



Public-Private Partnership Stories

Philippines: Power Distribution in Olongapo City



Olongapo City's electric distribution system was gravely affected by failures in safety, reliability, and performance. City administrators needed to improve the delivery of electricity by mobilizing private sector participation for the rehabilitation, upgrading, management and expansion of the system. IFC, the lead transaction advisor, assisted investors and conducted a fair, transparent and competitive selection process for the client. The improvement in Olongapo's electric distribution system will provide residents and businesses with safe, reliable services, continuously operating at peak performance.

In June 2010, Cagayan Electric Power and Light Company (CEPALCO) offered to purchase the distribution assets at the reserve price on the same terms and conditions stipulated in the approved Asset Purchase Agreement. On July 14, 2010, Olongapo City signed the contract with CEPALCO for about \$13.3 million. CEPALCO paid 50 percent of the sale proceeds; the remaining 50 percent will be paid after the company acquires a new franchise from the Philippine Congress. In addition, as part of the transaction CEPALCO will invest in system repairs and upgrades, about \$2 million immediately and a further \$11 million over a five year period.

This series provides an overview of public-private partnership stories in various infrastructure sectors, where IFC was the lead advisor.

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BACKGROUND

Residents of Olongapo, an autonomously-administered region of the Philippines, were long frustrated by an electric distribution services system beset by serious technical problems. More than 40,000 consumers, or approximately 200,000 people, including households, businesses, and institutions, bore the consequences: low reliability, frequent outages, high systems loss, and variable current. In 2005 the Mayor decided to introduce private sector participation through a concession. This attempt failed because the city was unable to obtain a favorable decision from the Energy Regulator Commission, the regulatory body, for a rate increase.

Conditions deteriorated as Olongapo City's Public Utilities Department (PUD) experienced financial difficulties and was unable to cope with its capital and operational needs. The Mayor pushed for another round of invitation for private sector participation to be managed by a credible transaction advisor, and IFC's mandate was signed in December 2007.

IFC'S ROLE

IFC assisted Olongapo City in the preparation, design, and implementation of a transaction for mobilizing private sector participation.

The IFC team conducted extensive due diligence throughout the course of the transaction, including a full diagnostic of the city's Public Utilities Department to identify key operational, legal, technical, and financial issues that would impact the structuring of a bankable transaction. Results of the due diligence were presented and discussed with the City government. IFC flagged two critical issues: the importance of the reconciliation of arrears of the PUD with the National Power Corporation (NPC), and the substantial increase of PUD debt as a result of delayed payments and overdue amounts. IFC recommended that PUD engage an independent and qualified party to prepare a complete financial database that would help create a restructuring plan.

IFC then prepared a Strategic Options Report which outlined the best options for Olongapo to improve the reliability and quality of service through the private sector, including settlement of past due accounts with NPC and suggestions for marshaling public support.

IFC's Transaction Structure Report included details on the recommended transaction and tender process for the selection of the private investor and operator. IFC marketed the transaction to potential investors at a pre-bid conference held in July 2009. IFC also completed the Information Memorandum for the transaction and prepared the necessary bid, tender, and contractual documents.

TRANSACTION STRUCTURE

In September 2009, Olongapo City issued an invitation to pre-qualify and bid for transaction, which included the sale of its electric distribution system and the obligation to invest in a predetermined emergency program in the first year of operation, as well as in other repairs and upgrades over time to meet the regulator's standards of service. IFC drafted the tender documents, which included the bidding procedures; bid forms; instructions to

bidders; asset purchase agreement; and related documents. IFC assisted the city during the pre-bid consultations with prospective investors.

IFC prepared a financial model to advise Olongapo City on valuation ranges for sale of distribution assets. IFC also advised the City on determination of past debts from PUD to NPC and on options for restructuring these debts.

BIDDING

Two bidders submitted bids; both were pre-qualified. Both bidders also submitted firm and binding offers, in compliance with bidding procedures. However, in June 2010 Olongapo City declared a failure of bidding since neither bid met the reserve price. At that point, the city chose to initiate exclusive negotiations with CEPALCO, the higher-ranked bidder.

IFC drafted the key elements and legal procedures to conduct a formal negotiation with CEPALCO. Exclusive negotiations began, and in late June 2010, CEPALCO offered to purchase the distribution assets at the reserve price on the same terms and conditions stipulated in the tender documents. On July 14, 2010, Olongapo City signed the sale of its electricity distribution system to CEPALCO for about \$13.3 million. CEPALCO paid 50 percent of the sale proceeds; the remaining 50 percent will be paid after the company acquires a new franchise from the Philippine Congress, a requirement for all distribution utilities.

EXPECTED POST-TENDER RESULTS

- Implementation of an emergency investment program of about \$2 million in the first year of operation.
- Significant improvements in reliability, systems loss, safety, sustainability, customer service, and overall value for money are expected within the first five years of the concession, to be maintained throughout the contract period.
- CEPALCO will be able to secure a Congressional franchise after 15 months and complete its modernization program over a five to 10-year period.
- In scale and complexity, the PPP solution to be carried out by the City will be pioneering and can have a high demonstration effect for other LGUs planning to develop and implement key infrastructure privatization projects.

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