Umeme pushing to renew its contract

Reason. Although Umeme's contract to manage Uganda's electricity distribution network assets runs until March 1, 2025, industry watchers cite a number of reasons why the company needs to renew the agreement early

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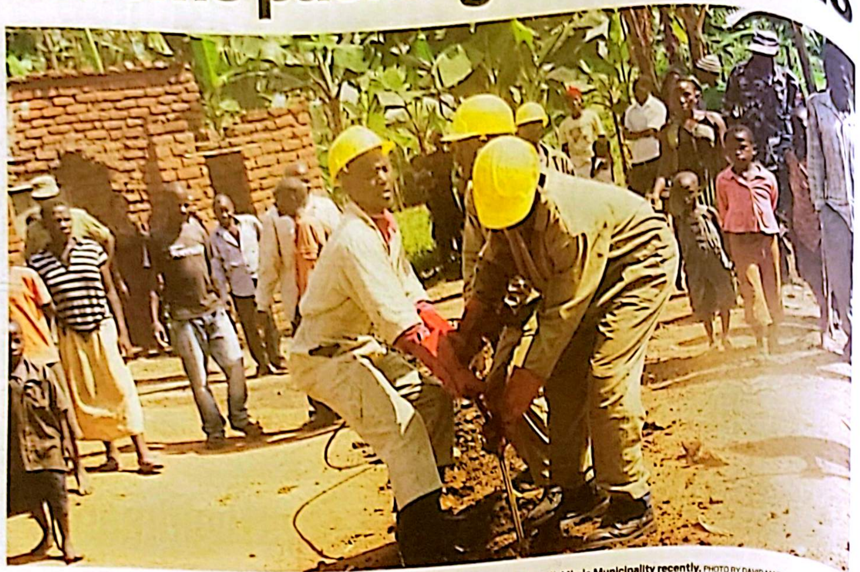

Power loss. Umeme officials uproot power cables used to illegally connect power to people's houses in Doko cell, Mbale Municipality recently. PHOTO BY DAVID MAFABI

KAMPALA. Electricity distributor Umeme has launched a charm offensive to renew its concession to distribute power with almost eight years left on its running contract. Umeme currently serves one million customers across the country.

Through the Lease and Assignment Agreement signed between Uganda Electricity Distribution Company Limited (UEDCL) and Umeme in 2005, the power distributor was to run UEDCL's electricity distribution network assets until March 1, 2025.

Whereas it would appear that there is still plenty of time to run on Umeme's concession, *Saturday Monitor* has learnt that the power distributor is knocking on several doors, starting with State House's, to advocate for a renewal of the contract, a fact the company's top executive acknowledges.

"I know there have been discussions in the corridors of power," Mr Selestino Babungi, Umeme's managing director, told this reporter at his office in Kampala a week ago.

Why renew contract early

On why Umeme is engaging this early on the subject of renewing its contract, industry watchers cite a number of reasons.

The need to get fresh loans.

Between now and 2025, as has been the case over the last 12 years, Umeme has to invest in the electricity distribution network. It has to connect more Ugandans to the grid by erecting more electricity lines (poles and cables) and electrical transformers, to mention but a few.

Although people who apply for connection pay for the service, they pay less than the actual cost. For instance, although a treated electricity pole costs $200 (about Shs700,000), Umeme charges $90.5 (about Shs300,000) for it.

Over the next eight years, Umeme, according to Mr Babungi, will have to sink $1 billion (about Shs3.5 trillion) in the distribution network assets. Most of the money the utility invests in the network is debt finance.

Dr Fred Muhumuza, an economist, says lenders usually "want to match assets with debt." He uses the government's decision to refinance the Bujagali hydropower plant, one of the government's measures to lower the end-user electricity tariffs, to drive the point home.

The financiers asked the government for a 15-year corporation tax waiver for Bujagali Energy Ltd to match the lenders' 15-year loan.

Dr Muhumuza says if there is no indication the government will renew the concession, Umeme's shareholders could consider moving their money elsewhere.

"So it is about signalling these people who have invested [in Umeme] to leave their money there...if they pull out, you [will] see Umeme begin to face financing problems," Dr Muhumuza says.

Turbulent history

Another possible reason for Umeme engaging early is that its history as a power distributor in Uganda has been mixed, with opposition to its concession spiking as high as leading to a parliamentary resolution to have the concession revoked.

In 2011, Gen Caleb Akandwanaho, commonly known as Salim Saleh, who had in 2009 headed a commission of inquiry into the energy crisis the country was facing, urged the government to repossess the Uganda Electricity Distribution Company Limited (UEDCL's) assets that Umeme is now using.

He argued that unbundling Uganda Electricity Board (UEB) into three separate entities was not well thought out. He said the West forced Uganda to liberalise. The other two companies that were born out of UEB are Uganda Electricity Generation Company Ltd and Uganda Electricity Transmission Company Ltd.

"It was cast round our throats," Gen Saleh said when he appeared before Parliament's Ad hoc Committee on Energy (ACE).

In October 2009, Gen Saleh had handed to then Energy minister Hilary Onek a report of investigations into the high cost of electricity in Uganda, which pointed to a number of irregularities in setting power tariffs and collection of energy bills. It also faulted the process of signing Umeme's concession to manage the distribution of power in Uganda.

The Speaker of Parliament, Ms Rebecca Kadaga, instituted the ad hoc committee to, among other tasks, look into energy losses, the tariffs and make recommendations.

But Energy minister Irene Muloni would later say Umeme was doing well.

"Whether the targets were low or otherwise, that is an area to deal with separately," Ms Muloni later said through a February 2013 Cabinet Paper. Before joining politics, Ms Muloni was the managing director of UEDCL, whose assets Umeme is managing.

Parliament would later (in March 2014) urge the government to terminate Umeme's power distribution concession and settle for a Public-Private Partnership in the power distribution sector, with the government having a 51 per cent stake.

Parliament, in passing the resolution, argued that the procurement of Umeme had been characterised by manipulation and that the agreements had "scandalous provisions".

Among the provisions the MPs took issue with is one that says that should Umeme be indebted to say its Ugandan shareholders by the time of terminating the agreement, the government will either pay off the debt or cancel it.

In the Support Agreement, the government waives its immunity in claiming its assets in case Umeme brought any legal proceedings against it.

The agreement

According to the Power Sales Agreement, in case UETCL sells to Umeme less power than had been projected, UETCL must compensate Umeme for the lost revenue, and where ministries, government departments or agencies Umeme has billed do not pay, Umeme is free to pay UETCL less the amount the ministries, departments or agencies owe the company.

The MPs also argued that the Attorney General, the government's chief legal adviser, was not the one who drafted the agreement between Uganda and Umeme; that it was foreign transaction advisers who did it.

That omission, the House said, was in contravention of the Constitution.

While voting in support of the termination of the concession, Parliament directed the Executive to report back to the House within three months after Parliament's resolution was passed.

The Executive has not reported back since.

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Shs37b

Investment. The amount ($10.2m) Umeme invested in the first 18 months of which $2.9m (Shs10b) was on connections and the rest on network assets.

Shs936b

Termination. The amount ($260.1m) Uganda would pay Umeme if the concession were to end today.

1 million

Connections. The number of customers Umeme had added to the grid against a target of 60,000 12 years into the concession.

17.5%

Reduction. The current percentage to which Umeme has reduced energy losses, from 33 per cent in 2005.

UMEME SHAREHOLDERS

Institution	Percentage
Kattegat Trust	41.93
National Social Security Fund	23.17
Kimberlite Frontier Africa Master Fund	6.50
Allan Gray	5.44
Investec Asset Management	4.92
Utilico Emerging Markets Ltd	4.31
Ashmore holding	3.40
Duet Group	2.97
International Finance Corporation	2.78
Coronation Global Opportunities	2.62

Focus on lenders

Companies vie for business primarily to make profit, and Umeme is not an exception. But its profit margin has been contested before.

Umeme is entitled to a Return on Investment (ROI/profit) of 20 per cent, which critics say is very hard to get in many markets. Watchers say the ROI is generous bearing in mind that the interest rate on loans it gets could at most be 9 per cent.

The lenders will be reluctant to lend the utility large sums if, in their assessment, the utility will face challenges clearing the loans within the next eight years should its contract not be renewed.

It is in this context that Umeme needs a signal that the government is amenable to renewing its agreement.

Some of the institutions that have in the past lent Umeme money include the International Finance Corporation, Nederlandse Financierings-Maatschappig voor Ontwikkelinsslanden N.V. and the World Bank.

From the public, Umeme was able to mobilise $65 million (about Shs230b) during the 2012 Initial Public Offer (IPO), $28 million (about Shs100b) of which it used to repay some of its debt.

A number of institutions and some individuals now own shares in the company. Additionally, Umeme was able to secure a $190m (about Shs684b) loan from IFC, Stanbic Bank Uganda and Standard Chartered Bank Uganda to invest in the distribution network.

High voltage. Umeme installs transformers in many trading centres so that electricity from high voltage lines such as these is altered to levels that households can use. PHOTO BY ABUBAKER LUBOWA

Achieving targets

Mr Selestino Babungi, the Umeme managing director, says it would be good for Uganda if the concession is renewed since Umeme has proven it can attract private capital to finance investment in the electricity sector. He says Umeme has been meeting the targets ERA has been setting and it should continue.

When Umeme started managing the network in 2005, the targets set then were to boost investment in network assets, connect more Ugandans to the national power grid, increase revenue collections and, above all, reduce energy losses.

In the first 18 months into the concession, it was to invest $5m (about Shs18b)

In the first five years, the company was to invest $65 million (about Shs234b) and connect 60,000 people to the grid.

On energy losses, Umeme was to reduce them from 33 per cent in 2005 to 15.70 per cent by 2017.

Since the end-user tariffs factor in energy losses, a reduction in energy losses should, other variables remaining constant, lead to a reduction in the tariffs.

The other target for Umeme was to increase revenue collection from 80 per cent in 2005 to 96.2 per cent (2011).

Umeme has performed thus: In the first 18 months, it invested $10.2m (Shs37b), of which $2.9m (Shs10b) was on connections and the rest on network assets.

Six years into the concession, it had added 113,000 customers to the grid against a target of 60,000. Twelve years later, Umeme has 1 million customers. It has achieved this through, partly, grid intensification – installing transformers in many trading centres so that electricity from high voltage lines is altered to levels that households can use. Revenue collection improved from 80 per cent to 100 per cent as of 2013.

Through informing electricity consumers they risk imprisonment for illegally tapping power or in the extremes and electrocution, it has reduced energy losses from 33 per cent in 2005 to 17.5 per cent as of 2017.

Umeme has increased the cumulative capital investments in the network from $6m (about Shs22b) in 2005 to $371.7m (about Shs1.3 trillion) (2017). Of that amount, it has so far recovered only $149.6 million (Shs538.4b). Were the concession to end today, Uganda would have to pay Umeme the balance, $260.1m (about Shs936b).

Now, with Umeme investing more and more annually in the network but recovering less annually, the gross accumulated capital investments could only increase.

KEY PLAYERS

Mr Selestino Babungi, Umeme's managing director. He says it would be good for Uganda if the concession is renewed since Umeme has proven it can attract private capital to finance investment in the electricity sector.

Gen Caleb Akandwanaho alias Salim Saleh. He, in 2009, headed a commission of inquiry into the energy crisis the country was facing, urged the government to repossess the Uganda Electricity Distribution Company Limited's assets that Umeme is now using

Irene Muloni, Energy minister. She disputed Gen Saleh's report, saying Umeme was doing well. "Whether the targets were low or otherwise, that is an area to deal with separately," Ms Muloni later said through a February 2013 Cabinet Paper

Deeply involved

Umeme is deeply entrenched in Uganda's power sector. It is a co-signatory to the financing agreements on the Power Sales Agreement for Karuma and Isimba hydropower plants' loans, which are expected to come on board next year or soon after that.

By one account, for Uganda to engage a different electricity distribution company, the Export Import Bank of China, the financier of the power plants projects, has to give a no-objection.

Umeme collects user fees from end-users and pays the Uganda Electricity Transmission Company Limited (UETCL), which then pays the generation companies. Since Uganda borrowed $2b (about Shs7 trillion) from China to construct Karuma and Isimba, it will want the money collected without disruption.

Next year, ERA is expected review Umeme's performance targets for the period 2019 to 2025. The review will set a new energy loss trajectory, operation and maintenance costs, collection rates, connections to the grid, outages, quality of supply.

The government might want to consider putting in more public money in the distribution network because for long as it is Umeme's money, it has to get its 20 per cent return on investment locked in and recoverable through the tariff.