中交产投巴基斯坦电力有限公司
CIHC PAK POWER COMPANY（PVT.）LIMITED

No. CPPC (2023-05) SD-019

May 5th, 2023

R & I Section
National Electric Power Regulatory Authority
Ataturk Avenue (East), G-5/1
Islamabad
5/5/23.
18:45

The Registrar
National Electric Power Regulatory Authority ("**NEPRA**" or the "**Authority**")
NEPRA Tower, Ataturk Avenue-East,
G-5/1, Islamabad

Subject: Addendum to the Tariff Modification Petition filed with the Authority for 300 MW Imported Coal Independent Power Generation Project at Gwadar, Baluchistan (the "Project")

Dear Sir,

This is with reference to the Petition for Modification of the Revised Tariff Determination, filed vide letter No. CPPC (2022-08) SD-047 dated August 25, 2022 ("**Modification Petition**") against the determination by the Authority vide letter No. NEPRA/TRF-434/CPPCL-2018/9802-9804 dated May 31, 2019 ("**Revised Tariff Determination**"), in addendum to which CIHC Pak Power Company Limited ("**CIHC**") would like to submit additional information in support of the submissions within the Modification Petition which, in the Company's opinion, will assist the Authority in a fair and prudent determination against the same.

For reference throughout the rest of the document, please note that the Company initially filed a tariff petition on January 12, 2018 ("**Tariff Petition**") against which the Authority issued its determination vide letter No. NEPRA/TRF-434/CPPCL-2018/19549-19551 dated December 19, 2018 ("**Tariff Determination**"). Aggrieved of the same, the Company filed a motion for leave for review against the Tariff Determination on December 29, 2018 ("**MFLR**"), against which the Authority issued Revised Tariff Determination.

*Tariff Determination and Revised Tariff Determination are attached herewith as "**Annexure A**" and "**Annexure B**". Modification Petition filed with the Authority is attached herewith as "**Annexure C**".*

The additional information against the respective submissions in the Modification Petition is provided below:

Additional EPC Cost Claims

According to a typical bidding process/contracting, price submitted as part of a bid or agreed upon within an EPC contract always has a term of validity. Once the term of validity lapses, any EPC contractor has the right to claim an adjustment to the previously agreed price on account of price escalations and/or design changes, if any, or to terminate the contract. The underlying reasons for the delay in Project development have already been submitted as part of Section II (a) of the Modification Petition.

To date, a Notice to Proceed (NTP) was not issued on account of delays for reasons beyond the control of the Company. The EPC contractor has claimed an adjustment to the EPC price since three years have elapsed from the EPC contract execution date and major events have occurred including but not limited to COVID-19, Russia-Ukraine war, global price hikes, foreign exchange devaluation, imports prohibition, non-availability of FOREX and economic crisis within Pakistan which have had a serious financial impact on the EPC price during this period.

*EPC price adjustment request from contractor is attached herewith as "**Annexure D**".*

In light of the foregoing, the Company requests that the Authority may please rely on its own capital cost adjustment mechanism as approved in vide letter No. NEPRA/TRF-ITTC/2013/7195-7197 dated June 26, 2014 ("**Upfront Tariff**"), which utilizes US Power Producer Indices (PPI) for adjustment of capital cost between any two dates.

As per Clause II (viii) of the Upfront Tariff, 51% of the capital cost was allowed to be indexed to the US PPI for Steel, 38% with US PPI for Electrical Machinery, with no indexation allowed for the remaining 11% of the capital cost. Since the Project's tariff was determined by the Authority in May 2019, the Company has indexed the EPC price allowed by the Authority in the Revised Tariff Determination to the values prevailing today i.e. March 2023. The formula as provided within the Upfront Tariff is reproduced below for reference.

$CC(n) = (CC(o) * 51\% * \Delta ST) + (CC(o) * 38\% * \Delta EI) + (CC(o) * 11\%)$

Where:

$CC(n)$ = EPC Cost at the time of opting the tariff during the validity period
$CC(0)$ = EPC Cost at the beginning of the validity period
ΔSI= Variation in US PPI for Steel i.e. SI (n)/SI(0)
$SI(0)$= PPI Steel at the time of opting the tariff i.e. May 2019
$SI(n)$= PPI Steel for the month of March 2023
ΔEI= Variation in US PPI for Electrical Machinery i.e. EI(N)/EI(O)
$EI(0)$= PPI Electrical Machinery at the time of opting the tariff i.e. May 2019
$EI(n)$= PPI Electrical Machinery for the month of March 2023

After analyzing the data on the fluctuation of the US PPI, as recorded and disseminated by the US Bureau of Labor Statistics between May 2019 and March 2023, the Company computed the adjusted EPC price using the methodology prescribed by the Authority in the Upfront Tariff and as provided below, which results in the revision of EPC price from USD 321.4 million to USD 416.63 million. Please note that the Company has adopted the indices used by the Authority itself for determination of one-time adjustment at COD of Sahiwal Power Plant, Port Qasim Power Plant, China Hub Power Plant and Engro That Power Plant – US PPI Iron and Steel and US PPI Electrical Machinery and Equipment:

Revised EPC Price = 321.4 * 51% * (337.14/229.1) + 321.4 * 38% * (133.761/116.9) + 321.64 * 11% = USD 416.63 million.

*PPI Detailed Report for the month of May 2019 and March 2023 as published by US Bureau of Labor Statistics is attached as "**Annexure E**" and "**Annexure F**", respectively.*

The Company believes that the modifications sought, which are predicated on the calculations presented above, are fair and reasonable. The Company respectfully requests that the Authority carefully and objectively evaluate the Company's appeal, taking into account the significant impact of inflation rates and the changes in the US PPI on Project's EPC cost, as well as the comprehensive Project cost and schedule. The Company maintains that the proposed modifications are equitable and pragmatic and would substantially facilitate the execution of the Project.

Additionally, the Company would like the Authority to reconsider the actualization of various EPC cost items such as bridges, housing colony, site leveling, boundary wall, security cost, anticorrosion, construction power, cost of black start facility measures vide Section 7(II)(c)(d)(e) of the Revised Tariff Determination. This is not only difficult to assess and segregate from a lump sum EPC contract but it is also not a standard practice followed in turnkey EPC contracting and even in the precedent projects with NEPRA. The Authority must consider that the bidding process which was conducted in accordance with guidelines issued by the Authority did not had actualization of components of the EPC price as per the standard practice as well. Therefore, the onerous conditions imposed by the Authority in the Revised Tariff Determination are unreasonable and may please be removed.

The primary purpose of a turnkey contract is to provide a complete solution that includes all the necessary components and services to deliver the project. If we require actualization of the components of the EPC cost, the Company will essentially be managing/coordinating on each component of EPC cost separately, which defeats the purpose of a turnkey contract. Actualizing the components of the EPC cost in a turnkey contract also increases the risk for the Company, reduces the accountability of the contractor, and can lead to cost overruns and delays and protracted disputes between the Company and the contractor, as well as impact the quality of the Project.

Therefore, it is important for the Company to ensure that the EPC costs are included in the turnkey contract and that the contractor delivers a complete solution.

In view of the above, it is requested that the Authority may please remove the actualization clauses related to EPC cost items from the Revised Tariff Determination.

Indexation of Local EPC and Other Project Costs

In 2017, the Company conducted an international open bidding process for procurement of EPC services, in compliance with the "EPC contractor Selection Guidelines" issued by the Authority, and enlisted the services of an impartial third-party evaluation agency for the bidding appraisal. Following the assessment, the Company issued a Letter of Award (LOA) based on the bid evaluation report and subsequently entered into an EPC contract with the winning bidder **at a further discount to the lowest bid price**. Subsequently, the Company filed a Tariff Petition with the Authority along with the bid documents and the EPC contract stipulating the payment currency to be in US dollars. Subsequently, upon issuance of the Revised Tariff Determination, the Company conducted competitive price negotiation with the Powerchina through Sepco-1,Dongfang (ranked No.2,No.3 respectively in the evaluation stage) and other bidders, and the payment currency for the EPC contract remained in US dollars.

Please note that the sponsors of the Project are till date facing litigation from the original bid winner with which the EPC contract was executed, since the EPC contractor did not accept the determined EPC price as the Company could not afford the differential loss between the requested price with EPC contractor and price determined by the Authority.

In Section 7 Clause II (b) of the Revised Tariff Determination, the Authority stipulated that for cost items other than foreign EPC cost, the amounts allowed in USD will be converted in PKR using the reference exchange rate of PKR/USD 105. The Company has already sought clarification from the Authority on the same, however, to date the Company has not received a written reply or clarification from the Authority. The clarification required is whether the cost items other than foreign EPC costs refer to:

All other Project cost items: or

All other EPC cost items.

If the Authority fixes the exchange rate at even the Onshore EPC Cost, it renders the Project as infeasible and unviable. The rationale for the same is detailed below:

The Project's entire investment in the project is in US dollars. The Tariff Petition, which details all Project expenses, is measured in US dollars as per the Power Policy 2015. Although the tariff is denominated in rupees, a mechanism to adjust the tariff based on exchange rate fluctuations is in place to mitigate investor risk.

Company believes that the currency circulation loop of the investment on Project initiated and closed in USD currency, therefore any exchange rate adjustment in the process of the tariff computation in PKR currency should not contribute to the exchange rate risk or loss of the investors.

The rationale behind splitting the EPC contract into offshore and onshore is not to segregate the payment currencies of the contract but is multi-fold. In South Asian countries, intricate and constantly evolving tax policies pose significant challenges to tax consulting firms, which are often unable to accurately determine the tax basis and rates during Project preparation or implementation phases. Consequently, the Company observed that the Authority did not precisely evaluate the sales tax and withholding tax rates and amounts when calculating Project tariffs, resulting in an unclear specification of this cost in the total Project investment. Hence, investors split the EPC contract into onshore contract, which typically consist of design, installation and local procurement, and offshore contract, which involve equipment procurement and transportation. As the original EPC contract is bifurcated into two contracts, onshore and offshore, an umbrella agreement links them organically to maintain consistency with the original EPC contract in terms of work scope, price, schedule, rights and obligations. Therefore, the EPC contract splitting does not compromise the integrity of the original EPC contract. Investors/contractors opt for the US dollar as the payment currency for the onshore contract due to the following reasons:

The currency of the Project financing is the US dollar;

Choosing a strong currency lowers the EPC price and prevents contractors from increasing their offers to shift the exchange rate risks significantly;

The economic environment is unfavorable, with the local currency and US dollar exchange rate are highly volatile or consistently depreciating.

The Authority's decision to lock the exchange rate for the onshore portion of the EPC contract in violation of the bidding documents and executed EPC contract signed following the same. This is because the EPC contract stipulates the US dollar as the payment currency, and locking the exchange rate will trigger various contractual issues such as payment mode, risk allocation, and contract terms, leading to conflicts between the EPC contractor and the Company, and eventually harming the Project.

The PKR/USD exchange rate trend is notoriously challenging to forecast accurately. In recent years, the rupee has heavily depreciated on account of concomitant falling in exports, foreign exchange reserves, and economic downturn. When the Company filed its tariff petition in January

2018. the exchange rate was PKR/USD 112.65. which was 139.9 by the time the Authority issued its Tariff Determination and 149.15 by the time the Authority issued its decision on the review. The decision was unjust even then. Presently the exchange rate has falled to PKR/USD 300. Given the current and projected economic conditions. there is no visibility on interest rate for the next three to four years. Three years ago, no professional consultancy or expert predicted that the exchange rate would move in the way as did. Consequently. EPC contractors or investors now find it impossible to pursue the Project with such onerous clauses within the scope of Revised Tariff Determination. particularly where the development of the Project has not even started yet and the EPC contract has yet to commence the construction activities.

At the request of the Governments of China and Pakistan. the Company initiated a financing effort with the assistance of its shareholders to facilitate the progress of the Project and resolve the obstacles in the Project. Presently, progress stands at 35 percent since the inception of financing endeavors in April 2021. Notably, China Development Bank has approved a loan for the Project. subject to certain conditions. In addition, Sinosure has strongly indicated a buyer credit insurance policy for the loan facility and has obtained the necessary approvals from its respective headquarters.

It is imperative to note that fixing of the exchange rate for the EPC or converting the financing currency to PKR would jeopardize the progress made till date undertaken by the Chinese and Pakistani governments towards financing the Project. The current economic conditions and challenges within the power sector in Pakistan created significant difficulties for investors in securing loans for the Project and fixing exchange rate for the onshore EPC contract will result in the compulsory termination of the Project.

Taken together. the Authority's decision to lock in the exchange rate for the onshore EPC contract could have dire consequences for Project's viability. Such an action is certain to increase the exchange rate risk for investors. contravene contractual agreements. and initiate contractual disputes between investors and EPC contractors. It is therefore imperative that the Authority takes into consideration the perspectives and reasonable request of both investor and EPC contractor in dealing this matter. in order to safeguard the viability of the Project.

As the pricing and payment currency for the EPC contract are both in US dollars. the Company earnestly requests that the Authority clarify or revise the determination of the onshore EPC cost based on the actual exchange rate at the date of the milestone payment. Please refer to Section 14.15 of the EPC Procurement and Construction Contract (onshore contract) for a reference. reproduced below:

"The currency of payments for each milestone shall be as indicated in Annex [R] (Payment Schedule), shall be United States Dollar or equivalent Pakistan rupee converted on the date of making this payment using the exchange rate offered by the State Bank of Pakistan."

*EPC Procurement and Construction contract is attached as "**Annexure G**".*

Sinosure Fee and Bank Guarantee Fee

As part of the Tariff Petition, the Company applied Sinosure fee based on Overseas Investment Insurance Policy while retaining the right to claim the same under Buyer's Credit Policy in case Sinosure requires from the Company to procure the same under the latter policy noting that such request was in line with the Authority's past precedents. Section 5.1.10 of the Tariff Petition is reproduced below for reference:

"Since the terms and modalities of the SINOSURE policy are still under discussions with the lenders and SINOSURE, it is proposed that a provision may be included in the tariff where an adjustment may be allowed in case of an upfront premium payment."

However, the Authority as part of Section 6.103 & 6.104 of the Tariff Determination did not provide any flexibility to the Company to switch between Buyer's Credit Policy (Upfront Payment) and Overseas Investment Insurance Policy (Annual Payment during debt tenor).

Although the Company applied Sinosure fee based on Overseas Investment Insurance Policy in the Tariff Petition, the Company requested the Authority for flexibility to switch to Buyer's Credit Policy in its Tariff Petition as the inclusion of the Sinosure cost based on Overseas Investment Insurance policy was purely indicative. The Company has repeatedly followed up with the Authority to issue clarifications in this regard, references to which are provided below:

No. CIHC/POCPEC/2018-218 dated April 16, 2019
No. CIHC/POCPEC/2019-244 dated July 25, 2019
No. CIHC/POCPEC/2019-259 dated September 27, 2019
No. CIHC/POCPEC/2019-315 dated December 25, 2019
No. CPPC (2021-06) SD-65 dated June 23, 2021
No. NEPRA/SAT-II/TRF-434/18789 dated October 8, 2019

The Authority may wish to note that the choice of either policy is not primarily at the discretion of the Company but is dependent on credit risk assessment in respect of the host country and the project by the lenders and insurance companies/ agencies.

The Authority may also note that the cost of two alternatives cannot be compared as Sinosure Fee under Buyer's Credit Policy is calculated based on swap rate corresponding to the respective tenor of the Project at the time of procurement of insurance and is procured one time at the start of the Project, while Sinosure Fee under Overseas Investment Insurance Policy is calculated based on prevailing quarterly LIBORs during the operating period which has potential to change and hence effective cost under the same remains uncertain. Therefore, it is not appropriate to compare the two alternatives in terms of cost.

The Company would also like to state that the proposed policy under the Upfront Tariff is Buyer's Credit Policy and no provision exists for Overseas Investment Insurance Policy, despite the facts that projects under the Upfront Tariff 2014 were entitled to both options based on their unique arrangements with the lenders. Moreover, the Authority has provided flexibility to adopt either policy in Section 36.5 of the tariff determination for Matiari-Lahore Transmission Line Project vide letter No. NEPRA/TRF-351/PP1B-2016/11318-11321 dated August 18, 2016.

In spite of the above precedents and submissions, the Authority issued the following clarification in response to its ruling vide letter No. NEPRA/SAT-II/TRF-434/18789 dated October 8, 2019:

"In case of alternative Sinosure fee arrangement, the same shall be compared with the cost allowed as per the above mechanism and in case the alternative arrangement is within the allowed cost, the same shall be considered for adjustment at the time of COD."

In light of the above, the Company requests that the Authority revisit the Revised Tariff Determination in line with modification sought as part of the Modification Petition and allow the Buyer's Credit Policy as an alternative policy, which would most likely be adopted for the instant Project, as it has already been strongly indicated by Sinosure as the most likely policy under which Sinosure shall insure the Project.

*Sinosure's letter of intent, issued by the Sinosure, clearly indicating the buyer's credit policy and rate for the instant Project is attached herewith as "**Annexure H**".*

Company hereby humbly requests the honorable Authority to approve the Buyer Credit Insurance Policy for the instant Project sought within the scope of the Tariff Petition, MFLR and Modification Petition.

In addition, the Company would like to submit that Sinosure has refused to insure tariff payment default risk upto 95% of aggregate principal and interest amount as is typical requirement of the Chinese lenders and has instead indicated that it will only insurance of tariff payment default risk upto 70% of aggregate principal and interest amount as Sinosure has already executed by Sinosure with Shanghai Electric Thar Power Plant. This reduction in risk insurance has been triggered in recent times due to delayed payments by CPPA-G. default to open revolving account by CPPA-G as agreed with precedent projects. and the occurrence of default on debt obligations by precedent projects.

*The letter of interest as received from Shanghai Bank is attached herewith as "**Annexure I**".*

The default and payment delay triggered the remaining 25 percent of the tariff payment default of aggregate principal and interest amount to be guaranteed by a third party. Moreover. the Company has received an indication that 1% guarantee cost will apply on the guarantee amount. with guarantee amount being equivalent to the following: whole debt amount x 25% x (1 + Cost of Debt) for the entire repayment period. Therefore. it is humbly requested that in light of the recent developments in Sinosure terms and conditions. the cost of providing guarantee may please be allowed as part of the Project cost (for portion related to construction period) and O&M cost (for portion related to operating period).

Development Costs

The Company claimed development cost of USD 47.86 million as part of the Tariff Petition. the details of which are provided in the table below.

Cost Item	Amount (USD Mn)
1. Development Costs	**47.86**
1.1 Owner's Direct Costs	***26.84***
1.1.1 Salaries	*20.08*
1.1.2 Rents	*1.89*
1.1.3 Travel	*3.44*
1.1.4 Administration	*1.43*
1.2 Consultant and Advisory Costs	***20.43***
1.2.1 Lead Project Development Advisor	*0.65*
12.2 Local Legal Advisors	*0.26*
1.2.3 Chinese Legal Advisor	*0.50*
1.2.4 FS + Project Studies	*6.62*
1.2.5 Independent Engineer	*0.50*
1.2.6 Accounting & Tax Advisor	*0.41*
1.2.7 Project Owner's Engineer	*10.00*
1.2.8 Other Advisors	*0.49*

1.2.9 Technical Advisor	*1.00*
1.3 Regulatory Fees (NEPRA, SECP, etc.)	***0.60***

However, the Authority considered the amounts claimed in the Tariff Petition to be on a higher side and determined USD 7.73 million against the claimed amount of USD 47.86 million largely on the basis that CMEC's claim of similar costs were 2.87% of the capital expenditure for its 330 MW Pind Dadan Khan Salt Range Power Project. This was later revised by the Authority to USD 10.50 million as part of the MFLR.

As part of the MFLR, however, the Company submitted the following rebuttals to the Authority's view, which in the Company's view were not considered by the Authority:

The reference to the CMEC Salt Range Power Project is unreasonable and unjustifiable as the same is an abandoned project reference and the EPC contractor in that case was also the sponsor of the project and the cost economics/allocation might have been different in that case.

Furthermore, it is not reasonable to benchmark such costs against capex of 1,200 MW thermal project either as the absolute cost remains in the same range regardless of project size. Moreover, RLNG projects costs were based on local sponsor/employee costs, and the package deal with NESPAK spans three similar projects and locations far more developed than Gwadar.

The Authority has itself has admitted in the past that these costs do not scale linearly with Project size completely and therefore comparisons with other thermal projects of much larger size are not warranted.

Comparison of development costs of a project to be developed in Punjab/Sindh cannot be compared with the same project to be developed in Gwadar, which requires a premium of 60-70% for sustainability of the project.

The Authority may please further note that the Company has already incurred costs of USD 17.37 million (development cost: USD 13.29 million) from 2017 till June 30, 2022, which has well exceeded the budget allowed by NEPRA of USD 10.50 million, noting that the Company is yet to commence its construction and has 30 months of development costs to be incurred during the construction phase. These are pre-development costs that the Company believes have been incurred on the Project over the last six years due to the delay in the Project development solely attributable to the Government of Pakistan and its entities. Hence the Company believes that it has a just right to claim these costs and therefore humbly requests that the same may please be allowed as part of the Project cost. The Company has enclosed the audited financial statements to corroborate the expenses incurred to date.

*Financial statements for 2019, 2020 and 2021 are attached herewith as "**Annexure J**".*
*Letter to GOP regarding delay in the Project development is attached herewith as "**Annexure K**"*

No.	Cost Item	Amount (USD Mn)
	Cost incurred till June 30, 2022 (A+B)	**17.37**
	Less: Cost related to EPC contractor	(0.80)
	Less: Cost related to land as initial payment	(3.28)
	Development Cost incurred till June 30, 2022	**13.29**
A	**Cost Paid – till June 2022 (A-1 + A-2)**	**15.65**
A-1	**Cost Paid**	**14.93**
1.1	Advance payment paid to contractors	0.80
1.2	Initial payment for land	3.28
1.3	Development cost	10.85
1.3.1	*Management fee*	*0.70*
1.3.2	*Travel expenses*	*0.55*
1.3.3	*Business expenses*	*0.06*
1.3.4	*Salaries*	*4.75*
1.3.5	*Consulting fees*	*2.26*
1.3.6	*Government fees*	*0.96*

1.3.7	*Labor costs*	*1.08*
1.3.8	*Security fee*	*0.18*
1.3.9	*Other expenses*	*0.32*
A-2	**Exchange Loss on Payment**	**0.73**
B	**Cost Payable**	**1.71**
3.1	Pick-up truck rental	0.02
3.2	Financing lawyer (lender)	0.32
3.3	Employer's insurance for the owner	0.007
3.4	Terrorist attack insurance	0.03
3.5	Translation	0.009
3.6	ESIA final payment	0.20
3.7	Hydro-meteorological final payment	0.08
3.8	Groundbreaking ceremony	0.31
3.9	Feasibility study publishing	0.15
3.10	Arbitration lawyer (former EPC contractor arbitration application)	0.05
3.11	Financial advisor final payment	0.46
3.12	Financing lawyer (Company)	0.08

Additionally, the project management service providers have requested compensation for the relevant costs during such pre-development period. The total cost claimed by PMC contractor and security agency is USD 1.58 million and USD 0.43 million, respectively, for a total of USD 2.01

million. The Company is currently in negotiations with PMC contractor and security agency to waive the cost claim due to the delays attributable to the reasons beyond of Company control.The matter is not yet closed. Therefore, the Company requests that the Authority may please consider that in case the cost claim is not waived by the above parties, the same shall be claimed from the Authority at the time of the COD.

Furthermore, the Company believes that it will incur the cost of USD 36.80 million if it were to start construction today, it would incur of USD 36.8 million, a detailed breakdown of which is provided in the table below.

S. No	Cost Item	Amount (USD Mn)
1	**Owner's Direct Costs**	**26.59**
1.1	Salaries	10.69
1.2	Rents	1.45
1.3	Travel	1.80
1.4	Administration	1.36
1.5	Project Owner's Engineer	11.28
2	**Consultant costs**	**8.21**
2.1	Lead Project Development Advisor	0.65
2.2	Local Legal Advisors	0.26
2.3	Chinese Legal Advisor	0.50
2.4	FS+Project Studies	2.79
2.5	Independent Engineer	0.50
2.6	Accounting & Tax Advisor	0.42

2.7	Other Advisors	1.79
2.8	Design review	1.30
3	**Regulatory Fees (NEPRA, SECP, etc.)**	**2.00**
	Total Development Cost to be incurred	**36.80**

Based on the forgoing, the Company requests that the Authority may please allow USD 47.87 million in consideration of the following:

Development cost of USD 13.29 million incurred

Development cost of USD 36.8 million to be incurred

Portion of development cost originally budgeted but already paid USD 2.23 million

S. No	**Cost Item**	**Amount (USD Mn)**
1	Development Costs Paid/Payable	13.29
2	Development Fee Originally Budgeted	36.80
3	Development Fee Originally Budgeted and Paid	(2.23)
	Total Development Fee Claim	47.87

API-4 as the index for Coal Pricing

The Authority has allowed the API-3 index in the Tariff Determination and Revised Tariff Determination for the purpose of pricing coal, which not only goes against the Authority's decision in the precedent case, but also the Fuel Pricing Mechanism dated September 23, 2016 and the Upfront Tariff.

The Authority changed the benchmark prices for coal price from API-4 to API-3 on the premise that the design coal requirements for the Project was 5,500 kCal/kg. The Authority may note that as per the performance guarantees submitted to the Authority, the design coal calorific value is 5,371 kCal/kg (LHV) on a received basis, which is basically the minimum calorific value required to ensure performance of the boiler. As result, the calorific value of the coal used may exceed 5,500 kCal/kg during operations, upon which API-4 will be the relevant index. Therefore, it has been proposed that the relevant index may be kept flexible depending on which calorific value coal will be procured by the Company, and the Authority may by no means fix the index for the Project. Moreover, it is highly recommended that the pricing for the instant Project may please be kept at least in line with the pricing of other similar coal projects operating in Pakistan and can by no means be worse than the coal pricing mechanism applicable to other projects.

Moreover, the API-3 index is not an accepted benchmark for pricing of coal in international market due to the following reasons:

API-3 lacks liquidity and responsiveness in the international market and therefore cannot be considered as a true reflection of the market price of coal. Coal being a volatile bulk commodity requires a corresponding futures contract for hedging, and the same is available for the API-4 index for South African coal, which makes the API-4 index easily accepted by traders in all segments of the market as a basis for pricing. The API-3 index, on the other hand, has little liquidity, no hedging instruments and virtually no turnover, and does not reflect the true price in the market. As a result, no mine or trader accepts this index as the basis for pricing South African coal, particularly for long-term contracts.

South African's coal consumers mainly include India, South Korea, Malaysia and Vietnam. The amount of coal required from Pakistan is not enough to influence and change current international pricing mechanism. Therefore, it is difficult to promote API-3 index or any other index to replace API-4 for South Africa coal with a calorific value ranging from 4800-6000 kcal/kg.

Typically, for coal procurement based on contracts the following factors are taken into consideration by the parties:
Trading and financial standing of the parties: the price agreed by the parties in a long-term coal supply agreement will vary depending on the risk factors to the individual financial status of the parties;
Large volume of coal to be supplied on uninterrupted basis; long term supply agreements are executed on pricing in order to ensure uninterrupted supply so that the power generation is not affected at any time due to lack of supplies (fuel). Any volume option a buyer has requires a substantial premium for the seller;
Where the supplier fails to deliver the required volumes liquidated damages are also imposed and the same is a common practice in long-terms coal supply agreements;
Where the supplier fails to deliver the required quality and coal in the requisite specs price is adjusted and or liquidated damages are also imposed and the same is a common practice in long terms coal supply agreements;
Required quality and coal in the requisite specs is ensured to guarantee availability and efficiency of the generation facilities to avoid penalties from the Power Purchaser under the PPA;

Freight and freight fixing risk are also taken into account in the long-term coal supply agreements in order to ensure that the supply chain risks associated with the uninterrupted delivery of coal are reasonably covered:
Argus / McCloskey only accounts for spot transaction and not contracts 2,3 or 4 years into the future. Therefore, there is no accounting for future uncertainty, which certainly commands a premium:
Different incoterms other than FOB;
Quality differences: Appellant requires specific sizing of the coal to be delivered - sized coal commands a substantial premium in the market.

Therefore, the Authority is requested to change the benchmark for coal price from API-3 to API-4 in accordance with international practice, the precedent set by the Authority and the coal pricing mechanism.

Taxes & Duties

The Company claimed taxes and duties of USD 40.11 as part of the Tariff Petition pursuant to the laws and regulations prevailing at the time. A summary and basis for the claimed cost is provided in the table below.

S. No	Item	Amount (USD Mn)	Description
1	Customs duty	12.51	5% tax rate. The final amount will be adjusted based on the actual amount paid at COD
2	Withholding tax	9.64	7% tax rate. If the assumed conditions change, it will be included in the Project cost through a one-time adjustment at COD
3	Sales tax	17.96	15% tax rate. Since the Company only pays sales tax on the tariff portion, there is no additional operating period sales tax to offset the sales tax paid during the construction period after adjusting the fuel cost and variable operation and maintenance costs. Company cannot collect all sales taxes during the operation period.
4	Other taxes & duties	Corporate income tax, dividend	Pass-through

		withholding tax, etc.	

The Company would like to submit that in the event that the above tax rates and/or budgeted amounts turn out to be different, the Authority may please approve the same as a portion of the Project cost accordingly.

Furthermore, any tax incidence related to corporate income tax, dividend withholding tax, poverty alleviation tax, employee profit-sharing fund, employee welfare fund and the taxes levied in Balochistan province are not considered in the Tariff Petition and hence the Tariff Determination/Revised Tariff Determination. If the Company becomes liable for the said taxes, the Company would like the Authority to consider allowing them for a portion of the Project cost.

As per section 11.4 of the Tariff Determination, the Authority has determined that the following:

"Actual withholding tax not being of refundable/adjustable nature shall be incorporated at the time of COD on the basis of verifiable documentary evidence. Sales tax is a value added tax and has not been considered as part of the Project cost."

Against this backdrop, the Company sought the admissibility of sales tax costs as part of the Project cost, while which was clarified by the Authority as part of Section 6.76 of the Revised Tariff Determination as follows:

"The Authority while adjusting tariff at the time of COD of a new commissioned coal power plant included non-adjustable sales tax during construction period on import of plant & equipment and construction activities in the Project cost and the same mechanism shall apply in the instant case."

However, with reference to other coal power projects: Port Qasim power plant, Sahiwal power plant and China Hub power plant, while withholding tax has been fully allowed by the Authority, sales tax has not been fully allowed by the Authority on the basis that the same can be adjusted by the companies against the output sales tax.

While such power plants have filed claims with the FBR for adjustment of output sales tax/refund applications, the same have either been rejected by the FBR for one reason or another, or the companies have not been able to fully adjust the same for many years of operation.

The Company would like to submit that sales tax paid by the Company, whether adjustable/non-adjustable, remain part of the Project construction cost requiring the Company to finance the same with debt and equity. If the adjustable sales tax is not approved as part of Project cost, the Authority does not reimburse the Company for the financing costs/debt/equity/return on debt/equity accruing until such time as the same is not recovered by the Company from FBR.

Therefore, we request the Authority to approve the following:

To approve the inclusion of adjustable sales tax in the Project cost.

The Project cost approved by the Authority currently do not capture the costs related to withholding taxes, sales tax amounts and resulting incidental costs associated with the Sinosure fee and IDC. While the Authority does recognize that it will calculate the same based on the verified documents to be submitted at COD, lenders do not recognize this when sanctioning the loan amount for the Project, especially given the uncertainty associated with recent One-time Tariff Adjustment Determinations at COD of various coal-based generation projects. As a result, the lenders have insisted that the Project cost to be used as approved by the Authority, unless the Company seeks clarification from the Authority regarding on the provisional amounts so that the financing against the same can be considered by the lenders.

We humbly request that the Authority determine a provisional amount for withholding tax and sales tax, subject to adjustment at the COD, and include it in the Project cost amount to enable the Company to meet the requirements of the lenders. The Company has sought calculation of the same from its tax advisers, which is attached for the information of the Authority to consider the same for inclusion in their determination.

*Calculation of tax amounts and underlying tax opinion have been attached herewith as "**Annexure L**".*

Estimated tax amounts payable on other Project cost items cannot be accurately budgeted currently. The relevant tax payment basis and proof will be filed at the COD for inclusion in the Project cost. Therefore, the Authority may please determine that the same will be allowed at the COD as in practice.

Return of Equity

The Company claimed an Internal Rate of Return (IRR) for the Project of 17% as part of the Tariff Petition, which was reduced by the Authority as part of the Tariff Determination and Revised Tariff

Determination to 14%, citing reduction in country risk as the basis for such decrease. However, such a reduction is unjustified and unreasonable on the following grounds:

The Authority reduced the IRR based on a inexact understanding of the overall country risk. The mere addition of power to the grid and the development of IPPs does not in itself bring down the overall national risk. Instead, as is evident in sub clause (e) below, all the macroeconomic indicators of Pakistan have been trending negatively since 2018, and the overall country risk is currently at an alarming level.

The Authority ignored the high-risk zone in which the Project is located and the strategic nature of the Project.

The Authority ignores that even for those precedent projects with allowed IRR of 17%, the precedent projects have till date been unable to repatriate dividends to the shareholders.

If Capital Asset Pricing Model ("**CAPM**") is adopted to understand the minimum equity returns for investments within the Project as of today, it would provide a sound mechanism widely accepted by finance professionals in the investment sector for understanding the risk dynamics of investment in the Project keeping in view the return in mature markets, overall country risk, inflation differential compared to mature economies, equity risk premium within the country etc. For computation of equity returns based on CAPM, data from the IMF outlook, the US treasury website, and publications of Professor Aswath Damodaran have been relied upon. Based on the same basis, overall cost of equity investment in the Project works out to be at least ~43%, while ignoring any Project specific risks that may apply. Based on the same and ROE on IRR basis mechanism established by Authority, the Company believes that 17% IRR is an extremely fair claim of the Company keeping in view the similar precedent projects, extreme risks of investment in Pakistan and the fact that 14% IRR is suitable for investment in economies which have mature economies and low risk environment.

Cost of Equity Computation	**%**	**Basis**
Risk Free Rate	3.75%	The risk-free rate of 3.75% is based on the yield of a US 20-year treasury bill (as at 11 April 2023), adjusted for Pakistan's country risk premium and the inflation differential between Pakistan and the United States (Source: US Treasury Published Data, IMF, Damodaran)
Inflation Differential	10.31 %	
Country Risk Premium	12.94 %	
Adjusted Risk Free Rate of Return	**28.72 %**	

Equity Risk Premium	18.88 %	Market risk premium is estimated at 18.88% for Pakistan as of Jan 2023 (Source: Damodaran).
Emerging Markets Unlevered Beta	0.42	Unlevered beta of 0.42 is based on companies engaged in the power sector within emerging economies (Source: Damodaran Emerging Markets Jan 2023). https://www.stern.nyu.edu/~adamodar/pc/datasets/ctryprem.xlsx
Target D/E	0.80	
Levered Beta	0.76	
Beta	0.76	
Cost of Equity	**43.09 %**	

*Evidence for risk free rate, country risk premium and equity risk premium has been attached herewith as "**Annexure M**".*

Pakistan has witnessed, since the issuance of the Revised Tariff Determination, the following, which increases the country's risk premium to a high level and corroborates the Company's claim to require an IRR of at least 17%:

Pakistan entered its worst political and economic crisis in years marked by a government takeover and the dissolution of the National Assembly, amid political chaos and uncertainty.
PKR/USD depreciated by 100% between FY19 and FY22.
As end of FY22, Pakistan's external debt and liabilities increased to ~USD 130 Bn (34.5% of the GDP) from USD 106 Bn in FY19.
Pakistan's official foreign exchange reserves fell to a low of USD 5.8Bn-the lowest level since April 2014 and Pakistan's gross external financing needs for FY23 have been pegged at USD 31 Bn.
Power Sector Circular debt increasing from Rs. 818 Bn in FY17 to whopping Rs. 2,600 Bn in FY22 owing to delay in fuel cost adjustments, DISCO's inefficiencies, other adjustments and build-up of unpaid subsidies despite several efforts and plans to curb its annual flow, including implementation of the Circular Debt Management Plan agreed to with the IMF.
State Bank of Pakistan increases policy rate by 800 bps to 21.
Indecision and failure to come to terms with the IMF carries the continued risks of a hard default.
Imposing of tougher than expected IMF conditions, i.e. continued monetary tightening, more taxes amid ambitious fiscal targets and exorbitant revision in energy prices. In addition, the IMF has demanded withdrawal of power subsidies which has created pressure on the power sector to settle its dues in a timely manner.

Geopolitics and capacity issues have resulted in high global commodity prices that have put pressure on Pakistan's balance of payments and inflation.
The worsening law and order situation poses a significant risk to sustainable economic growth. Increase in terrorist attacks (a fresh wave witnessed recently) among other challenges not only restricted foreign investment but also resulted in wider loss to the economy.

O&M Cost

The Company submitted a total O&M tariff of PKR 0.9001 per kWh (O&M cost of USD 17.43 million) which includes several operator and non-operator costs such as O&M contractor fee, corporate overheads, security cost, ash disposal, desulphurization etc. The Company believes that the aforesaid costs to be justified on the following grounds:

This includes special security cost of USD 2.26 million per annum (PKR 0.1167 per kWh), which given the strategic nature of the Project and its location is fully justified. The O&M tariff net of the special security cost works out to be PKR 0.7834 per kWh.

The proposed security costs for the operating period are calculated by referring to the agreement signed with the security service provider for the construction period at the annual cost of USD 2.26 Million, which does not take into account the provision of security by the Pakistan Army. The security cost during operating period approved by NEPRA was made by taking reference of a 1263MW RLNG power Project (only USD 0.61 Million per year). We would like to draw the Authority's attention to the fact that the security situation at Gwadar district is far more severe than that of Punjab. Therefore, it is inappropriate to directly cite the security costs of a project from Punjab. Additionally, the Project has unique environmental factors including the occupation area, terrain, number of entrances and exits, boundary wall, security personnel allocation, requirements for security patrols and inspections, level of vigilance level and work pressure. As a result, its security arrangements are unique compared to the rest of the country. We believe that the minimum annual security cost for the operating period shall not be less than USD 2.00 million to ensure the safety of personnel as and the power plant.

The amount includes cost of ash disposal of USD 1.64 million per annum (PKR 0.0848 per kWh) as well. This information was shared with the Authority on September 2, 2018. O&M cost (net of security and ash disposal cost) works out to be around PKR 0.6987 per kWh.

The above analysis is sketched in the table below (PKR per KWh).

	Upfront Tariff 2014	Upfront Tariff 2014 – Indexed	Gwadar Tariff Petition
Fixed O&M – Local	0.1806	0.2044	0.2592
Fixed O&M – Foreign	0.1806	0.2127	0.5031
Variable O&M – Local	0.0456	0.0516	0.0717
variable O&M – Foreign	0.0684	0.0806	0.0662
Ash Disposal	0.2200	0.2200	-
Limestone	0.0900	0.0900	-
Total O&M cost	**0.7852**	**0.8593**	**0.9002**
Adjusted for:			
Ash Disposal	0.2200	0.2200	0.0848
Security cost	-	-	0.1167
Net O&M Cost	**0.5652**	**0.6393**	**0.6987**
Difference			**9.29%**
Indexation Parameters			
Exchange Rate (PKR/USD)	97.10	110.50	
US CPI	238.34	246.669	
Local CPI	194.74	220.42	

Based on the indexed values for Upfront Tariff 2014 as per table above, net O&M cost of PKR 0.6987 per kWh is only 9% higher compared to indexed O&M tariff of Upfront Tariff 2014, which stands justified on grounds of substantial escalator in terms of manpower and services cost which prevail in Gwadar compared to other similar projects developed in Pakistan.

The Authority may please further note that the Authority made an oversight/error while using Regulation 29 of CERC Tariff Regulations 2014 India. The Authority erroneously used a cost of 30.51 lakh/MW for a 200-250 MW unit while overlooking that the CERC Regulations allow escalation on a per unit basis for smaller units and that the unit size for the instant Project is 150 MW. So if we use the same table used by the Authority as reference and apply the escalation available within the table for 200-250 MW unit over 300-350 MW unit of 19.79% (30.51/25.47 - 1), the resulting cost would be 36.55 lakh/MW (USD 50,760/MW), which further results in USD 15.23 million per annum. Adding the USD 2.26 million security cost claim would result in a total assessed O&M cost of USD 17.49 million, which justifying the claim of the Company of USD 17.49 million. The Authority may please note that this does not yet take into account that the CERC

Regulations require an escalation in costs, given that the same were published in 2014 and the Authority issued its decision in 2019.

*CERC Regulations benchmarked by the Authority has been attached herewith as "**Annexure N**".*

In light of the above, the Company finds the originally claimed amount to be justified and hence the Company requests the Authority to approve the originally petitioned amount of USD 17.43 million for which details have been provided to the Authority in addition to the DSRA LC cost as per the preceding paragraph.

Additionally, the Company would like to bring to the Authority's attention that as an alternative to funding the debt service reserve account through Project finance, the Company has to issue a standby letter of credit against the amount to be reserved for debt service, cost of which has been indicated by the issuing bank at 1%. Therefore, the Company requests that the same may please be allowed as part of the O&M expenses on an actual basis.

The following requests are from tariff petitions or the issues arise during the PPA negotiation and financing process that are not in the submitted tariff modification petition. Company requests that the Authority review these requests in conjunction with the other submitted petition documents.

Debt-to-Equity Ratio

As per Section 19.3 of the Tariff Determination, the Authority mentioned that once proposed by the Project Company, change in capital structure resulting in higher tariff shall not be permitted. This was determined by the Authority in spite of the fact that the Company had disclaimed in the Tariff Petition that the 80% debt-based funding was strictly provisional and based on indicative term sheets provided by lenders, which could vary as the Project progressed.

The capital structure typically determined by the Authority in the past allows for debt in the range of 70% -80% range and even the Guidelines do not provide for any change in this regard.

The Authority may please note that the Company explicitly stated in the Tariff Petition that it has not yet reached on a final agreement with its banks on the financing terms. The Company further sought from the Authority to allow the Company the flexibility to adjust its debt-to- equity-ratio based on realized ratio. The Company believes that under the Power Policy 2015, the Government of Pakistan allows equity funding fluctuations of 20 to 30%.

In light of this, the Authority may kindly retain the flexibility on the debt-to-equity-ratio as per the precedent as the lenders have raised the above issue several times and the investors are also concerned that this provision will affect the Project's viability.

The Authority may please further note that no project can achieve exactly 80:20 of debt-to-equity-ratio. This is because typically under the Sinosure-backed financing, lenders fund only 85% of the EPC costs and Sinosure's fee and interest during construction. Therefore, the Authority's limit of 80:20 of the debt to equity is unjustified.

Given the circumstances at hand, it is our recommendation to adjust the allowed debt-to-equity ratio to 70:30, as this appears to be reasonable as per the preceding paragraphs. The third parties have given their assent to furnish an irrevocable bank guarantee to the lenders to cover the risk of tariff payment default of 25% of the aggregate principal and interest amount. It must be noted that the Company bears an actual risk amounting to 40% of the total investment, rendering the imposition of a fixed debt-to-equity ratio impractical by the Authority. Generally, banks prefer to have a lower debt-to-equity ratio to mitigate the risks they are exposed. Thus, a high debt-to-equity ratio can hamper a syndicate's fundraising initiative given that it is almost impossible to achieve. Furthermore, the low IRR and high debt-to-equity-ratio approved by the Authority does not represent a balanced risk-sharing model for the Project. Consequently, even if external pressures necessitates the commencement of the Project, the risk of abandonment remains.

In summary, the Company respectfully appeals to the Authority to approve the proposal to flexibly adjust the proportion of debt and equity amounts at the COD, based on the final loan terms realized with the lenders, with a floor of 70:30 on the debt-to-equity ratio. This approach will better reflect the actual financing requirements of the Project and balance the risks and returns of both the investors and the lenders. The proposal aligns with market's best practices and the provisions of the Power Policy 2015 which allows for a flexible equity ratio between 20% to 30%. The Company strongly believes that this adjustment will enhance the Project's investment and financing prospects.

*Power Policy 2015 has been attached herewith as "**Annexure O**".*

<u>Long Term Coal Agreement under QPP Mechanism</u>

During the negotiations of the Quadpartite Power Purchase Agreement ("**QPPA**") with CPPA-G, CPPA-G introduced a Quarterly Power Purchase ("**QPP**") mechanism in the QPPA to replace the "Minimum Annual Energy" mechanism available in the standard PPA for other coal power projects (which in turn required minimum procurement to be at least 0.5 of the Available Capacity during an Agreement Year).

Under the QPP mechanism, the System Operator submits and notifies the energy requirements on a quarterly basis with no long-term energy requirements notification, which makes it extremely difficult for the Company to procure coal under a long term contract due to no long term commitments and hence the Company has to rely more on spot purchases.

As per Section 5.14 of the QPPA, the Company is permitted, subjected to the approval of CPPA-G, to procure additional quantities of coal through spot market purchases if not available under the long-term Coal Supply Agreement. As per Section 5.2 of the QPPA, the quantum of the quarterly energy and hence coal requirements remain at the sole discretion of the System Operator.

As a result, the Company believes that due to very short tenor of the order, no long-term agreement for coal supply may be available. Therefore, we would like to inform the Authority that coal pricing mechanism for the instant Project may not be competitive enough to match the prevailing mechanism for other large operators in Pakistan procuring coal on long term basis and that the Authority may please allow the Company to procure coal from spot market with percent flexibility if coal unavailable or not meet the demand of the operation under the long term agreement.

Others

The Authority may please clarify that the payments required to be made subject to Section 8.7 of the QPPA will be allowed by the Authority during Commission Tests and pre-COD sale of energy (if any).

Current tariff computation does not include Project contingencies, debt service reserve account and maintenance reserves. These should also be considered in calculation of the Project cost and tariff.

Power Purchaser is responsible for paying for all fuel, chemicals, and consumables during plant testing, so the testing tariff is sought in Modification Petition by the Company.

LIBOR is scheduled to exit the international market in June 2023. On this basis, lenders have indicated that the pricing of the loan to be obtained for the instant Project will most likely be based on SOFR plus a certain spread. As a result, the Authority may clarify that SOFR+spreads will be allowed to be adopted for the purpose of pricing senior debt.

The Authority, in determining that interest during construction is excluded from its calculation Sinosure fee and financing fees & charges which are Project cost items, must understand that a significant portion of the same is funded from senior debt and must therefore be included in the calculation of interest during construction and project cost along with Sinosure fee and financing fees & charges.

Your prompt action and kind cooperation in this regard will be greatly appreciated.

Regards

For & Behalf of the Project Company

Zhao Bo
Chairman

Enclosed: (USB)

Annexure A: Tariff Determination
Annexure B: Revised Tariff Determination
Annexure C: Modification Petition
Annexure D: EPC Price Adjustment from contractor
Annexure E: PPI Detailed Report – May 2019
Annexure F: PPI Detailed Report – March 2023
Annexure G: EPC Procurement and Construction contract
Annexure H: Letter of Intent by Sinosure
Annexure I: Letter of Intent by Shanghai Bank on guarantee structure
Annexure J: Financial Statements for 2019, 2020 and 2021
Annexure K: letter to GOB regarding delay in the Project development
Annexure L: Tax calculation and tax opinion by PwC
Annexure M: Source of risk-free rate, country risk premium and equity risk premium
Annexure N: CERC Tariff Regulation 2014
Annexure O: Power Policy 2015