

1. TRF-83
2. ME

CHAPTER 1
FORMAT OF THE PETITION

Sapphire Electric Company Limited
Petition for Tariff Revision

Rule 3 PETITION

Petition under Rule 3 of the NEPRA (Tariff Standards and Procedures) Rules, 1998 (the "Rules") for revision/modification of the Generation Tariff Determination dated 15 June 2006 as subsequently amended (the "Tariff Petition") of Sapphire Electric Company Limited (the "Petitioner").

Rules 3(2) (a) PETITIONER'S NAME AND ADDRESS

Mr. Shahid Abdullah
Chief Executive Officer
Sapphire Electric Company Limited
7-A/K, Main Boulevard, Gulberg II
Lahore
Tel: +92 42 111 000 100
Fax: +92 42 5713753, 5758783

Rules 3(2) (a) GENERATION LICENSE

Generation License No. IG SPL / 05 / 2006
Dated: 21 June 2006

Rule 3(2) (b) GROUNDS

- a) EPC and Other Costs Associated therewith
- b) Other Issues

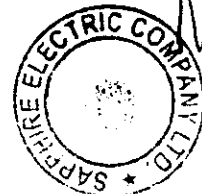
Grounds forming the basis of this Tariff Petition are elaborated in Chapter 2 hereof.

Rule 3(2) (c) RELIEF SOUGHT

Relief sought is mentioned in Chapter 3 hereof.

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AD(2)
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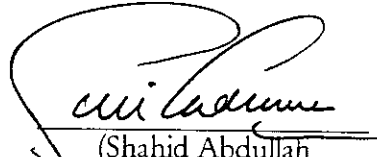
Rule 3(2) (d) **COMPARATIVE SCHEDULE OF EXISTING TARIFF
AND PROPOSED TARIFF**

Tariff tables are attached herewith in Chapter 4 hereof.

Rule 3(2) (f) **SUMMARY OF EVIDENCE (BRIEF PARTICULARS OF
DATA, FACTS, EVIDENCE IN SUPPORT OF PETITION)**

Attached as Annexes hereto.

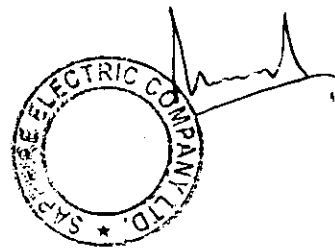
Signed by or on behalf of the Petitioner:

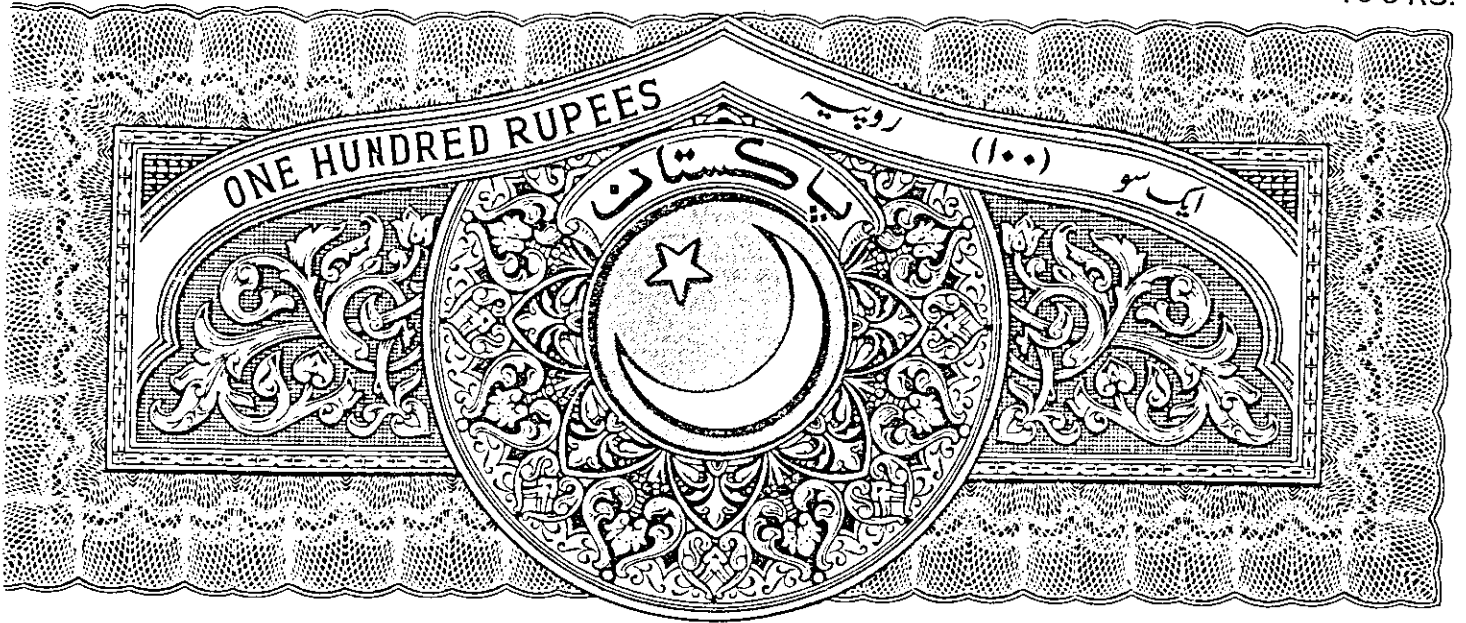

(Shahid Abdullah
Chief Executive Officer)

Dated: September 03, 2007

Attached:

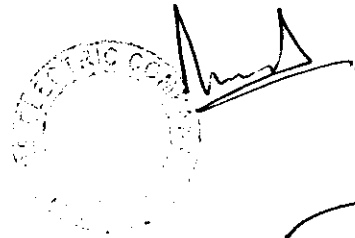
- Affidavit in accordance with Rule 3(8).
- Board Resolution.
- Evidence of Fee.
- Evidence in support of the submissions made in the Tariff Petition.





BEFORE THE NATIONAL ELECTRIC POWER REGULATORY
AUTHORITY

I, Shahid Abdullah, Director, Sapphire Electric Company Limited, being duly authorized representative / attorney of Sapphire Electric Company Limited, hereby solemnly affirm and declare that the contents of the accompanying Tariff Petition for modification of the Tariff including all supporting documents are true and correct to the best of my knowledge and belief and that nothing has been concealed. I also affirm that all further documentation and information to be provided by me in connection with the accompanying petition shall be true to the best of my knowledge and belief.



Lahore
August 29, 2007


DEPONENT



7A/K, Main Boulevard, Gulberg II,
Lahore, Pakistan
Phone: 92-42-111-000-100
Fax: 92-42-5758783-5713753

SAPPHIRE ELECTRIC COMPANY LIMITED.

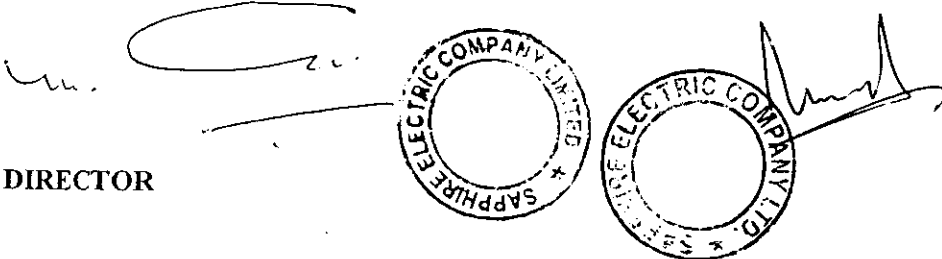
RESOLUTION PASSED BY THE BOARD OF DIRECTORS OF SAPPHIRE ELECTRIC COMPANY LIMITED HAVING ITS REGISTERED OFFICE SITUATED AT 7 A/K, MAIN BOULEVARD, GULBERG II, LAHORE THROUGH CIRCULATION ON 18TH DAY OF JUNE, 2007.

RESOLVED THAT the Company be and is hereby authorized to file revised Tariff Petition under Rule 3(1) of Tariff Standard and Procedure Rules, 1998 with National Electric Power Regulatory Authority (NEPRA).

FURTHER RESOLVED THAT Mr. Shahid Abdullah, Chief Executive Officer of the Company be and is hereby authorized for and on behalf of the Company to sign all necessary documents, pay necessary fee, appear before the Authority as needed and to do all such acts necessary for processing and completion of this Revise Petition.

For SAPPHIRE ELECTRIC COMPANY LIMITED

DIRECTOR



The image shows a handwritten signature in black ink over a circular stamp. The stamp contains the text "SAPPHIRE ELECTRIC COMPANY LIMITED" around the perimeter. To the right of this stamp is another circular stamp, also with "SAPPHIRE ELECTRIC COMPANY LIMITED" around the perimeter, which is partially obscured by a second handwritten signature.

Payee's A/c Only



PKR***2,659,250.00
Habib Metropolitan Bank Ltd.
Lahore Branch
Lahore

HMB/DD0444754
044754 1239
Date: Aug 29 2007

ON DEMAND PAY

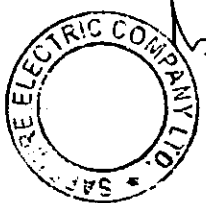
NATIONAL ELECTRIC POWER REGULATORY AUTHORITY A/C OR ORDER
SAPPHIRE ELECTRIC CO LTD.*****

Rupees Two million six hundred and fifty nine thousand two hundred and fifty only

TO
Habib Metropolitan Bank Ltd.
Islamabad Branch(10)
Islamabad

PKR***2,659,250.00

for Habib Metropolitan Bank Ltd



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Authorised Signature
B-256

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Authorised Signature

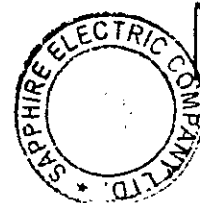
CHAPTER 2 GROUNDS

CONTENTS

1. EPC and other costs associated therewith
2. Other issues
3. Annexes

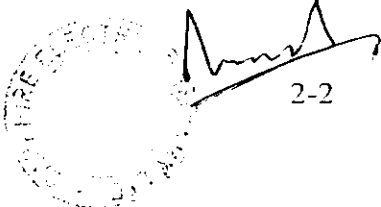
1. EPC PRICE

- a) The Petitioner is only the second IPP in Pakistan which has achieved “Financial Close” under the Federal Government’s 2002 Power Policy, and the first to have achieved this major milestone well before the deadline stipulated in its Letter of Support (the “LOS”).
- b) The National Electric Power Regulatory Authority (the “Authority”) approved the Petitioner’s tariff in June 2006, which was further amended in August 2006 (the “Tariff Approval”).
- c) Immediately after the Tariff Approval, the Petitioner started its negotiations with the three short-listed renowned EPC Contractors (namely, M/s SKODAEXPORT from Czech Republic, M/s Gama Power from Turkey and M/s Doosan Heavy Industries from South Korea). After competitive bidding and due diligence, the Petitioner finalized the “EPC Contracts” consist of Supply Contract (“Offshore Contract”) and Construction Contract (“Onshore Contract”) respectively with M/S SKODAEXPORT Company Limited (“Offshore Contractor”) and M/S Albario Engineering (Private) Limited (“Onshore Contractor”) collectively “EPC Contractors” .
- d) The EPC Contractors were selected on the basis of their respective international reputation and due to the competitive nature of the EPC Contracts vis-à-vis the world-class engineering required for the project. The Petitioner, as a matter of business prudence, did not wish to take any undue risks that may be faced in having an inexperienced contractor and taking chances on the qualitative aspects of the project nor the Petitioner wanted to jeopardize the extremely tight timelines for the Commercial Operation Date (the “COD”). The EPC Contractors are very well recognized and



internationally reputed companies with decades of experience and top-class rankings to their credit.

- e) Since most of the equipment selected for the project originated from first-rate manufacturers from Europe, the Offshore Contractor was eager to sign a Euro-denominated Offshore Contract. In view thereof, since the major portion of the EPC Contract cost consists of the Offshore Contract, a Euro-based contract would have been a logical choice. However, in conformity with the policy guidelines of the Federal Government, the Petitioner was obliged to convert the Euro-based price of the Offshore Contract into a US\$130 million contract at the Euro-US\$ parity of 1.257 prevalent at the time of signing of the Offshore Contract. The Offshore Contract is attached as Annex 1 while Euro-US\$ parity data is attached as Annex 2.
- f) The EPC Contractors, due to very volatile market conditions all over the world, only agreed to provide the validity of the EPC Contract price till 30 November 2006. The EPC Contracts were signed on 17 October 2006 with the agreement that if the Petitioner did not issue the "Notice to Proceed" to the Contractors within the stipulated timeframe, the EPC Contract price was subject to change in accordance with the agreed indexations.
- g) In its resolve to keep the project cost at the bare minimum levels, the Petitioner fought every inch with the EPC Contractors to agree and finalize the reasonable escalation terms applicable to the agreed prices. The indexation formulae agreed between the parties were essentially based on Euro-US\$ parity and the US Producer Price Indices (PPI). The indexation formulae are attached herewith as Annex3.
- h) It is pertinent to mention here that the Petitioner has been generally successful keeping the costs and timelines of its EPC Contracts to pragmatic and commercially excellent limits, especially considering the overall market situation that is being faced by the IPPs throughout the world generally and more so in Pakistan. As it is common knowledge now, the EPC Contractors are not taking any more bookings and the ones who are doing it they do not promise optimistic completion dates and on top of all this, the contractors are demanding the commitment premiums which is, as an obvious result, taking the EPC costs to the very brinks of the same being commercially viable. It may also not be out of place to state that the plant and equipment costs have increased

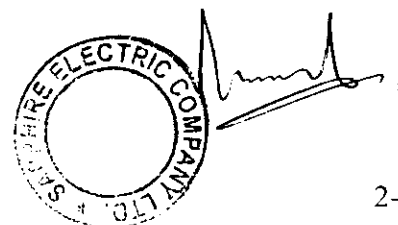

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drastically in the last nine months or so and the contractors as well as the IPPs are finding it extremely difficult to deal with this situation. It was however due to the highest professional commitments of the Petitioner and the gigantic efforts it had to undertake to keep the EPC costs to minimum and still ensure the achievement of RCOB (the PPA-stipulated COB) intact.

- i) It is equally important to appreciate that while the EPC Contracts were being negotiated, the abovementioned situation of the market was not out of sight and the EPC Contractors were fully conscious of the same. It was therefore not possible for the Petitioner to negotiate a longer validity period as the market factors were not ignorable even at that time. However, the Petitioner in order to secure the overall EPC price and the timelines, accepted the aforesaid validity period for the overall benefit of the project which is undeniable especially in the current circumstances when the IPPs are even finding it hard to find EPC Contractors.
- j) At the time of signing of the EPC Contracts the Petitioner was targeting to achieve the “Financial Close” in three to four months. However, due to certain reasons beyond the reasonable control of the Petitioner the delay occurred in finalization of the project agreements. Thus the Financial Close could not be achieved within expected timelines. Had the Petitioner been able to achieve its expected timelines, the EPC Contract price would have remained within reasonable limits, as is apparent from the table below:

Expected EPC Price as on	Revised EPC Contract Price	Total Increase	Increase due to	
			Euro/US\$ parity	US PPI
30-Nov-06	150,575,482	575,482	-	575,482
31-Dec-06	150,929,625	929,625	-	929,625
31-Jan-07	151,505,108	1,505,108	-	1,505,108
28-Feb-07	161,146,899	11,146,899	7,162,790	3,984,109
31-Mar-07	162,520,834	12,520,834	8,226,849	4,293,984
30-Apr-07	169,225,904	19,225,904	11,813,733	7,412,171

- k) The Financial Close was, however, achieved within the time allowed under the LOS. Therefore, the timelines vis a vis achieving Financial Close were within the knowledge of the concerned parties.

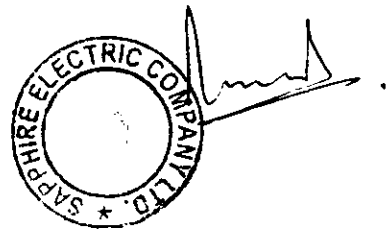


- l) It can be appreciated from the above that the Petitioner had a reasonable expectations of keeping the overall cost of the EPC Contracts fixed or at least very close to US\$150 million (as agreed in October 2006). However, from February 2007 onwards the change in Euro-US\$ parity and US PPI changed beyond all reasonable estimations and therefore the same could have never been expected at the time of application for the tariff determination in 2006 or even at the time of signing of the EPC Contracts. For instance, the Euro-US\$ parity has changed from 1.257 on the date of signing to 1.34 on the date of opening of the Letter of Credit. Whereas, US PPI increased in the range of 2% to 7%. The supporting evidence in this regard is appended at Annex2. After the application of the relevant index values at the time of L/C opening, the revised value of the EPC Contracts stands at US\$166.4 million. The detailed calculation for the final EPC price is attached as Annex4.
- m) Although the EPC Contractors had a legitimate legal claim over the revised cost of US\$166.4 million under the provisions of the EPC Contract, the Petitioner tried its best to restrict the price to a reasonable level. In this regard, the Petitioner held a number of meetings for negotiation with the EPC Contractor, who held back-to-back negotiations with their third party contractors and equipment suppliers in order to limit the EPC price to a reasonable level. Thus after extensive negotiations, the EPC Contractors restricted the Contract price to the value of US\$158.85 million. The Offshore Contract was amended to reflect the revised price, shown in Annex5.
- n) The Authority would also very kindly appreciate the following pertinent facts:
- (i) The Petitioner has demonstrated its genuine concern towards mitigating the prevailing power crisis in Pakistan by making a non refundable down payment to EPC Contractor of US\$3 million for securing the production slot with equipment manufacturers. At that time, the Petitioner took the risk for making such payment to the Contractor from its equity before the Financial Close of the project. Thereafter, the Petitioner made a substantial Advance Payment of US\$22.5 million to the Contractors despite tremendous pressure from the lenders who wanted to resolve the issue of the increased EPC price prior to the opening of the Letter of Credit in favour of the EPC Contractors. Any delay by the Petitioner at that stage could have cost, approximately, additional US\$3-4

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million to the country/consumers, as the Euro-US\$ parity value for instance has gone as high as 1.38 after the date of opening of the L/C.

- (ii) It is also to the credit of the Petitioner that it successfully signed the EPC Contracts whereby the COD has been confirmed by the EPC Contractors. The Petitioner will be one of the first IPPs under the Power Policy 2002 to be operational by the end of July 2009 which would provide significant relief in the context of the power shortage crisis in the country.
- (iii) All variations on account of monetary and market fluctuations were locked on the date of opening of the Letter of Credit and **no further indexation or escalation will be admissible to the EPC Contract price.**
- o) In view of the above efforts and achievements of the Petitioner, the Authority must kindly appreciate that it was commercially prudent for the Petitioner to have agreed the Euro-US\$ parity only till the opening of the L/C under the EPC Contracts. Thus the Petitioner was able to cover the risk of change in the overall EPC costs till COD on account of change in Euro-US\$ parity during the construction phase.
- p) It is therefore most respectfully submitted that the Petitioner deserves the requested relief in all fairness of the overall market situation when compared with the Petitioner's achievements.



2. OTHER ISSUES

- *Withholding Tax calculation on ROE*

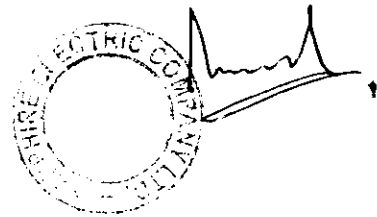
Tax authorities calculate the withholding tax on dividends on a gross-up basis. The tax amount calculated in this way remains on higher side as compared to the amount calculated by direct application of tax percentage to the base amount to be taxed. This apparent disparity between the calculation methods for withholding tax needs to be rectified.

- *Hedging Costs*

As per the direction of the Authority, the Petitioner has not opted for hedging protection against the possibility of cost overruns on account of fluctuations in US\$-Rupee parity. This might eventually affect the debt to equity ratio for the project, as the lenders will not participate into the cost overruns beyond a certain limit.

- *Treatment of SECL Equity*

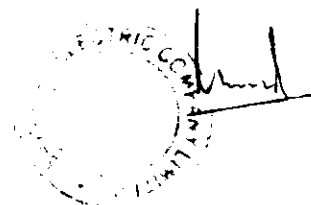
As per Petitioner's earlier Tariff Determination, the Equity allowed for the Project was in foreign currency. We request the Authority to allow us to bring in Local Equity as well as Foreign Equity into the Project.

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CHAPTER 3 RELIEF SOUGHT

In view of the facts and evidences provided herein, the Petitioner prays to the learned Authority to:

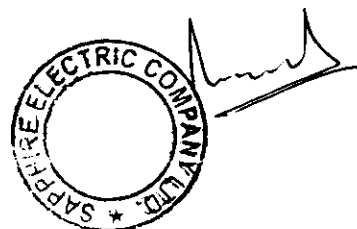
1. Modify the Tariff by increasing the fixed EPC cost to US\$158.85 million, which comprises US\$138.85 million against Offshore contract and the US\$20 million against Onshore contract.
2. The customs duty amount may be changed accordingly by using the mechanism provided in the Tariff Ruling (i.e. 5% of the Offshore Contract price), while any increase in such amount be a "pass through" item to the Power Purchaser.
3. The formula for calculation of withholding tax on ROE be modified to reflect the actual calculation method of the tax authorities.
4. The debt to equity ratio of the project may change from its current value of 75:25 on account of non-availability of hedging cover, as under the financing document the Petitioner will cover the debt gap, which may arise due to change in US\$-Rupee parity. The appropriate change on this account may kindly be allowed at the COD on actual basis.
5. The following indexations recently approved by the ECC be allowed to the Petitioner in addition to the previously allowed indexations:
 - a) US CPI Indexation on Foreign O&M Costs
 - b) ROE and ROE DC receivable on Local and Foreign Equity to be indexed to US\$-Rupee parity
6. The Petitioner would respectfully submit to the Authority that there are few other components of the tariff which require upward revision on account of the circumstances mentioned above. However, the Petitioner has restricted the scope of this Petition to only the most critical elements with a view to limit increase in the overall tariff. Accordingly, all other matters determined by the Authority pursuant to the Tariff Ruling for which no change has been requested herein may remain the same as per the Tariff Ruling.



CHAPTER 4
COMPARATIVE SCHEDULE OF EXISTING TARIFF
AND PROPOSED TARIFF

CONTENTS

- I. Comparative Schedule of Relevant Existing Tariff Costs and Proposed Tariff Costs
- II. Comparative Schedule of Existing Indexation and Revised Indexations
- III. Comparative Schedule of Existing Tariff Table and Proposed Tariff Table

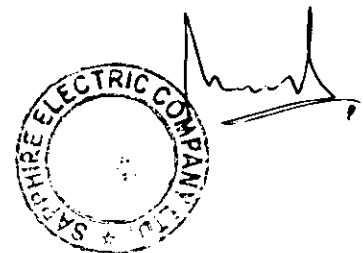


I: COMPARATIVE SCHEDULE OF RELEVANT EXISTING TARIFF COSTS AND PROPOSED TARIFF COSTS

EXISTING			PROPOSED	
1.	EPC Cost	\$143.900M	EPC COST	
			Offshore Contract	\$138.850M
			Onshore Contract	\$20.000M
		\$143.900M		\$158.850M
2.	Non-EPC Cost	\$22.257M	NON EPC COST	\$22.257M
3.	Custom Duties	\$5.037M	Custom Duties	\$6.943M
	Cost Before IDC	\$171.194M	Cost Before IDC	\$188.050M
4.	IDC		IDC	
	<i>To be calculated at COD on Actual basis For Calculation Purposes</i>	\$14.358M	<i>To be calculated at COD on Actual basis For Calculation Purposes</i>	\$15.826M
5.	Cost Including IDC	\$185.552M	Cost Including IDC	\$203.876M

II: COMPARATIVE SCHEDULE OF EXISTING INDEXATION AND PROPOSED INDEXATION

Tariff Component	Existing Indexation	Proposed Indexation
1. O&M Foreign	US\$/PKR	US\$/PKR + US CPI
2. O&M Local	WPI	WPI + US\$/PKR
3. Cost of Working Capital	KIBOR Adjustment	KIBOR Adjustment
4. Insurance	US\$/PKR	US\$/PKR
5. Debt Servicing	KIBOR Adjustment	KIBOR Adjustment
6. Return on Equity	US\$/PKR	US\$/PKR
7. ROE During Construction	US\$/PKR	US\$/PKR
8. Fuel Cost Component	Fuel Price	Fuel Price
9. Variable O&M	US\$/PKR	US\$/PKR + US CPI



III: COMPARATIVE SCHEDULE OF EXISTING AND PROPOSED TARIFF

Tariff Comparison on Operation on Gas Operation

Tariff Component	Existing Tariff	Proposed Tariff
<u>Energy Charge on Gas Rs./Kwh</u>		
Fuel Component	1.7787	1.7787
Variable Component	0.1746	0.1746
<u>Capacity Charge PKR/kW/Hour</u>		
O&M Foreign	0.0652	0.0652
O&M Local	0.0434	0.0434
Cost of Working Capital	0.0163	0.0163
Insurance	0.0637	0.0703
Return on Equity	0.2280	0.2505
ROE during Construction	0.0208	0.0229
W. Tax on ROE	0.0187	0.0222
Debt (for 1-10 Year)	0.7892	0.8669
Average Tariff (in US cent/kWh)	5.2531	5.4213
(in Rupee/kWh)	3.1519	3.2528
Levelized Tariff (in US cent/kWh)	5.9513	6.1882
(in Rupee/kWh)	3.5708	3.7129

Tariff Comparison on Operation on HSD Operation

Tariff Component	Existing Tariff	Proposed Tariff
<u>Energy Charge on HSD Rs./Kwh</u>		
Fuel Component	6.7151	6.7151
Variable Component	0.2520	0.2520
<u>Capacity Charge PKR/kW/Hour</u>		
O&M Foreign	0.0652	0.0652
O&M Local	0.0434	0.0434
Cost of Working Capital	0.0349	0.0349
Insurance	0.0637	0.0703
Return on Equity	0.2280	0.2505
ROE during Construction	0.0208	0.0229
W. Tax on ROE	0.0187	0.0222
Debt (for 1-10 Year)	0.7892	0.8669
Average Tariff (in US cent/kWh)	13.6611	13.8293
(in Rupee/kWh)	8.1967	8.2976
Levelized Tariff (in US cent/kWh)	14.3593	14.5962
(in Rupee/kWh)	8.6156	8.7577