Power Sector Solutions Brief - 3

b. Medium Term Measures aim is to Optimize Electricity Tariff to 8-9 cents

1. Privatization, Homegrown Improvement and Governance of DISCOs

- Background
    - Denationalization Policy was initiated in 1978
    - The government was and is committed to bring itself out of the business of running businesses and this creating space for private sector to play a vital role in development process in realizing the dream of a prosperous Pakistan
    - In FY23, SOEs gross revenues reached Rs 11,922 bn, aggregate profits were Rs 703 billion, while loss-making SOEs reported an aggregate loss of Rs 905 bn, up 23% from last year, resulting in aggregate net losses of Rs 202 bn, reflecting a 25% increase from the previous year. The book value of assets reached Rs 35,218 billion, up 16%, while liabilities also increased to Rs 29,721 bn, up 20% indicating higher financial leverage. Consequently, net equity stood at Rs 5,496 bn, down 2.55%.
    - The Government of Pakistan provided aggregate support of Rs 1,021 bn in form of Equity Injections Rs 267 Bn , Grants Rs 223 Bn, Subsidies Rs 403 Bn, and Loans Rs 128 Bn to sustain these SOEs and support the economy. However, this support represented more than 10% of the federal budget's receipts, indicating significant fiscal strain.
    - Currently, 87 commercial companies are operating in government departments, sources said. Federal ministries have recommended not privatizing 39 government commercial companies.
    - The Power sector, particularly on the DISCO side, continued to be dominated by loss-making entities. Aggregate losses on power side totalled Rs 304 Bn despite the fact that Rs 759 Bn was spent supporting this sector.
    - Substantial working capital lock-up due to aged receivables and payables throughout the SOE chain, leading to a circular debt exceeding Rs 4 trillion. Additionally, operational inefficiencies in the power sector continued to negatively impact SOE profitability with spill over effects all across the chain.
    - Government would limit its business only to strategic and essential SOEs under its domain.

- Measures to alleviate impact of heightened capacity charges, it is crucial to implement technical cost-reduction measures/plans for reduction in T&D and bill recovery losses that contribute to escalation of circular debt; both tied with strong performance accountability of MoE
  - SOE (Governance and Operations) Act 2023 and now Amendment Ordinance 2024, SOEs C Level Appointments Guidelines 2024 is reflective of inability (despite knowing the need, criticality and yearly burden) and delay to implement reforms
- A game changer solution requires building on privatization success stories in banking and K-Electric by reducing number of DISCOs thru merger, handing over to provinces and vertically integrating with IPPs vs implementing in house measures by appointing CEOs and BODs
  - The privatization of a vertically integrated utility (KE), which includes the distribution and supply of electricity, marked a pioneering step in Pakistan's energy sector.
  - Initially hailed as potential role model for future privatizations, it has encountered challenges from very beginning for reasons including but not limited to ad-hoc arrangements.
- These circumstances raise questions regarding the efficacy of the privatization endeavor.
  - Regrettably, the anticipated benefits have not been fully realized, posing concerns for all stakeholders, including the national exchequer and the electricity consumers.
  - A through reevaluation is imperative to ensure privatization aligned with its intended objectives and to provide substantial relief to all concerned parties.
- The NEPRA Amendment Act, 2018 has also entirely changed the concept of DISCOs' exclusivity to distribute electricity to consumers in their respective service territories.
  - Continuity of those inefficiencies, which were accumulated earlier by DISCOs, cannot be allowed as such, with their new roles under the Amendment Act, 2018.
- Per State of Industry Report 2019
  - "The real dilemma of the sector is that due to continued centralized control at every level, the DISCOs tend to seek shield against any measure, which leads to competition and opening of the sector".

- Since years, government has been considering privatising public Discos under different modes. It is about time the government finalizes an approach instead of current thinking
    - Three phase based 2024-29 for privatization of DISCOs calls for three entities i.e. HESCO, PESCO and SEPCO will be offered for long term concession while six entities, IESCO, FESCO, GEPCO, LESCO, MEPCO and HAZECO will be completely privatized through sale. Faisalabad, Islamabad and Gujranwala electric power companies will be privatized in the first phase, while Lahore, Multan, Peshawar, Hazara, Sukkur and Hyderabad electric supply companies will be privatized in the second phase with two to be retained
    - And 4 government power generation companies will be privatized in phases as well
- Persisting with this model may only reinforce the failure.
    - Therefore, for any recovery of the sector, DISCOs have to be made independent, while total or partial privatization of DISCOs undertaken forthwith.
    - It requires restructuring and in country solution as privatization continues to fail
- *This necessitates Structural Change by reviving 'PIDC' to undertake disruptive measures inside the box and catalyse SOEs disinvestment over a 5 year time period possibly under P3 mode.*
    - PIDC having an independent Board of local and external professionals only, Chairman with strong experience and academic credentials with rank of Deputy Prime Minister/Senior Minister reporting to PM and operating on lines of Saudi Arabia's Public Investment Fund, Qatar's Investment Authority, Emirates and Abu Dhabi Investment Authority, Norway Wealth Fund etc. is a must.
    - Barrick's request for confirmation by Parliament and SC of its agreement highlighted concerns that needed mitigation and Board and its decisions are to be protected under Foreign Investment (Promotion and Protection) Bill, 2022.
- The proposition requires an enabled and empowered PIDC to manage commercial assets, consolidation of government shareholding and roles, undertaking aggressive transformation, reduction and merger of departments/companies with mandate to disinvest *over a 4 year time period possibly under P3 or other mode.*
    - GOP share holding of commercial SOEs are categorized into eight distinct sectors of Financial, Oil & Gas, Power, Infrastructure Transport & ICT, Manufacturing Mining &

Engineering, Industrial Estate Development, Trading & Marketing, and Miscellaneous be placed under PIDC (non strategic) and sorted by similar functional firms into vertical holding companies e.g

- E&P, Fertilizer, Gas Utilities and Coal;
- OMC, Refinery;
- Mineral;
- Manufacturing and Industry;
- Power Generation, DISCOs and Transmission;
  a. Deliver minimum ROE of 15%, ROA of 5%, ROCE of 2% above its WACC and Current ratio of 1.5%
- Media, Communication and Digital Solutions;
  a. Merger of PITC and PRAL with induction of private sector IT firm(s) under 3P to manage services and digitalization in GOP
- Logistics, Supply Chain and Services;
- Engineering, Conservation, Urban and Rural Development and SEZs;
- Circular Debt, Pension, Wealth and Development Fund;
- Product Development, Marketing and Trading;
  a. The SOEs introduce products and services into local and international market by aggressive development and improvements to existing ones by collaboration of engineering industry under a revitalized EDB (rebranded as Innovation and Technology Development) merged with NEECA
  b. EDB facilitate vocational institutes and engineering universities to developed skilled resources
  c. And collaboratively build on strengths of defence production industry and other industry, increase exports of engineering goods, auto and tractor exports.

2. Regulatory Measures by NEPRA via CPPA-G

- Implement measures to enhance operational efficiency of power plants and minimize part load operation
- No tariff cross subsidy with one uniform tariff charged across the country and difference paid directly by GOP thru budget; similarly, no cross subsidy amongst DISCOs
- Expedite multi-buyer/seller market setup; evolve competition with liberalization and deregulation of sector ensuring GOP out of Power business

- FCA be determined for 6 months (as done for gas sector) to avoid monthly determinations and aim to give credit to consumer every quarter

3. *GOP*

a. *MoEnergy*

- Increasing demand by industry, ensuring conservation by all users, integrated planning and accountability of measures will contribute in reducing capacity payments and imported fuel bill
- IGCEP 2023-24 and TSEP are based on projected 10 year scenarios and necessitates review of basis as solar is gaining momentum and be redrafted as an integrated document
- Peak demand be based on next 3 years of GDP growth projections of IMF including for 2024-25 and that be taken as basis for 1+ 3 year revolving plan; 5+10 year revolving plan be based on loner term projections
    - Consumer tariff (CPP+EPP) projections be made part of the document based on impact of investment planned
    - Renewable Energy power plants be allowed to participate in the wholesale electricity market/CTBCM as merchant power plants
    - Expired PPAs and those expiring not be given any extensions. Their contracts be extended under "no electricity, no payment" model. NTDC's 7228 MWs are to be retired
        i. 2020MWs of GENCOs, 1300MWs of KAPCO operating due network constraints and 3908 MWs due to PPA expiry including HUBCO between 2027 and 2034
        ii. And 1102 MWs of KE due PPA expiry between 2025 and 2033
        iii. With addition of 3 solar projects (150MWs) and removal of Kot Addu power plant (1336MW) due expiry of PPA, installed capacity in FY 24 is of 40,281MW vs 41.460MW in FY 23
        iv. Implement of solar, coal and nuclear repowering initiatives for expensive GENCOs e.g Lakhra, Jamshoro, Multan, Muzaffargarh, and Faisalabad under 3P
        v. Effective energy conservation and efficient equipment development under lead of NEECA, PEC and EDB facilitating (as a merged entity) to catalyze forced energy conservation
    - Resulting in reduced capacity addition by PPIB

- Catering for electricity consumption dropping to 7-9pc in '23 and 2% in 2024.
    - Start to deliver only electrons and LPG to residences, captive be offered LNG and indigenous gas be utilized by power and industry based on performance based incentives
- Average fuel cost is down by 6% to Rs 8.8/Kwh vs Rs. 9.3Kwh in FY23 and reflects result of decision takers bringing a shift in the energy mix
- 45% generation from Coal, RLNG and Gas at Rs 17/ unit necessitates critical review of present Procurement Strategy
    - Coal prices have declined to Rs 12.9 per unit due to 47% decline in international coal prices till using local Thar Coal in imported plants
    - LNG price opener in 2026 with move to buy from spot like oil
    - Nuclear, RE, Hydel, Net Metering evaluation of tariff impact on our energy mix, capacity payment and
- Consideration in parallel of
    - Merit order being changed to CPP+EPP and not EPP only
    - And transmission and distribution network expansion plans

b. *Provincial Governments*

- Current criteria of free panels based on units needs reconsideration including abuse of installation in urban areas requires judicious control
    - Rs 7bn by Punjab, 200k solar home systems FY20 for rural of grid households and FY25 200k with WB and rest 300k themselves, USD 100m for Sind Solar Energy Project, solarise 29 government hospitals at cost of Rs1.2 billion
    - Instead initially defaulter PMT areas be provided solar panels, AMR, Prepaid Meters and
    - Focus be on off grid development in rural tehsils be phased in over 5 years (39 divisions with 166 districts at an average of 4 to 5 tehsils per district each having 8 to 12 union councils with 10 to 12 wards in each union council)