

ADB-funded Power Projects in Sri Lanka*

Power sector restructuring, fiscal management, the restructuring of People's Bank, and the strengthening of the private sector are focuses of economic reforms supported by Asian Development Bank (ADB) in Sri Lanka. The current Government of Sri Lanka (GOSL), which took office in November 2005, has announced that it would seek alternatives to privatization to bring greater efficiency into the state-owned sector. ADB says that strong opposition by labor unions has been one of the major factors holding back reforms.

The Bank further says that the power sector remains a major trouble spot for the economy because its least-cost generation plans have not been implemented for the last 20 years. Electricity tariffs is among the highest in the region, despite the fact that the sector does not charge cost-recovery tariffs; this has resulted in daily losses of SLRs 50 million and an accumulation of large debts. Operational problems are exacerbated by rising power demand and high capacity utilization in the transmission and distribution system. Many lines and transformers are becoming overloaded and this will result in rising maintenance costs, deteriorating performance, and higher technical losses.

The power sector of Sri Lanka consists of the Ceylon Electricity Board (CEB), Lanka Electricity Company (Private) Ltd. (LECO), and several independent power producers. CEB is state-owned, services 2.69 million customers and is responsible for more than 90% of the country's power generation, all transmission, and 85% of distribution, with LECO providing the balance. Although LECO is incorporated as a private company, the Government and CEB own 99% of its shares. The Ministry of Power and Energy supervises CEB and LECO.

Reforms in the power sector began in 1998 and have led to the passing of the Electricity Reforms Act and the establishment of the Public Utilities Commission (PUC), a multi-utility regulatory body. The restructuring of the CEB, which has been at the planning stage since 1997 and supported by ADB and the Japan Bank for International Cooperation (JBIC), is making slow progress. According to ADB, this is a concern as 'weaknesses in CEB's management need to be identified and addressed, staff performance improved, the level of implicit cross subsidies determined, and more private direct investment in power generation attracted.'

In 1998, GOSL approved a restructuring plan that called for the unbundling of the power sector into separate companies for generation, transmission, and distribution; the unbundling of CEB is now put on hold. The Government is now seeking to bring more transparency into rate setting and procurement. The Government raised tariffs by an

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average of 5.3% in June 2000, the first increase since September 1997. The Government increased tariffs again in April 2002, with an amendment in August 2002.

ADB assistance to power sector reforms in Sri Lanka include the following:

- **Second Power System Expansion (Sector) Project**¹ (\$80.0M Loan – 1995) aims to: (i) assist the Government in implementing its rural electrification program; (ii) finance urgent transmission and distribution system development that CEB required; and (iii) expand and reinforce the distribution systems of CEB and LECO. Loan covenants include requiring CEB and LECO an 8% annual rate of return and a timebound action plan for the privatization of LECO; this latter action was suspended pending the outcome of power sector restructuring.
- **Power Sector Restructuring** (TA, 1998) aims to: (i) unbundle CEB into separate generation, transmission and distribution companies; (ii) prepare a new electricity act to support establishment of new power sector companies; and (iii) establish an independent regulatory agency to regulate the activities of the new power sector companies and the power sector.
- **AES Kelanitissa Power Project**² (\$25.93M – Loan; 31.0M – Private guarantee; 2000) aims to build, own, operate, and transfer a 163 MW diesel-based combined-cycle power generating plant under a 20-year concession agreement with GOSL. The plant is located within CEB's existing Kelanitissa power station premises in the northern part of Colombo. CEB will purchase capacity and energy output under a 20-year PPA (Power Purchase Agreement); GOSL will guarantee the payment obligations of CEB under the PPA. The Project attracts private capital to the power sector which frees up GOSL funds to meet other pressing financing requirements in the social sectors. Project sponsor is AES Kelanitissa Limited (AKL), a joint venture between AES Corporation, a leading US-based independent power producer, and Hayleys Limited, a diversified Sri Lankan conglomerate; commercial operation is expected to begin in 2002/2003. The project is a direct offshoot of power reforms to attract private investments in energy generation through BOT and build-own-operate-transfer (BOOT) schemes, allowing private developers to build and operate new thermal and minihydro power plants as government maintains control over large hydro plants.

¹ According to **Second Power System Expansion (Sector) Project**, Project Completion Report (Sep 2004) <http://www.adb.org/Documents/PCRs/SRI/pcr-sri-25388.pdf>: CEB has not complied with the covenant requiring an 8% annual rate of return on revalued net fixed assets in service. One of the major reasons for CEB's failure to comply was the absence of a proper tariff adjustment. LECO complied with all of its loan covenants, and always exceeded the 8% rate-of-return covenant.

² AES Kelanitissa Power Project <http://www.adb.org/projects/project.asp?id=34912>, <http://www.adb.org/Documents/PIDs/34912014.asp>

- **Power Sector Development Program**³ (Policy Loan - \$60M; Project Loan – \$70M; 2002) aims to: (i) establish independent regulation and tariff setting mechanism, (ii) enhance efficiencies in the sector by introducing competition and commercialization through change in management practices, (iii) encourage private sector participation in the sector through the development of an enabling transparent business environment, and (iv) improve the quality and quantity of supply by expansion, modernization, and rehabilitation of the distribution system, and additional rural electrification participation.

³ Power Sector Development Program <http://www.adb.org/Projects/project.asp?id=30207>, <http://www.adb.org/Documents/PIDs/30207023.asp>, <http://www.adb.org/Documents/PIDs/30207013.asp>, <http://www.adb.org/Documents/PIDs/30207012.asp>; Restructuring of Power Sector - Phase II <http://www.adb.org/projects/project.asp?id=35006>; Technical Assistance Report, April 2002 http://www.adb.org/documents/tars/sri/tar_sri_35006.pdf; Technical Assistance Completion Report, March 2006 <http://www.adb.org/Documents/TACRs/SRI/35006-SRI-TACR.pdf>; Power Fund for Poor <http://www.adb.org/projects/project.asp?id=36586>, <http://www.adb.org/Documents/Profiles/GRNT/36586012.ASP>

RECENT ADB PROJECTS IN THE POWER SECTOR IN SRI LANKA *

TITLE	DESCRIPTION	TYPE OF ASSISTANCE	DATE OF APPROVAL	AMOUNT (US\$)
Power Sector Development Program	Support reforms: (a) Establishing independent regulatory and tariff setting mechanisms (b) Introducing competition and commercialization (c) Encouraging private sector participation. It will also address drain on national resources arising from financial deterioration of state-owned utility, Ceylon Electricity Board (CEB).	Policy Loan	Oct 2002 (CLOSED)	60.0M - OCR
	(a) Finance 600 rural electrification subprojects all over the country (b) Provide or expand power supply in 820 villages housing 112,500 consumers (c) Strengthen CEB's distribution networks and provide transmission lines and substations.	Project Loan	Oct 2002	70.0M - ADF
	<i>Power Fund for Poor</i> – To enhance poverty impact of Power Sector Development Program, in the form of a revolving fund, initially funded on a grant basis and implemented by two or more local microfinance institutions. Poor households will be able to access funds to amortize upfront costs of connecting to the grid.	Grant – Japan Fund for Poverty Reduction	April 2004 (CLOSED)	1.5M
	<i>Power Sector Restructuring II</i> – To support actual unbundling of CEB's vertically integrated operations into separate Government-owned entities, each incorporated under the Companies' Act, and help establish and develop generation, transmission, and distribution companies.	TA Special Fund; SIDA	April 2002 (CLOSED)	0.8M
	<i>Power Sector Restructuring I</i>	TA – Japan Special Fund	Dec 1998 (CLOSED)	1.0M
AES Kelanitissa Power Project	To build, own, operate, and transfer a 163 MW diesel-based combined-cycle power generating plant at a cost of \$104 million under a 20-year concession agreement with Government of Sri Lanka (GOSL). The plant is located within Ceylon Electricity	Private Sector	Dec 2000	25.93M – Loan; 31.0M – Private guarantee

* TA – Technical Assistance; ADF – Asian Development Fund (concessional terms); OCR – Ordinary Capital Resources (less concessional)

	Board's existing Kelanitissa power station premises in northern part of Colombo. CEB will purchase capacity and energy output under a 20-year PPA; GOSL will guarantee CEB's payment obligations under PPA. AES Kelanitissa Limited (AKL) is a joint venture between AES Corporation and Hayleys Limited. AES Corporation, a leading US-based independent power producer, will provide equity of US\$24 million while Hayleys Limited, a diversified Sri Lankan conglomerate, will provide additional financing of US\$2 million.			
Second Power System Expansion (Sector) Project	(i) assist Government in implementing its rural electrification program; (ii) finance urgent transmission and distribution system development that CEB required; and (iii) expand and reinforce distribution systems of CEB and LECO.	Loan	Dec 1995	80.0M
OTHERSⁱ	Rural Electrification and Network Expansion - To ensure even distribution of economic growth by providing electricity to rural areas currently not covered by the national grid, and ensuring the opportunity for increased economic activity in rural areas.	TA Special Fund	Dec 2003 (CLOSED)	0.6M
	Energy Sector Master Plan - To formulate energy sector master plan (ESMP) to develop a sustainable energy sector: (i) reviewed existing materials such as laws, regulations, sector plans, and business practices; (ii) identified options available concerning sources and utilization of energy; (iii) detailed directions of developing an efficient and cost effective energy sector; and (iv) developed an investment plan for the energy sector.	TA Special Fund	May 2003 (CLOSED)	0.5M

ⁱ **Rural Electrification and Network Expansion** <http://www.adb.org/Projects/project.asp?id=34323>, <http://www.adb.org/Documents/Profiles/PPTA/34323012.ASP>; Technical Assistance Report, Dec 2003 http://www.adb.org/Documents/TARs/SRI/tar_sri_34323.pdf; Consultants' Reports, Dec 2005 <http://www.adb.org/Documents/Reports/Consultant/34323-SRI/default.asp>; **Energy Sector Master Plan** <http://www.adb.org/Projects/project.asp?id=36177>; Technical Assistance Report, May 2003 http://www.adb.org/Documents/TARs/SRI/tar_sri_36177.pdf; Technical Assistance Completion Report, July 2006 <http://www.adb.org/Documents/TACRs/SRI/36177-SRI-TACR.pdf>