



# Project Finance and Guarantees

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Resource Mobilization and Cofinancing Vice Presidency  
Project Finance and Guarantees Group

## World Bank Guarantee Catalyzes Private Sector Investment for Uch Power Project In Pakistan

### Project Overview

*“Because of the relatively large financing of the Uch Power Project, the participation of the Bank and IFC were critical to the mobilization of private sector finance. The Uch Power Project promotes private sector participation in the power sector and will help alleviate electricity shortages through the efficient use of domestic resources”, Richard Frank, World Bank Managing Director.*

The Uch Power Project is the first Partial Risk Guarantee operation since the mainstreaming of the Bank's Guarantee Program in 1994, and the second such operation after the Hub Power Project. The Project has been precedent setting in terms of a Bank Group approach to the financing of infrastructure projects. This landmark collaboration between the Bank and IFC demonstrates the way both institutions are able to leverage their respective strengths for the benefit of the client country. The Bank's partial risk guarantee helped mobilize a US\$75 million syndicated commercial bank loan for a 15 year term - the longest maturity to date for a commercial financing for Pakistan. In conjunction with the guarantee, a US\$10 million World Bank loan was provided through the Private Sector Energy Development Fund (PSEDF), set up in Pakistan in 1988, which helped to catalyze funding from bilateral donors of around US\$188 million. The IFC, on its part, was able to mobilize the largest IFC 'B' loan for Pakistan of US\$75 million. Both the Bank and IFC worked as part of a Project team along with the lenders and sponsors which enabled them to operate well within the Sponsor's timetable for Financial Closure.

The Project, which consists of a gas-fired conventional combined cycle plant with an installed capacity of 586 megawatts located in Pakistan's Baluchistan Province, will be implemented on a Build-Own-Operate (BOO) basis. Due to the relatively large financing requirement of US\$ 690 million (including standby finance), the participation of both the Bank and IFC was critical to the mobilization of \$530 million in long-term debt finance. All potential sources of funds in the form of export credits and IFC 'A' and 'B' Loans had been maximized prior to an approach to the Bank, as 'lender of last resort' to help catalyze the funding of the balance of the financing requirement through the Bank guarantee. Uch reached financial closure in May 1996 and construction is expected to be completed by December 1997.

The power generated will be sold to the Water and Power Development Authority (WAPDA) on the basis of a twenty-three year Power Purchase Agreement (PPA). The power station will use low Btu-gas from the nearby Uch gas field to be supplied by the Oil and Gas Development Corporation (OGDC), the national oil and gas company, on the basis of a twenty-three year Gas Supply Agreement (GSA). Under the terms of the agreement, OGDC will be responsible for developing the Uch field as well as supplying the natural gas to the plant through a 50-km pipeline. Among power projects in Pakistan, this Project is unique in that it will rely entirely on a plentiful, indigenous fuel source. The Uch field was discovered in 1955 but abandoned because of the low energy content of the gas. Technological improvements in gas turbines over the last 20 years have enabled them to run reliably on low-to-medium-Btu gas, and in the mid-1980s interest was rekindled in developing the Uch field. As the Project will utilize indigenous gas with no alternative economic use, it is considered by the Government as a priority Project. This is also consistent with the Bank's country assistance strategy for Pakistan, as it will not only alleviate electricity shortages through the efficient use of domestic resources but will promote private sector participation, thereby reducing reliance on the Government's scarce budgetary resources.

### Sector Background

Since the mid-1980's, Pakistan has taken vigorous steps to reform and develop its energy sector as developing Pakistan's energy sector is critical to the country's economic growth. The Bank and the IFC have worked together with the Government in defining a greater role for the private sector in the country's power generation, transmission, and distribution activities. The Government's far-reaching institutional and policy reform program includes: creating new institutions to encourage the

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*"This financing package demonstrates how the Bank and IFC, working together, can effectively combine their strengths to catalyze private sector power and infrastructure investments", Per Ljung, Chief of Energy & Project Finance Division in the South Asia Department.*

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construction of power plants by the private sector, promoting energy conservation, reforming energy prices, and restructuring of the sector entities. Opening up the sector to market forces and involving the private sector have resulted in:

- Hub (1,292 MW): Pakistan's first private power generation project, which recently commenced operation.
- Eleven private power projects, with an aggregate capacity of over 3,000 MW, have reached financial closure during the past year;
- The restructuring and unbundling of WAPDA's generation, transmission, and distribution facilities is taking place;
- The sale of a controlling 26 percent equity stake in the 1,600 megawatt Kot Addu power plant to National Power of the UK has been approved by the Cabinet;
- Financial advisors have been appointed for the sale of the Jamshoro power plant, the Faisalabad Area Electricity Board, and the Karachi Electricity Supply Corporation; and
- The creation of National Electric Power Regulatory Authority.

## Project Background

The Government of Pakistan (GOP) issued a Letter of Support in 1991 and authorized the Sponsors to proceed with project development. In 1992, the Sponsors invited proposals from leading international gas turbine equipment suppliers, on the basis of which GE was awarded the EPC contract, particularly because of GE's experience with turbines which burn low-to-medium Btu gas. GE subsequently brought in the Harbin Companies ("Harbin") of China to form a consortium for both the power plant and a housing colony. A special purpose company, Uch Power Ltd. (UPL) was incorporated in Pakistan in July, 1994 to own and operate the Project. The Sponsors described below are equity investors in the company:

- Midlands Power International - MEP is a wholly-owned subsidiary of Midlands Electricity plc, a UK-based Regional Electricity company which has a 40% stake in UPL and is the largest shareholder.
- General Electric Capital Corporation (GECC) - GECC is a diversified financial services company, wholly-owned by General Electric Company of the US, and has an 18.4% of equity interest in UPL.
- Tenaska Inc - Tenaska, the lead developer of the Project, is a privately owned company based in Omaha, Nebraska and specializes in developing, designing, financing, owning, and operating cogeneration and independent power projects with a 30.3% share ownership in UPL.
- Hawkins Oil & Gas Incorporated of the US - Hawkins, an independent oil and gas exploration and services company, has 8.5% share ownership in UPL.
- Hasan Associates pvt Ltd. of Pakistan - A private development and construction company has a 2.8% shareholding in UPL.

## Financing Structure

The Project is estimated to cost around US\$690 million, including contingencies of US\$60 million. The financing plan for the Project is based on a 20:50:30 equity: subordinated debt: senior debt ratio. Subordinated debt will be provided to GOP, to be earmarked for onlending to the Uch project through the PSEDF. The senior debt will comprise of a commercial loan guaranteed by US Eximbank, IFC 'A' and 'B' loans and a commercial loan to be supported by the proposed Bank guarantee. This was the first Bank guarantee operation co-financed with US Eximbank which has provided a Guarantee to commercial lenders for the construction period and 'take-out' financing following commencement of commercial operations. The Lead Arranger and Underwriters of the Senior Debt Facilities are ABN AMRO and Deutsche Bank (Asia Pacific), Ltd, who successfully syndicated the US Eximbank Facility, the Bank guaranteed Facility and the IFC 'B' loan as part of the same financing package to a group of international banks. Details of the financing plan are given below.

## Contractual Framework

The security structure for the project consists of a set of contractual agreements which defines the rights and obligations of the major participants in the project. The Project related risks such as completion and operation risks, including the gas reserve risk, will be borne by the sponsors and the lenders as well as the natural force majeure risks other than those related to either WAPDA and OGDC. Sovereign or political risks are assumed by the GOP and its agencies and are backstopped by the Bank's Guarantee. These risks are identified and allocated through the Project's contractual framework, which comprises of the following main agreements:

- The Implementation Agreement (IA) between UPL and GOP was signed on November 19, 1995. The GOP Guarantee of the payment obligations of WAPDA under the PPA and of OGDC under the GSA constitutes an Annex to this Agreement. The IA grants UPL the right to implement the Project and extends certain concessions to the Company as well as defines each party's responsibility during the construction and operation phases of the project.
- The Power Purchase Agreement (PPA) between UPL and WAPDA was signed on November 23, 1995 by which WAPDA undertook to purchase the capacity and energy output of the Project for a period.
- The Gas Supply Agreement (GSA) between UPL and OGDC was signed on November 2, 1995, which provides for the supply of gas from the Uch gas field to the Project for a period of 23 years.
- The Engineering Procurement and Construction Contract (EPC) between UPL and subsidiaries of GE and of Harbin Companies of China was signed on February 10, 1996. The EPC is a fixed price and date certain turnkey contract for the entire project including civil works.
- The Operations and Maintenance Agreement (O&M)

between UPL and the Electricity Supply Board of Ireland, which has the necessary worldwide expertise to operate and maintain combined cycle gas turbine projects, was signed on February 20, 1996. It provides for operation and maintenance of the plant for a 23 year period according to specified terms and technical criteria.

- Loan documentation comprising of: the Common Debt Agreement and the Facility Agreements between UPL, the lenders and their agents; the Project Funds Agreement between UPL, the sponsors, the trustee and the intercreditor agent; and the Intercreditor Agreement between all the lenders, their agents and the intercreditor agent also constitute an integral part of the security package.

## Bank Guarantee

The Bank's Guarantee is designed to be triggered in the event of a debt service default that results from noncompliance by GOP of one or more of its payment obligations as outlined in the Project documents between UPL and GOP or one of its agencies. Specifically, the partial risk guarantee will provide coverage for defaults on scheduled debt service payments of both principal and interest resulting from GOP's failure to meet its payment obligations under the IA and the GOP Guarantee. There are five main categories of risks covered by the Guarantee:

- Breach of contract of governmental entities: GOP's guarantee of payment obligations of OGDC under the GSA and of WAPDA under the PPA
- Availability and convertibility of foreign exchange: GOP's obligations as to the availability and convertibility of payments in foreign exchange under the IA and the GOP Guarantee in support of the PPA and the GSA
- Changes in law in Pakistan: Any change in Pakistan law (including Sharia'a Law) which would cause GOP or UPL to be unable to fulfill their obligations or the lenders to enjoy or enforce their rights under the project agreements
- Force Majeure events: These cover political events within Pakistan, and natural force majeure events affecting WAPDA and/or OGDC; and
- Other GOP events of default: These cover events such as expropriation, creeping nationalization, and/or acquisition of a controlling interest in UPL.

The Bank's Guarantee support is enshrined in a Guarantee Agreement with the lenders which outlines the scope of the Bank's risk coverage and defines the trigger mechanics of the Bank's Guarantee. In parallel, the Bank has an Indemnity Agreement with GOP, under which GOP counter-guarantees the Bank for any payments made under the Guarantee Agreement. A counter-guarantee is a requirement of the Bank's Articles of Agreement. The Bank's US\$75 million commitment under the guarantee is recorded at

100% of its nominal value in the lending program as the Bank's risk coverage extends to the whole loan amount, albeit for certain specified risks as outlined above.

## Benefits of the Guarantee

The Bank Guarantee fosters partnership with the private sector for the benefit of Governments, Project Sponsors, and Lenders. The Uch Guarantee demonstrates such benefits:

- Helped to mobilize funds for the completion of the Project.
- Catalyzed cofinancings of over US\$600 million, whilst minimizing Bank support to only 11% of total Project Financing.
- Helped to provide long term finance substantially beyond prevailing market terms for the country, with positive impact on tariff levels.
- Reduced financing costs significantly through the credit enhancement.

## Bank Group Role in Pakistan's Private Power Initiative

The role played by the Bank Group through guarantee operations, the PSEDF, and credit enhanced financings by IFC, has been an important factor in Pakistan's success in reaching financial closure over and above its targeted 3,000MW of power project financings. Both the Bank and GOP have benefited from this partnership. So far as GOP is concerned, the regulatory framework has been further developed into the Power Policy Framework with the Private Power and Infrastructure Board as a one-stop window for all project negotiations between project sponsors and GOP. The risk allocation between GOP and the private sector has been refined, on the basis of which model project documents (Fuel Supply, Gas Supply, Power Purchase and Implementation Agreements) have been developed as a framework for GOP support for International Power Producers (IPPs). Given the increased experience of GOP with private power projects as well as the greater familiarity of investors and lenders with the country through the Hub Power Project and IFC-supported financings, the level of guarantee coverage in the case of Uch was reduced in scope, reflecting the more limited contractual obligations of GOP compared with the Hub Power Project. Through greater risk sharing with the market, the Bank was thus able to reduce its level of overall support as well as its guarantee coverage; thereby enhancing the role of the private sector. This was demonstrated by an extension of the term of the Uch financing to 15 years, beyond the 12 year term for the Hub Power Project, and a reduction in Bank support to around 12%, compared to Hub's 23%.

*For more information on the Uch Power Project*

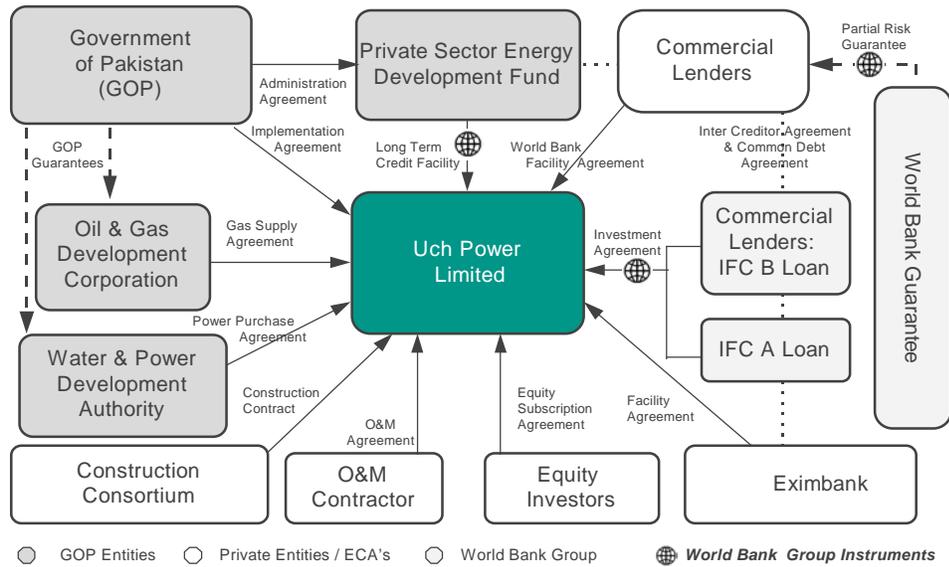
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*"The Uch loan demonstrates that the partial risk guarantee is now a regular instrument of the Bank and several other similar transactions are in the pipeline under this program for countries in Latin America, the Middle East, and South East Asia", Richard Frank, World Bank Managing Director.*

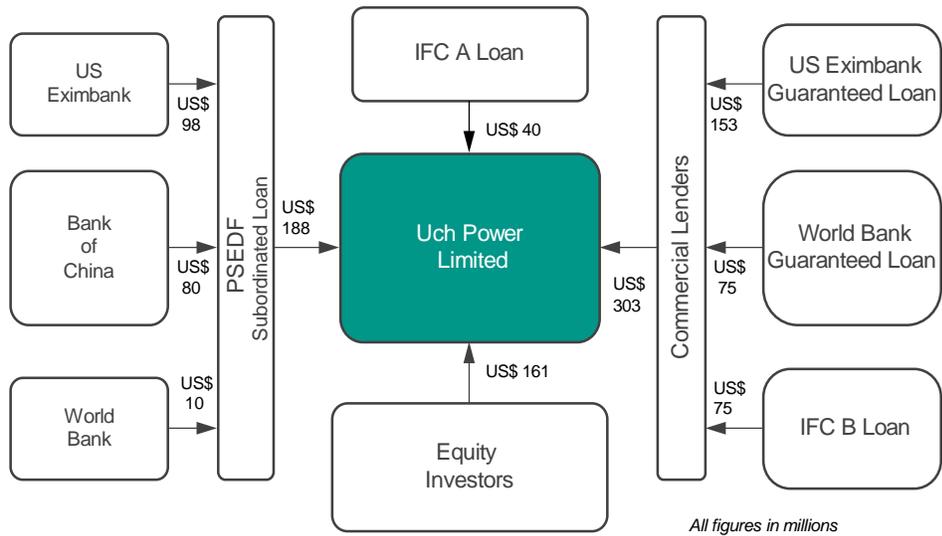
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and the Bank's Partial Risk Guarantee, please contact Farida Mazhar, CAPPF (ext. 31235) or Per Ljung, SA1EF (ext. 81933).

### THE ROLE OF THE WORLD BANK GROUP



### UCH PROJECT FINANCING - (US\$ 690m)



To obtain a copy of the brochure, *The World Bank Guarantee: Catalyst for Private Capital Flows*, please call (202) 473-3045. Please direct editorial comments to Andres Londono, tel: (202) 473-2326.