the CCI and CCoP.
- b. Confirmation that privatization procedures were consulted with Provincial Governments; responses/comments received from the Government of Punjab and Balochistan were placed on record while the Governments of Sindh and Khyber Pakhtunkhwa provided no comments.
- c. In order to ensure continued provincial participation in the privatization process, the Chief Secretary of the respective Province would be invited to attend all meetings of the PC Board and the CCoP in which the privatization of an entity (i.e., relevant DISCO) located in the relevant Province was to be considered.

The CCI<sup>70</sup> gave its approval, further ordering that the Provincial Chief Secretaries would be members of the Privatization Board while the Provincial Chief Ministers would be members of the CCoP, with respect to power sector privatization issues pertaining to that Province (the 2<sup>nd</sup> 2011 CCI Approval).

## **II. PRIVATIZATION PROGRAM**

In view of the approvals for privatization of the DISCOs by CCI, the various steps taken by the GOP so as to proceed with the privatization process during this period are succinctly stated (see text box).

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<sup>68</sup> In a meeting held on April 28, 2011.

<sup>69</sup> August 15, 2011

<sup>70</sup> In a meeting held on August 27, 2011.



On February 12, 2009, the Privatization Commission, Ministry of Privatization submitted a summary to the CCoP containing proposals to support private sector investment in public sector operations (i.e., DISCOs) and seeking to adopt a new market framework. The summary stated that the existing privatization policy of strategic sale (51%-100%) be reviewed and revised following a PPP concept in which management would be transferred to investors through sale of 26% shares while ensuring transparency and all other aspects safeguarded through documentation.

Illustrative Privatization Program		
Date of Approval	Approving Body	Directive
2009	CCoP	Approval of PPP as a mode of privatization. PPP Mode means divestment of 26% shares with management.
2013	CCoP	Approval of the privatization program for early implementation. It was also indicated that the PPP Model with respect to FESCO, IESCO and HESCO may be adopted.
2014	CCoP	Approval to include LESCO, MEPCO, GEPCO, PESCO, QESCO, and SEPCO for early implementation.
2014	Cabinet	Ratified decision of CCoP.

As a result, a policy framework prepared by the Privatization Commission was presented to the CCoP for approval, and required:

- a. As a matter policy, electricity sector privatization would be conducted along the proposed PPP model that transferred full management control and 26% company equity (PPP Model).
- b. Following a certain period of implementation, if the PPP Model did not have the expected outcomes, the Privatization Commission would revert back to CCoP with alternate models.
- c. A stringent pre- and post-privatization modality, procedures and framework would be formulated by the Privatization Commission.

The list of entities envisaged for the PPP Model included QESCO and FESCO. In its 2009 approval of the PPP policy guidelines and plan,<sup>71</sup> the CCoP further included HESCO in the list of entities for PPP Model by the CCoP.

<sup>71</sup> February 12, 2009



Thereafter, as per Rule 17(1)(c) of the Rules of Business, a summary<sup>72</sup> was presented by the Ministry of Privatization before the Cabinet for ratification of the decisions of CCoP mentioned above. The list of entities proposed in the summary for privatization under the PPP Model additionally included PESCO.<sup>73</sup>

The summary proposed that GOP representatives would be included on privatized Boards, reflecting the retained ownership of the entities. Cabinet ratified the proposals approved by the CCoP.<sup>74</sup>

In 2013, the Privatization Division submitted a summary on the privatization program to CCoP.<sup>75</sup> The summary stated that:

- a. The scope of the Privatization Commission included all the DISCOs, except TESCO.
- b. The Privatization Commission Board<sup>76</sup> considered and approved a number of PSEs in program for early implementation, including IESCO, HESCO and FESCO.
- c. Confirmation that the proposed privatization model would transfer full management control and 26% of shares.
- d. CCoP approval of the privatization program was requested.

In 2013, the CCoP approved (the 2<sup>nd</sup> CCoP Approval) the privatization program<sup>77</sup> through which line ministries were directed to provide all relevant information to the Privatization Commission in respect of public sector entities undergoing privatization that were presently under their administrative control. In essence, MWP for the government-owned DISCOs is to provide all relevant information to the Privatization Commission.

Thereafter, the Cabinet Division placed a summary before the Cabinet with regard to confirmation of the decisions taken in the 2<sup>nd</sup> CCoP Approval.<sup>78</sup> On May 15, 2014, the Cabinet ratified the above CCoP decisions.

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<sup>72</sup> December 5, 2009

<sup>73</sup> It was stated that CCoP had also approved this entity. However, the documents provided to us do not include the name of this entity when the summary was moved to CCoP.

<sup>74</sup> In a meeting dated January 6, 2010.

<sup>75</sup> October 1, 2013

<sup>76</sup> In a meeting held on September 10, 2013.

<sup>77</sup> October 3, 2013

<sup>78</sup> October 24, 2013



# CHAPTER – 9 KEY FINDINGS AND RECOMMENDATIONS

Key legal due diligence findings and recommendations are provided in this Chapter. Findings have been identified by the Consultant based on the literature review, consultations and analysis of the legal framework in which Pakistan’s government-owned DISCOs are operating with the expectation of privatizing the DISCOs. Recommendations have been prepared with the intention of preparing the DISCOs for privatization.

## **PRE-PRIVATIZATION PREPARATION**

In order to implement the legal due diligence findings and as part of pre-privatization preparation, the Consultant recommends that the GOP may immediately establish a “DISCO Privatization Committee” that will consider the findings and recommendations of this report and prepare a work plan to implement pre-privatization issues and to guide the privatization process in a transparent and regularized manner. This committee may be chaired by representative of PC or MoF and be reportable to CCoP.

## **FINDING No. 1: REQUIRED APPROVALS FOR PRIVATIZATION ARE IN PLACE**

1. The initiative to privatize nine government-owned distribution companies (DISCOs) has been approved by CCI, except TESCO.
2. It is unclear if compliance with CCI approvals has been completed, i.e., that the Provincial Chief Secretaries were formally invited for the meeting of the Privatization Board, and the Provincial Chief Ministers were invited in meeting of the CCoP for any relevant power sector (DISCO) privatization matter in that Province.
3. The CCoP has approved the DISCOs to be placed in the privatization program for early implementation. It is also indicated that proposed program for IESCO, HESCO and FESCO may be modelled around the concept of PPP Model. The Cabinet has also ratified the CCoP Approval in 2014.



**Recommendation:**

- a. Legal, financial and technical due diligence must be conducted for any specific DISCO undergoing privatization actions as each DISCO will have its specific aspects for consideration.
- b. The strategy and mode for privatization and its program may be framed on the basis of due diligence being conducted by PC for each individual DISCO. This envisaged arrangement shall require the requisite approvals.
- c. For such approvals, it should be ensured that the directions given in the CCI approvals, in particular regarding requirement that Chief Minister of the relevant province is to be a member of the CCoP for an item relating to privatization of a power sector entity in that Province, are complied with and similarly with respect to Chief Secretary for Privatization Board.

**FINDING No. 2:**  
**NEED TO RECONCILE CORPORATE OWNERSHIP OF THE DISCOS**

1. Upon the execution of the transfer of business functions and assets from WAPDA to the eight government-owned DISCOs, each DISCO was to issue ordinary shares; to date, only one distribution company, MEPCO, has issued shares, and even that issuance process requires review.
2. The 1998 Federal Government Executive Instruction stipulated that DISCO shares were to be issued in the name of the Office of the President of Pakistan. The Business Transfer Agreement (BTA) and the SBTA legally state that the shares would be allotted to WAPDA; on this basis, only MEPCO has allotted ordinary shares to WAPDA. This process of allotment to WAPDA by the DISCOs (except MEPCO), and thereafter transfer to President of Pakistan, is yet to be completed.

**Recommendation:**

- a. Each DISCO should assess issues relevant to the issuance of shares in light of the Companies Ordinance that states that ordinary share capital may only be issued against cash or in-kind (non-cash). In the present context, ordinary shares are to be issued by the DISCOs as “in-kind”.
  - i. Compliance with the procedure specified in the Companies (Issue of Capital Rules), 1996 is required.
  - ii. Each DISCO should undertake this process, in coordination with the MWP or PC, which would facilitate resolution.



- b. The entity to which ordinary share capital is to be issued (i.e., to WAPDA and thereafter transfer to the Office of the President of Pakistan or directly to the Office of the President of Pakistan under a separate contractual arrangement) needs to be considered by MWP and WAPDA and resolved.
- c. DISCOs and WAPDA, in coordination with the MWP, should verify those deliverables earlier required for closing the Business Transfer Agreement<sup>79</sup> and the SBTA<sup>80</sup> so as to eliminate any outstanding shortcomings with respect to vesting of the assets. It is possible that with so much time passing, many of these terms no longer are of significance, but final reconciliation of same will ensure clean transfer of business functions, assets and should address the handling of any related liabilities (i.e., will any debt transfer).
- d. The relevant rules of NEPRA with respect to the issuance/transfer of shares should also be reviewed and complied with by the DISCOs and GOP.

### **FINDING No. 3:** **LEGAL CONFIRMATION OF DISCO IMMOVEABLE ASSETS IS REQUIRED**

1. The legal transfer of WAPDA business functions and assets to the DISCOs was never legally completed in full. Although possession of immovable properties of WAPDA was transferred to the DISCOs under the BTA and SBTA, legal conveyance was not effectuated for a substantial number of immovable properties.
2. SEPCO and TESCO were created subsequent to the incorporation of the eight AEBs under WAPDA to become eight government-owned DISCOs. SEPCO and TESCO emerged from a realignment of service territory of HESCO and PESCO, respectively. However, the contractual and legal framework (which was earlier followed for corporatization of the eight AEBs) including certain legal documents is not in place for SEPCO and TESCO.

#### **Recommendation:**

- a. The DISCOs should work with relevant counterparts to reconcile completion of the legal conveyance of immovable properties of WAPDA business functions and assets to the DISCOs.

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<sup>79</sup> Clause 2.5 of BTA.

<sup>80</sup> Clause Nos. 4 and 7 of SBTA.



This reconciliation process may also be an opportunity to conduct an “asset evaluation” of each DISCO that will ensure updated information is provided as part of pre-privatization due diligence.

- b. Special attention to completing the legal transfer for SEPCO and TESCO is required. The senior management of these DISCOs along with relevant stakeholders should immediately assess the status of the SEPCO and TESCO legal incorporation and other framework gaps and prepare a plan to reconcile the same with the goal of establishing these two DISCOs as stand-alone corporate entities. The relevant businesses, assets and liabilities should be transferred to SEPCO and TESCO by way of legal instruments.

#### **FINDING No. 4:**

### **STATUS OF DISCO EMPLOYEES MUST BE RECONCILED**

1. As a consequence of the 1998 WAPDA Manpower Transition Programme, employees have been delinked from WAPDA onward to various DISCOs and other government-owned companies. This means that the DISCO management oversees employee pay, transfers, promotions and postings.
2. However, for those employees in the Basic Pay Scale 18 and above, PEPCO is still involved in certain aspects of promotion, transfers and postings. For officers in BPS 18 and above, centralized seniority is still being maintained by PEPCO and has not yet been delinked. Investors will want to understand the role of PEPCO in distribution employee relations.
3. Upon their incorporation, the DISCOs were to establish appropriate Provident Funds, Group Life Insurance, Welfare Fund, and Pension Funds. WAPDA was to transfer such amounts as were allocated to employees being transferred. No such arrangements have ever been implemented and legacy arrangements continue with regard to Provident Fund, Group Life Insurance and Welfare Fund. Resultantly, the amounts for such funds are forwarded to WAPDA and implemented through funds established by WAPDA. Again, investors will want to understand the role of WAPDA in distribution employee relations.
4. To the extent of the Pension Fund, in the absence of transferring same from WAPDA to the DISCOs, initially NEPRA had allowed pension liability to be included as part of the DISCO tariff calculation and determination on the basis of actuarial evaluation. However, due to the non-compliance of all the DISCOs to establish such pension fund, NEPRA is now only allowing such amounts as are actually projected to be paid by a DISCO during the specified tariff period to be



included in the DISCO tariff calculation. Investors will want to understand what their liability with respect to these funds is as well as whether any impact on their tariff calculations should be expected.

5. Currently, the pension of WAPDA employees who worked at AEBs and retired prior to incorporation of the DISCOs, (i.e., before July 1, 1998) is paid by the DISCOs. The DISCOs are of the view that this is WAPDA's liability and have continued over the years to enter this liability in their books of accounts as receivables against WAPDA. Investors will want to clearly understand and government needs to reconcile how legacy pensions shall be paid in the wake of privatization.
6. The applicability of the Employees' Old-Age Benefits Act, 1976 to the DISCOs needs to be resolved; this issue is pending adjudication before the Honourable Courts.
7. The industrial relations are still at central level i.e. WAPDA through a single collective bargaining agent representing all employees of all corporatized entities. The matter is under judicial review.

**Recommendation:**

- a. A strategy should be prepared and agreed by key stakeholders (i.e., MWP, PEPCO, DISCOs) and adopted through which legacy manpower and human resources (HR) matters are resolved. From then on, each DISCO without any intervention of PEPCO or other agents, should address all HR issues.
- b. The DISCOs should establish Provident Funds, Group Life Insurance, Welfare Fund, and Pension Funds.
- c. The relevant stakeholders (DISCOs and WAPDA) should resolve the issue of retirement benefits for those employees who retired before July 1, 1998.
- d. The applicability of the 1976 Act should be immediately resolved through inter-ministerial consultation that includes the Ministry of Law, Justice and Parliamentary Affairs, through MWP.
- e. Consultative processes should commence amongst the centralized union, WAPDA, management and employees of the DISCOs, and in this process MWP as well as PC should take the lead so that the privatization initiative may not be stalled.



## **FINDING No.5:** **NEED TO STRENGTHEN CORPORATE GOVERNANCE OF THE DISCOS**

1. Considerable intervention is in place relevant to DISCO management, particularly from PEPCO wherein the DISCOs are, at times, effectively centralized and operated as a department of the Government / PEPCO.
2. No assessment of the functioning and operations of the Board of Directors of the DISCOs so as to ascertain independent functioning have been undertaken.
3. The Companies Ordinance applies to the DISCOs but is often overlooked; policy makers at times still consider DISCOs as government departments:
  - a. The constitution of the Board of Directors, in line with the Companies Ordinance and Public Sector Corporate Governance Rules, is also to be implemented.
  - b. The recruitment process for the Chief Executive Officer(s) for the DISCOs is not in accordance with the Companies Ordinance and Public Sector Corporate Governance Rules.

### **Recommendation:**

- a. Institutional Reconciliation. GOP has to make clear commitments to the reconciliation of institutional oversight:
  - i. Presently, PEPCO and MWP at times continue to manage DISCO operations, such as maintenance of integrated seniority and promotion of DISCOs officers of BPS-18 and above, appointment of CEOs etc., which needs to be reviewed and streamlined in order to prepare a DISCO for privatization.
- b. Strengthened DISCO Boards of Directors:
  - i. MWP should ensure that the composition of DISCO Boards is legally compliant and the Board members are technically qualified to take on Board responsibilities. The findings of the Superior Courts enunciating principles for such appointments have been/are in line with the legal framework, and are required to be followed.
  - ii. MWP should promote full autonomy of the DISCO Board of Directors, and assess the role of PEPCO/GOP that should be taken over by the Board. As an illustration senior selection



board should be held by Board and not by PEPCO on the basis of integrated seniority. In this respect, envisaged dissolution of PEPCO under the Companies Ordinance should also be reviewed and settled.

- iii. The recruitment process of the CEOs should be on a professional and market basis and completed as a priority. The DISCO Board of Directors, in consultation with MWP, should immediately prepare and implement a plan for the same.

## **FINDING No.6:** **INCOMPLETE TRANSITION OF THE PAKISTAN POWER MARKET**

1. Throughout its power sector restructuring policies, the GOP has envisaged that a competitive power market arrangement would be established no later than July 1, 2012. This required: (1) an initial transition phase to a Single Buyer Plus trading arrangement which was to be established by July 1, 2004; and (2) establishment of the Competitive Trading and Bilateral Contract Market arrangement by July 1, 2012. Neither benchmark was met. The ECC, through the 2015 ECC Approval, and the Market Rules have now approved revised timelines (Single Buyer Plus from 2016 to 2020, and Competitive Market from July 1, 2020).
2. The Phase I for operationalization of CPPA-G has been achieved so as to achieve the objective of the GOP towards the segregation of the Market Operations and System Operations earlier being performed by NTDC. However, Phase 2 of the process is yet to be adopted and implemented.

### **Recommendation:**

- a. Appropriate steps should be taken by NEPRA, NTDC, CPPA-G, DISCOs and power producers to establish the framework for Competitive Trading and Bilateral Contract Market within the timelines approved by ECC and prescribed in the Market Rules.
- b. In order to adopt and implement Phase 2 for CPPA-G, a series of measures are required to be taken by way of consultative process, as also identified in the 2015 ECC Approval. These include:
  - i. Power Purchase Agreements, with energy price based on heat rate testing, be executed between CPPA-G on behalf of the DISCOs and GENCOs.
  - ii. CPPA-G to enter into PPA with WAPDA Hydel on behalf of DISCOs.



- iii. WAPDA to enter into an agreement with CPPA-G for the administration of current PPA for IPPs under 1994 Power Policy or if possible step mentioned at serial no. (iv) below may be adopted.
- iv. Novation of the PPA executed by CPPA of NTDC under the 2002 Power Policy and later such power policies in favour of CPPA-G.
- v. CPPA-G to enter into a Transmission Services Purchase Agreement with NTDC for the procurement of transmission of service on terms and conditions including the use of system charge settled by NEPRA.

**FINDING No.7:**  
**LACK OF RULES FOR POWER ACQUISITION PROGRAM AND MECHANISM FOR POWER POOL ALLOCATION**

1. The existing power market (to the extent of the distribution sector) does not have private investment. The procedures and standards for investment and power acquisition programs by DISCOs under Section 32 of the NEPRA Act are not yet framed and notified by NEPRA. This results in least optimal investment in the sector. This also results in reduced investor confidence in the sector.
2. In the current market, power allocation from the Power Pool to the DISCOs is made without any regulatory oversight.

**Recommendation:**

- a. In order to facilitate sector reform, and submission and approval of investment and power acquisition programs by the DISCOs, NEPRA should prescribe procedures and standards as authorized under Section 32 of the NEPRA Act. This process is under way, and should be expedited by NEPRA. This would facilitate integration of the power market structure with the national energy plan so as to facilitate realization of the reform objectives of the GOP. Consultation amongst key stakeholder including between Planning Commission, MWP and Ministry of Petroleum and Natural Resources should be conducted.
- b. The GOP should commission a detailed study to ascertain the demand and supply gap, and load growth of the DISCOs.



- c. Based on the study, a Power Pool Allocation Mechanism guiding how power will be allocated amongst the DISCOs during the period of such gap should be prepared by the MWP for CCI approval.
  - i. This mechanism may also encompass aspects with respect to collections by the DISCOs for the Power Pool and consequential re-arrangement of such allocation.
  - ii. The market operator should be legally authorized to execute despatch as per the power pool allocation policy so that prospective investor has confidence in power supply from the power pool.

## **FINDING No.8:** **RECONCILIATION OF LEGAL FRAMEWORK FOR DISCO** **PROCUREMENT**

1. As reviewed in Chapter 5, the laws and processes for public procurement, including procurements (goods and services) made by DISCOs, notably for equipment and supplies, i.e., transformers, are made in accordance with the public procurement law and uniform standards set forth by WAPDA / NTDC. Such application of uniform standards needs to be assessed should private investment enter distribution.
2. It can be expected that if only 26% shares are issued to private sector that government policy may support use of public procurement rules for privatized DISCO operations. This is typically detrimental for investors, as they require full flexibility to procure “best value” and to have the ability to use their own specifications apart from Government procurement rules, which generally constrain procurements. This does not mean that private investors won’t be accountable or required to operate in a transparent manner, but it means that investors will want to have their own procurement regimes.

### **Recommendation:**

A consultative process amongst relevant government agencies should be conducted to consider the applicability of PPRA laws and rules on DISCOs post-privatization. Application of procurement rules needs to be resolved with respect to the post-privatization scenario.



## **FINDING No.9:** **DISPUTES AND LITIGATIONS EXIST IN RELATION TO THE DISTRIBUTION SECTOR**

Chapter 6 reviewed various disputes with respect to commercial aspects, as well as management of the distribution sector. The judgments / pronouncements of the Superior Courts lay down various principles, and efforts should be made to comply with such principles.

### **Recommendation:**

#### **a. Load Management.**

##### **Finding / Recommendation:**

Any load shedding / load management must be administered on the basis of a formula put in place to ensure the distribution of electric power on equitable basis. Such a formula should be based on the basis of power allocation policy to be prepared by MWP and approved by CCI.

It may be noted that a review petition is pending in the Honourable Supreme Court, and any decision in the same may have an impact on these findings. Additionally, NEPRA has prescribed the NEPRA Performance Standards Distribution Rules, in which it has provided a priority list, which is to be followed in the case of load management. The load is to be shed / managed in the following order: (a) supply to consumers in rural areas, and residential consumers in urban areas where separate feeders exist; (b) supply to consumers, other than industrial, in urban areas; (c) supply to agricultural consumers where there is a dedicated power supply; (d) supply to industrial consumers; (e) supply to schools and hospitals; and (f) supply to defence and strategic installations. Furthermore, DISCOs are to prepare schedules of load disconnection in this priority, and are to ensure that load management within the above groups is done in a non-discriminatory manner.

#### **b. Power Allocation.**

**Finding:** The NTDC-K-Electric power purchase agreement has expired; the 650MW power contractually allocated from the power pool to K-Electric is legally to be returned to the Power Pool for allocation amongst all the DISCOs.

**Recommendation:** The issue pertaining to supply of electric power up to 650 MW by NTDC to K-Electric should be taken up and finalized by MWP, so that it is clearly established whether 650 MW is to revert back to the Power Pool for distribution among DISCOs.



c. **Tax Issues.**

**Finding:** Various tax issues primarily between DISCOs and the Federal Board of Revenue are pending adjudication as well as settlement at administrative forums. These issues impact financial portfolio of the DISCOs and will impact what potential investors perceive as financial risk in considering their investments.

**Recommendation:** An inter-Ministerial consultative process is underway and should continue, along with time-based reporting and benchmarks to ensure reconciliation in time for pre-privatization reviews, and in the meantime, an arrangement may be agreed under which no coercive steps (attachment of bank accounts, etc.) are taken against the DISCOs.

d. **Service Territory Dispute Re: IESCO and BTPL.**

**Finding:** The dispute of carving out of the licensed territory of IESCO by NEPRA is pending adjudication. A private investor looking to invest in the DISCOs may want guarantees of exclusivity in its service territory and the regulatory framework should deal with such aspects in a well-defined manner.

**Recommendation:** These aspects be considered prior to privatization and the prospective investor should be provided commitment that in so far as it is complying with its obligations under the license and NEPRA laws, its service territory shall not be modified without the consent of the licensee.

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# ANNEXURE – I

## INTERPRETATION OF TERMS

Unless the context otherwise requires, terms used in this Report are assigned the following meaning:

1. **1976 Act** – Employees’ Old-Age Benefits Act, 1976.
2. **1993 CCI Approval** – The approval given by CCI on September 12, 1993 pursuant to the 1993 MWP Summary.
3. **1993 MWP Summary** – Summary dated September 9, 1993 titled “Privatization of WAPDA and amendments to WAPDA Act”.
4. **1994 Power Policy** – The Policy Framework and Package of Incentives for Power Generation Projects in Pakistan.
5. **1995 Hydel Power Policy** – The Policy Framework and Package of Incentives for Private Sector Hydel Power Generation Projects in Pakistan.
6. **1997 CCI Approval** – The post-facto approval of CCI on May 29, 1997.
7. **1998 Action Plan** – The summary moved by MWP to ECC on June 17, 1998 for restructuring of Pakistan Power Sector.
8. **1998 Power Policy** – The Policy for New Private Independent Power Projects.
9. **2002 Power Policy** – The Policy for Power Generation Year 2002.
10. **2005 IPPR Regulations** – The Interim Power Procurement (Procedures and Standards) Regulations 2005 made by NEPRA.
11. **2011 CCI Approval** – The approval dated April 28, 2011 for privatization of, inter alia, nine DISCOs.
12. **2014 Guidelines** – The National Power Tariff and Subsidy Policy Guidelines, 2014.
13. **2015 ECC Approval** – The approval of the ECC dated April 30, 2015 and its subsequent modification with respect to phased approach towards the reform of power sector.
14. **2<sup>nd</sup> CCoP Approval** – The approval of CCoP on October 3, 2013 for composite privatization program.
15. **2<sup>nd</sup> 2011 CCI Approval** – The approval in meeting dated August 27, 2011.
16. **Amendment Act** – Pakistan Water and Power Development Authority (Amendment) Act, 1994.
17. **Business Transfer Agreement / BTA** – Agreement between WAPDA and DISCOs for transfer and sale of assets and business.



18. **Circular Debt Report** – The report dated March 13, 2013 prepared by USAID in collaboration with the Planning Commission of Pakistan.
19. **Commercial Code** – The commercial code prepared by CPPA-G and approved and notified by NEPRA in 2015.
20. **Companies Ordinance** – The Companies Ordinance, 1984.
21. **Constitution** – The Constitution of Islamic Republic of Pakistan, 1973.
22. **CPGENCO** – The approved generation companies selling power (for the Power Pool) to NTDC for onward sale to the DISCOs.
23. **CTBCM Implementation Plan** – The competitive trading bilateral contract market implementation plan to be framed by NTDC.
24. **Distribution License** – License granted for distribution services by NEPRA to the DISCOs pursuant to the NEPRA Act.
25. **Electricity Act** – Electricity Act, 1910.
26. **Federal Government Executive Instruction** – The Executive Order issued by the Prime Minister secretariat on October 24, 1998 bearing no. 11(22)E&F-1/98, for implementation of the Plan for Pakistan Power Sector Reform and WAPDA Restructuring.
27. **General Order 1** – General Order No.1 dated March 22, 1998 issued by Chairman WAPDA.
28. **Loan Liabilities Transfer Agreement** – The agreement between WAPDA and each DISCO for transfer of liabilities as a consequence of unbundling of WAPDA.
29. **Market Participants** – The market participants as defined in the Market Rules.
30. **Market Rules** – The National Electric Power Regulatory Authority (Market Operator Registration, Standards and Procedure) Rules, 2015.
31. **Manpower Transition Program** – The transition phase through which WAPDA employees were transferred to DISCOs.
32. **Memorandum of Agreement** – The agreement dated April 14, 1999 between WAPDA and PEPCO.
33. **NEPRA Act** – Regulation of Generation, Transmission and Distribution of Electric Power Act, 1997.
34. **NEPRA Licensing Distribution Rules** – National Electric Power Regulatory Authority Licensing (Distribution) Rules, 1999.
35. **Novation of ESA** – Novation of ESA through which WAPDA was substituted by NTDC, executed in 1999.
36. **Operation and Development Agreement** – Operation and Development Agreement executed between WAPDA and DISCOs at the time of corporatization.
37. **Operational Audit Report** – The report dated April 2011 of IRG.



38. **Pakistan Power Sector Reform Objectives of GOP** – The objectives of GOP in relation to reform of the Pakistan Power Sector leading to privatization of the sector.
39. **Power Pool** – The generating units from which NTDC may procure power on behalf of the DISCOs.
40. **Power Purchase Agency Agreement** – The power purchase agency agreement signed between CPPA-G and each of the DISCO, separately, in 2015.
41. **Public Sector Corporate Governance Rules** – Public Sector Companies (Corporate Governance) Rules, 2013.
42. **Reform Plan** – The plan and framework envisioned in furtherance of the Pakistan Power Sector Reform Objectives of the GOP.
43. **Service Territory** – Territory defined in licenses of DISCOs.
44. **SGV Work Program and Methodology** – Final report of consultants pertaining to WAPDA-CCP, rendered in October 1998.
45. **Share Capital Allotment Agreement** – Share Capital Allotment Agreement between WAPDA and DISCOs in July 2010.
46. **Transfer Price Mechanism** – The mechanism which was determined by NEPRA in NTDC’s tariff determination for 2012-13<sup>81</sup>, notified vide S.R.O.886(I) / 2013<sup>82</sup>.
47. **NTDC Transmission License** – Transmission license granted to NTDC by NEPRA on December 31, 2002.
48. **WAPDA-CCP** – Corporatization / Commercialization of WAPDA and its Existing Assets Blocks, a project initiated by WAPDA.
49. **WAPDA-CCP Services** – Terms of Reference of contract awarded for WAPDA-CCP services.
50. **WAPDA’s Power Wing** – The components of WAPDA involved in generation, transmission and distribution of electric power.

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<sup>81</sup> July 19, 2013

<sup>82</sup> September 24, 2013



# ANNEXURE – II

## LIST OF KEY LAWS, POLICIES & GUIDELINES

### STATUTES

1.	The Electricity Act, 1910
2.	The WAPDA Act, 1958
3.	Banking Companies Ordinance, 1962
4.	The Constitution of Pakistan, 1973
5.	The Companies Ordinance, 1984
6.	The NEPRA Act, 1997
7.	Securities and Exchange Commission of Pakistan Act, 1997
8.	Pakistan Environment Protection Act, 1997
9.	Insurance Ordinance, 2000
10.	Alternative Energy Development Board Act, 2010
11.	Private Power & Infrastructure Board Act, 2010

### RULES & REGULATIONS

12.	Companies (Issue of Capital) Rules, 1996
13.	Tariff Standard & Procedure Rules, 1998
14.	NEPRA Licensing (Application & Modification Procedure) Regulations, 1999
15.	NEPRA Licensing (Distribution) Rules, 1999
16.	NEPRA Licensing (Generation) Rules, 2000
17.	Special Procedure for Collection & Payment of Sales Tax (Electric Power) Rules, 2000
18.	Public Companies (Employees Stock Option Scheme) Rules, 2001
19.	Fine Rules, 2002
20.	NEPRA (Fee pertaining to Tariff Standard & Procedure), Regulation, 2002
21.	Insurance Rules, 2002
20.	Consumer Eligibility Criteria, 2003
22.	NBFC (Establishment and Regulation) Rules, 2003



23.	NEPRA (Resolution of Disputes between IPPs) Regulations, 2003
24.	NEPRA Performance Standards (Transmission Rules) 2005
25.	NEPRA Performance Standards (Distribution) Rules, 2005
26.	NEPRA Interim Power Procurement (Procedure & Standards) Regulations, 2005
27.	The Sales Tax Special Procedure Rules, 2007
28.	NEPRA Competitive Bidding Tariff (Approval Procedure) Regulations, 2008
29.	NEPRA (Review Procedure) Regulations, 2009
30.	NEPRA Fee Rules, 2009
31.	NEPRA Performance Standards (Generation) Rules, 2009
32.	NEPRA (Financial) Regulations, 2010
33.	NEPRA Up-Front Tariff (Approval & Procedure) Regulations, 2011
34.	NEPRA (Procedure of filing Appeal) Regulations, 2012
35.	Public Sector Companies (Corporate Governance) Rules, 2013
36.	NEPRA (Market Operator Registration, Standards and Procedure) Rules, 2015

#### **POLICIES & GUIDELINES**

36.	Power Policy, 1994
37.	Power Policy, 1995
38.	Power Policy, 1998
39.	Power Policy, 2002
40.	Renewably Energy Policy, 2006
41.	New Captive Power Policy, 2009 (N-CPP)
42.	Small Independent Power Projects (2011)
43.	National Power Policy, 2013
44.	Consumer Services Manual
45.	NEPRA Guidelines for determination of Consumer end tariff (Methodology and Process) 2015



# ANNEXURE – III

## I. ENVISAGED COMMERCIAL ARRANGEMENTS

The 1992 Reform Plan contemplated two commercial structures to be considered in the development of Pakistan's power sector:

- a. Vertically Integrated Generation and Transmission. The traditional, vertically integrated Generation and Transmission (G&T) monopoly, either government-owned or a regulated private utility (or group of such utilities in a power pool) that uses centralized command-and-control methods to direct the short run activities of all units on the system. The defining characteristic of the Vertically Integrated Model (VIM) was noted as that G&T monopoly which is virtually the sole buyer of power from generators and virtually the sole seller to distribution or final consumers.
- b. Centralized wholesale power market. This structure envisaged a competitive power market model in which a centralized wholesale electricity market determines the short run actions and compensation of all individual competing units on the system, and a parallel system of bilateral contracts, which defines and allocates the risks and benefits of long-run investments.

The Reform Plan supported the centralized wholesale power market option and the introduction of competitive commercial electricity pricing arrangements. This included:

- a. Application of the principle that a competitive electricity market should reasonably reflect the marginal cost of private electricity with the objective of economic and efficient tariffs, i.e., tariffs based on least cost expansion plan. In order to understand what measures were required, a cost of service study of WAPDA's generating and transmission system was to be conducted.
- b. Based on such study, a methodology for transmission pricing was to be developed, and simple but non-discriminatory transmission and system access charges were initially to be established.
- c. The elimination of subsidies and cross-subsidies and development of a cost reflective tariff structure.
- d. Review and decision-making to be made on key wholesale and retail market rules, i.e., (i) whether bilateral contract between generators and wholesale customers would be allowed; and (ii) whether electricity prices would depend on actual system conditions or a pre-determined time period.



Based on such decisions, pricing and system cost information would contribute to the ultimate design of the proposed wholesale electricity market.

- e. Review and decision-making relevant to distribution and retail supply would be conducted, i.e., methodology for determining distribution charges, and the manner of setting prices for retail customers, which may include pass-through items like wholesale power purchase costs plus regulated distribution system prices.

As a result, the establishment of an independent pricing structure for each segment of electric power service would be required. Assessment of WAPDA's pricing principles for determining transfer prices from generation to transmission, and from transmission to distribution, was therefore conducted in order to develop a methodology that was designed to:

- a. Determine demand and energy charges at which generation entities, including hydroelectric stations of WAPDA and GENCOs, would respectively sell electric power and energy to NTDC, whilst considering production costs and allowing alternative returns on their rate bases or equity.
- b. Determine total costs to NTDC of combined purchase costs of electric power and energy from the said generation entities and the IPPs. [IPPs have existing power purchase agreements with WAPDA defining the demand and energy charges.]
- c. Formulate the design for a basic rate of the demand and energy charges at which NTDC, as an incorporated entity, would affect power transfer between generation and consumers, including NTDC's transmission and delivery costs, allowing alternative returns on rate base, and prescribing the basic rate of NTDC to be charged for its service to the DISCOs.
- d. Develop a tariff model for distribution prices to be used by the DISCOs.

The study was geared toward the formulation of an appropriate methodology to calculate capacity and energy charges for the generation companies (GENCOs) and WAPDA Hydroelectric Stations. A detailed mechanism for calculating these charges was provided in the SGV Work Program and Methodology. Accordingly, the commercial arrangement associated with this methodology was executed in the form of ESA between WAPDA and DISCOs, subsequently modified by way of Novation of ESA in favour of NTDC.



## II. THE POWER MARKET TRANSITION

In view of the envisaged power market structure post-WAPDA Restructuring, NEPRA granted the requisite licenses to the newly incorporated GENCOs, NTDC and DISCOs and determined tariffs for such companies. In the context of transition of the power market from single buyer to competitive market operations, the license granted to NTDC prescribed the benchmarks for the eventual transition.

In view of the limitations and constraints of the conditions in which the Pakistan power sector operated at the time, the GOP determined that the adoption of transitional models for the power market to be implemented in phases would support an evolutionary sector reform process. Adoption of

### Transition Phases of the Power Market

1. Single Buyer
2. Single Buyer Plus (to be in place by July 2004)
3. Competitive Trading Bilateral Contract Market (to be in place by July 2012)

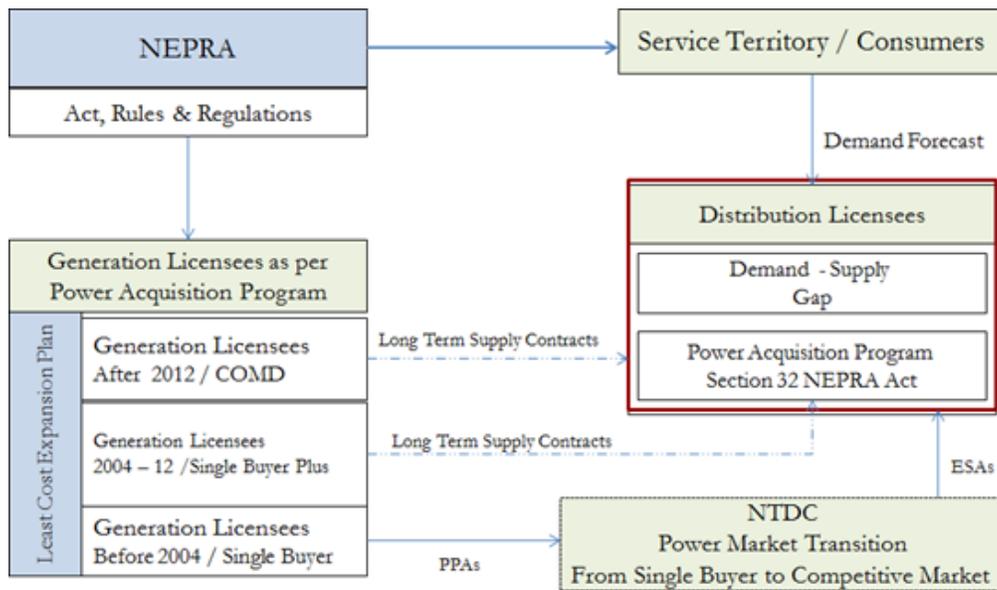
the “Single Buyer Arrangement” was identified as most appropriate for the Pakistan market (i.e., late 1990s, early 2000’s). In February 2002, the GOP accepted “the single buyer power market structure” for a period of 10 years.

Figure 12 illustrates the commercial arrangements and phases of transition from the single buyer to single buyer plus, and thereafter to competitive market operations, as envisaged in the NTDC Transmission License. The benchmark periods included:

- a. The single buyer arrangement would continue until the pre-requisites for transition to the next phase were met to give effect to the single buyer plus arrangement. Such arrangement was to be given effect by July 1, 2004.
- b. The single buyer plus arrangement was to be followed by the competitive trading bilateral contract market by the competitive market operations date, which was set as July 1, 2009. This date could be postponed to a maximum of three years, i.e., the competitive market trading arrangements were to be established at the latest by July 1, 2012.



Figure 12



## I. SINGLE BUYER ARRANGEMENT

The following “market rules” were proposed for the Single Buyer arrangement:

- a. Power distributors would not be allowed to directly negotiate with any energy producers, since it was logical to assume that the distributor would seek out the least cost power generators. A critical issue identified was the GOP’s responsibility to ensure equitable distribution of the country’s resources such that the comparable lower cost of power from WAPDA managed Hydroelectric Stations (as opposed to thermal) should not unduly advantage any particular DISCOs.
- b. Generators would not be permitted to deal directly with any customer, since it was likewise rational to assume that the generator would prefer to serve the DISCO/distributor which was likely to be most profitable.
- c. NTDC would act as both (i) purchaser of power and (ii) seller of power. It would buy power from the generators and place orders using “merit order”.<sup>83</sup> The power would be directly sold by NTDC to the DISCOs, the rationale being that no profit-seeking generator would be willing to serve non-viable DISCOs (such non-viable DISCOs include QESCO and PESCO).

<sup>83</sup> “Merit Order” refers to the dispatch of electric power from generation plants based on dispatching least cost electricity from the generation plants (cheapest to more costly).



- d. NTDC would act as the collection agent for the generators since DISCOs would pay the NTDC for the costs of both power generation and power service delivery.
- e. Under the Single Buyer concept, wheeling charges (i.e., charges to be paid to the distribution company for the use of the distribution network/transmission system for the distribution/transmission of electric power from one specified point to another) would not form part of the transmission tariff.

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## 2. TRANSITION TO A SINGLE BUYER PLUS ARRANGEMENT

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In 2004, NEPRA circulated the Transitional Arrangement Order No. 1 which prescribed the pre-requisites for transition from the Single Buyer to Single Buyer Plus arrangement. Transition Arrangement Order No.1 also directed that such transition should be achieved prior to July 1, 2004 and the following should be accomplished beforehand:

- a. Independent administrative and financial functioning of the GENCOs, NTDC, DISCOs and WAPDA Hydroelectric Stations.
- b. Tariff determination for each of the GENCOs and Hydroelectric Stations of WAPDA.
- c. Determination of transmission, inter-connection and ancillary charges for NTDC.
- d. Tariff determination for DISCOs.
- e. Establishment by NTDC of the: (1) Central Power Procurement Agency (CPPA); (2) Transmission Network Operator; (3) System Operator; and (4) Contracts Registrar Power Exchange Administrator.

The NTDC Transmission License also specified a similar arrangement for transition of the power market from the “Single Buyer” to a “Single Buyer Plus” arrangement, to be established no later than July 1, 2004.

Article 8(3) of the NTDC Transmission License envisaged that NTDC would continue to participate in the trading arrangements (and commercial codes) i.e. the Single Buyer arrangement, in its capacity as System Operator to give effect to the Single Buyer Plus trading arrangement by July 1, 2004. It would carry out the same functions and be governed by the same codes under the Single Buyer Plus arrangement and this would continue for the transition period until complete establishment of the market, which was to be pursuant to a competitive trading bilateral contract market implementation plan.



Article 8 of the NTDC License stipulated that NTDC would comply with directions and instructions of NEPRA to move toward, and facilitate the establishment of a “Single Buyer Plus” market arrangement. In this context, NTDC was required to – and did in part – establish four departments:

1. Central Power Purchasing Agency (CPPA) for the procurement of power on behalf of the government-owned DISCOs;
2. System Operator (SO) for the safe and reliable operation, control, switching and dispatch of transmission system and generation facilities and provision of balancing services;
3. Transmission Network Operator (TNO) for the operation and maintenance of transmission system, including planning, design and capacity expansion of its transmission system, generation expansion, least cost planning and siting of new generation facilities; and
4. Contract Registrar and Power Exchange Administrator (CRPEA) for recording and notification of contracts and other matters of bilateral trading between generators and distributors and Bulk Power Consumers (BPCs),<sup>84</sup> and between the generation licensees and the DISCOs for their future needs. The CRPEA was also intended to handle a financial settlement system in close coordination with the SO for the balancing market and for differences arising with CPPA.

NTDC issued an office order dated July 26, 2004 confirming that the Board of Directors of NTDC, as per the terms of Article 8 of the NTDC Transmission License and Transitional Arrangement Order No.1, had approved the organizational structuring of NTDC as specified above.

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### 3. SINGLE BUYER PLUS ARRANGEMENT

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The “Single Buyer Plus” arrangement envisages the Single Buyer (NTDC/CPPA) performing its role of procuring power for the DISCOs with the added option (“plus”) for the generating companies to directly contract with DISCOs. The framework for the Single Buyer Plus arrangement was as follows:<sup>85</sup>

- a. Establishment by CPPA of the sale rate during a billing period (to be progressively reduced from a monthly to ½ hourly period) as the weighted average sale rate of all the power generating stations used during the billing period, with capacity and energy charges calculated separately. The transfer capacity and energy charges were to include the transmission charges to the generation weighted average sale rate.

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<sup>84</sup> Means a consumer who purchases electric power at one premise for amount, voltage level and other characteristics as determined by NEPRA.

<sup>85</sup> Per Transitional Arrangement Order No.1 of NEPRA.



- b. The contract registrar and power exchange administrator to maintain a register of all contracts between generation licensees and the DISCOs or the Bulk Power Consumers, in addition to the existing contracts which formed part of the power pool.
- c. The power exchange administrator to be responsible for the settlement of the Single Buyer Plus payment arrangements.
- d. New generation companies to have the option of contracting with CPPA for additional power supply to DISCOs or to directly contract with any new DISCOs or BPCs.
- e. The power generators, contracting to sell electric power to DISCOs or BPCs, in accordance with the terms of the power purchase agreement and with NEPRA approval, may supply part or whole of their generated power to distribution companies or the BPCs, as applicable, through bilateral contracts, i.e., contracts for direct sale to the DISCO or BPC.

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#### 4. TRANSITION TO COMPETITIVE TRADING BILATERAL CONTRACTS MARKET ARRANGEMENT

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The Reform Plan and NTDC Transmission License prescribed that a competitive trading bilateral contract market (CTBCM) was to be established and made operational at the latest by July 1, 2012 (CMOD) by which time the following would have been achieved:

- a. Development of market arrangements to facilitate bilateral contracts for the direct sale of electric power to the DISCO or BPC by power producers.
- b. NTDC would have designed a competitive trading bilateral contract market implementation plan (CTBCM Implementation Plan) in consultation with all authorized electricity operators<sup>86</sup> and BPCs, with NEPRA's approval. This plan was to set out the steps to be taken by NTDC and/or authorized electricity operators and BPCs that, in the opinion of NEPRA, were found to be appropriate in order to assist development of competitive market and which gave full and timely effect to:
  - i. Any order issued by NEPRA for moving towards a competitive trading bilateral contract market.

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<sup>86</sup> Other than NTDC, any person authorized by NEPRA to use the transmission system of NTDC, through a license or otherwise.



- ii. Amendment of applicable documents including NEPRA rules and regulations, Grid Code, Distribution Code or other documents issued under them.
- iii. Confirmation of indemnity against liabilities pursuant to the single buyer plus trading arrangements.
- iv. Implementation of the CTBCM Implementation Plan and the Single Buyer Plus arrangement.
- v. Referral of any dispute to NEPRA for settlement, in respect of matter covered by the CTBCM Implementation Plan.

Article 20 of the NTDC Transmission License stipulated that NTDC would establish a settlement system for the calculation of any outstanding amount to be paid or received by licensees and authorized electricity operators in respect of sales and purchases of electricity, in accordance with the trading system in operation.

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## 5. COMPETITIVE TRADING BILATERAL CONTRACT MARKET ARRANGEMENT

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The third and final transition phase for the Pakistan power market contemplated an open and bilateral contract market in which power producers / generators would be directly selling to DISCOs and BPCs. The DISCOs would procure power in accordance with NEPRA-approved power acquisition programs through contracts, which would have the effect of reducing the role of the single buyer (NTDC/CPPA).

The NTDC Transmission License does not allow NTDC to procure or purchase power for the purposes of sale to third parties in this final market arrangement. Instead, it is only permitted to procure power to the extent required for providing balancing services for the provision of a safe and reliable transmission system. However, all contracts for power procurement approved by NEPRA prior to the competitive market operation date (CMOD), and contracts backed by sovereign guarantee, would continue to remain in force until expiry of their contractual term.

In the context of the CMOD and its implications envisaged in the NTDC Transmission License, other important provisions of the NTDC Transmission License are as follows:

- a. The NTDC Transmission License specifically caters for the distinction between the trading arrangement under the single buyer model and the CTBCM. As an illustration, reference is made to Article 15, which differentiates between the transfer price methodology for, prior to, and subsequent to the CMOD.



- b. The distinction in methodology for such distinctive trading arrangements is also stipulated for the commercial code under Article 23 of the NTDC Transmission License.
- c. Similarly, the dispatch criteria set out in Article 20 also carves out dispatch mode under the CTBCM from the doctrine of economic dispatch for all generating units.

In the context of developing the competitive trading bilateral contract market, the regulatory regime, particularly for generation licenses of the Hydroelectric Stations of WAPDA, GENCOs and the IPPs, stipulates that the licensee shall implement measures directed by NEPRA for the development of competitive trading arrangements and in the manner and time period specified by NEPRA. The generation licenses also stipulate that such requirement applies to:

- a. Any contract entered into by and between the licensee and another party prior to the enactment of the NEPRA Act, the performance of which is guaranteed by a sovereign guarantee provided by the GOP.
- b. Any contract entered into by and between the licensee and another party subsequent to the enactment of the NEPRA Act and another party with the approval of NEPRA.

However, the generation licenses specifically state that any variation or modification in any power purchase agreement is subject to mutual agreement of both the parties and NEPRA approval.

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