



**PARLIAMENTARY FORUM
ON ENERGY & ECONOMY**

Renegotiating Independent Power Producer (IPP)

Agreements

A Step Forward in Resolving the Energy Crisis?

BRIEF PAPER



The Parliamentary Forum on Energy and Economy is a cross-party group of parliamentarians focused on addressing the nexus between energy and economy. It is a platform for open discussions, research-based debates and candid conversations within its members as well as with experts, representatives of civil society, policymakers, policy implementers and, most importantly, the citizens of Pakistan on the issues and problems that bind energy and economy together. We believe that these cross-party interactions and discussions will better inform everyone involved in their respective domains, contributing towards possible solutions to the energy-economy crisis.

INTRODUCTION

One of the central reasons for Pakistan's grave energy crisis and its electricity-related circular debt is the Power Purchase Agreements (PPAs) that the government signed with the Independent Power Producers (IPPs). The agreements are based on a take or pay model which means that the government has to make a mandatory payment to the IPPs for having added a certain amount of power generation capacity to the national electricity grid regardless of whether any electricity is purchased from them or not. These agreements also put no restrictions on the choice of fuel to generate power and allow IPPs an equity requirement as low as 20 percent, which means that the rest of the required investment has to be arranged through costly loans covered by Pakistan's sovereign guarantees. Not just that, the government has also guaranteed a fixed and dollarized rate of return on the investments made by IPPs.

Consequently, Pakistan has been paying approximately 900 billion rupees annually to IPPs in capacity charges over the last many years. This amount, however, rose to an enormous 2.1 trillion rupees in 2024 due to a drastic depreciation of Pak rupees against US dollar and a sharp increase in the installed power generation capacity in the country. To arrange these whopping sums of money, the government had to raise electricity prices enormously between 2022 and 2024, with capacity payments standing at more than 60 percent of consumer electricity bills.

To address this problem, the federal government began to renegotiate PPAs with several IPPs late last year, reportedly saving more than 1,000 billion rupees. Under this process:

- ◇ The country's oldest and largest IPP, Hubco, set up in the early 1990s, has agreed to shut shop and thereby receive no capacity payments;
- ◇ Many small IPPs that started their operations in the 2000s have either reduced their capacity payments and guaranteed returns on their investments or they have agreed to close down their operations.

While there is consensus among policymakers, experts, and policy critics that these renegotiations offer a way forward, there are apprehensions that this process has been neither transparent nor across the board. Its critics point out that:

- ◇ The IPPs that agreed to close their operations have, indeed, already completed their lifecycles as per their PPAs;
- ◇ The IPPs that have agreed to reduce their capacity payments and guaranteed returns on investments are also approaching the end of their lifecycle as per their PPAs;

- ◇ The latter IPPs, in any case, are too small to have any major impact on the overall capacity payments and electricity prices;
- ◇ The government has left all the IPPs set up under the 2015 energy policy -- including many owned by itself -- out of the process of renegotiation.

To discuss all these issues in detail, the Parliamentary Forum on Energy and Economy organized a consultation on 15th January 2025 in Islamabad. The event brought together parliamentarians, key policymakers, experts, IPP owners, representatives of business associations and other stakeholders. Their discussion centered on the financial stress being caused by the exorbitant payments that the government is making to IPPs under the PPAs.

Given below are the challenges, options and recommendations identified during the event:

KEY CHALLENGES

RENEGOTIATING PPAs

The PPAs – first signed in 1994 and then in 2002 and 2015 – include sovereign commitments by the government of Pakistan. Their renegotiations can lead to legal and contractual complications, including the risk of triggering costly arbitrations and other judicial processes.

UNDERUTILIZED CAPACITY

Though Pakistan has an installed electricity generation capacity of 45,888 megawatts, it can utilize only approximately 34 percent of it due to the decreasing demand by the industrial sector, rapid solarization of the residential sector, transmission bottlenecks and a slow economic growth rate. The PPAs, on the other hand, are structured in such a way that a decrease in electricity's demand and consumption results in an automatic increase in capacity payments. Lower the electricity demand, higher will be the capacity payments.

LACK OF TRANSPARENCY

PPAs were drafted in such a way that public interest was not protected in them, mainly because the government failed to get due expert input during their signing. It is also apparent that renegotiation process has taken place behind closed doors, sometimes involving allegations of high-handedness.

WEAK REGULATORY OVERSIGHT

The National Electric Power Regulatory Authority (NEPRA) has failed to check various financial, administrative and technical irregularities in the working of IPPs. It has also failed to protect the rights of the consumers suffering from arbitrarily devised electricity prices and unreliable and iniquitous supply of electricity.

SINGLE-BUYER MODEL

The government is the only buyer of electricity in Pakistan (except in Karachi where a private entity, K-Electric, operates as the only buyer). This situation enabled IPPs to make this single buyer sign power purchase agreements based on their own convenience and interests.

OUTSIDE INTERFERENCE

International financial institutions such as the World Bank and the International Monetary Fund (IMF) have strongly

backed the IPP-based power generation in the past, leaving little policy room for other options.

OPTIONS

ALIGN CAPACITY PAYMENTS WITH ELECTRICITY CONSUMPTION

In their current form, PPAs allow heavy capacity payments even when the IPPs are producing little or no electricity. It is essential to renegotiate PPAs in order to align capacity payments with actual electricity consumption.

RENEGOTIATE POWER PURCHASE AGREEMENTS

Another policy option is to expand the PPA renegotiation process to all IPPs, regardless of whether they are old or new and irrespective of the fact that they are owned by the government or the Chinese investors.

CHANGE THE CURRENCY OF PAYMENT

Presently, capacity payments are dollar denominated. Shifting the currency of payments to the government-owned IPPs from US dollars to Pak rupees will be a good way to reduce strain on foreign exchange reserves.

EMPOWER THE REGULATOR

Unless regulation is not autonomous and independent, power sector reforms will never be able to address the shortcomings of the system. Going forward, strengthening regulatory oversight by NEPRA is imperative to protect the interests of the consumers and ensure transparency and fairness in the process of renegotiating PPAs.

LIBERALIZE ELECTRICITY MARKET

Liberalization and decentralization of electricity governance is long overdue in Pakistan. Replacing the single-buyer model with a decentralized system of power generation, transmission and distribution – with many buyers and many sellers operating at the national, provincial and local levels can increase efficiency and competition in the power markets.

SUSPEND NEW POWER PROJECTS

With the national grid underutilized, it is important to prioritize the existing capacity utilization over new power projects. No new power plant should be set up until the power system has the demand and capacity to utilize all the existing capacity to generate electricity.

CHANGE ELECTRICITY DEBT INTO PUBLIC DEBT

A possible way forward can be to transfer all the loans obtained for hydroelectric and nuclear power projects to the government's books instead of passing them on to electricity consumers because, apart from the heavily flawed PPAs, costly loans obtained for these projects are a major source of financial stress for the power sector. Since the main objective of these projects is to store water for irrigation and ensure Pakistan's strategic security, transferring their costs to electricity consumers alone, instead of all the tax payers, appears to be unfair.

RECOMMENDATIONS

ACROSS-THE-BOARD RENEGOTIATIONS

Though the government has started a process of renegotiating PPAs, this process remains limited to IPPs set up under the 1994 and 2002 energy policies. The government, therefore, must ensure that renegotiations with IPPs are conducted across the board to devise similar terms and conditions for all of them, ensuring fairness, transparency, consistency and predictability. The highest financial stress is being caused by the power plants set up under the 2015 policy, many of which are either owned by the government's own IPPs or have been set up by the Chinese companies under the China-Pakistan Economic Corridor (CPEC). Without a comprehensive renegotiation of the PPAs with these power plants, the financial problems being faced by the government and electricity consumers cannot be fully addressed.

AUDIT OF IPPS

NEPRA should duly assess financial and technical affairs of all the IPPs, through measures that include but are not limited to forensic and heat rate audits, to probe if there are any financial, administrative or technical irregularities in their working. This process can be initiated with the government-owned IPPs to set a precedent for others.

TRANSITIONING TO 'TAKE-AND-PAY' CONTRACTS

The government should first of all modify its contracts with those IPP-owned power plants that cater only to peak electricity demand, determining their tariffs based on their marginal costs under a take-and-pay mode. This will align capacity payments with actual electricity consumption and, thereby, reduce unnecessary financial burden on the government and electricity consumers.

CHANGING THE CURRENCY OF PAYMENT

The government should renegotiate PPAs with the IPPs owned by its own entities to change the currency of payments to them from US dollars to Pak rupees – except for expenses they have to make in foreign exchange -- so that the burden on the national foreign exchange reserves can be minimized.

DEBT TRANSFERRING

The government should transfer all the power sector debts, especially those obtained for hydroelectric power projects and nuclear power plants, to the government's own books rather than passing them on to electricity consumers. These loans should be serviced like any other public debt through tax and non-tax revenues.

PHASING OUT INEFFICIENT POWER PLANTS

The government should initiate the decommissioning of old, outdated, underutilized and fuel-inefficient power plants, particularly those running on imported fuels, to optimize green energy generation and reduce electricity costs.

SUSPENDING NEW GENERATION PROJECTS

The government should utilize its Indicative Generation Capacity Expansion Plan (IGCEP) to prioritize efficient utilization of the existing power generation capacity rather than adding new power plants to the system, so that additions to capacity payments and other related financial obligations are avoided.

UNIFYING THE ENERGY SECTOR

Since many IPP-owned power plants run on gas, establishing a unified energy ministry is essential to streamline policy planning, improve sectoral governance and ensure a single point for decision making in the entire energy sector. Simultaneously, the two regulators operating separately in the power and petroleum sectors must be merged into one and given administrative, financial and operational autonomy.

CONCLUSION

The forum believes that renegotiating PPAs is a step in the right direction but this alone cannot bring down electricity prices. Firstly, the renegotiation process should involve IPPs set up under the 2015 energy policy. Secondly, the process has to be accompanied by a stronger, better equipped and more autonomous regulatory regime, the removal of government control over electricity transmission and distribution and the strengthening and digitalization of the national grid to improve electricity transmission and information flows. A thorough restructuring of electricity distribution companies should be carried out to minimize their financial and technical losses owed significantly to their governance problems. Finally, the problem of unutilized capacity has to be urgently addressed so as to support equity and economic growth both.