

CEYLON ELECTRICITY BOARD ENGINEERS' UNION

(Registered under the Trade Unions Ordinance: Registration No. 770)

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September 23, 2021

His Excellency Gotabaya Rajapaksa
President of the Democratic Socialist Republic of Sri Lanka

Your Excellency,

Threat to Energy Security and Enormous Loss to the Country through the Unsolicited Proposal by the New Fortress Energy (NFE)

We are writing this at a time Sri Lankan power sector is subjected to lengthy conversations regarding an unsolicited proposal coming in from NFE for the supply of Liquefied Natural Gas (LNG), the establishment of LNG infrastructure and acquiring of 40% government shares of Yugadhanavi power plant. This NFE's unsolicited proposal was submitted disturbing the formal procurement through competitive bidding process where bids on terminal facility and pipelines are now in the final stage of evaluation.

Annexed with this letter is the findings of the comprehensive study carried out by CEB engineers on the Cabinet Memorandum of Ministry of Finance dated 2021.09.06 with the proposed Term Sheet of Gas Supply Agreement to be contracted with NFE. Some key points of the report are as follows:

1. This unsolicited proposal of NFE contradicts the provisions of the procurement policies and principles, the National Energy Policy gazette in Aug 2019 as well as Sri Lanka Electricity Act No. 20 of 2009, where competitive bidding process should be adopted to procure electricity as well as fuels. The national energy policy clearly states that the LNG procurement shall be kept under state control, considering the impact to the national energy security.
2. Since the LNG transaction to this country is in the range of USD 5000 - 6000 million for the next 10 years, it should be carefully assessed as only 5-10% is for LNG Infrastructure whilst 90- 95% of the value accounts for the LNG fuel supply contract.
3. The offered pricing formulas and the conditions of the Term Sheet attached with the Cabinet Memorandum for LNG supply are very much disadvantages to Sri Lanka. GOSL could lose up to USD 400 million for 5 years.

Thus, CEBEU requests the attention of Your Excellency to the annexed comprehensive study report by CEB Engineers titled "*Threat to Energy Security and Enormous Loss to the Country due to the Unsolicited Proposal of New Fortress Energy*" and kindly draw the intervention of Your Excellency to cancel the pursuing of this NFE's unsolicited proposal and make way for ongoing formal process to procure the LNG terminal facility and pipelines, and further ensure subsequent procurement of LNG supply also through competitive bidding process.

We expect due attention of Your Excellency would be drawn to this urgent and highly critical matter.

Thanking You,

Yours Faithfully,

CEYLON ELECTRICITY BOARD ENGINEERS' UNION

Jt. Secretary, CEBEU

Copy: Hon. Prime Minister
Hon. Minister of Power
Hon. Cabinet of Ministers
Hon. Members of Parliament
Secretary to the President
Auditor General
Secretary to the Prime Minister
Secretary of Ministry of Power
Chairman, CEB
General Manager, CEB

New Fortress Energy (NFE) Unsolicited Proposal Threat to Energy Security and Enormous Loss to the Country

National Energy Policy

- The Sri Lanka government has gazetted the National Energy Policy and Strategies of Sri Lanka in August 2019. The primary objective of the national energy policy is to ensure energy security through the supplies of reliable, cost effective and competitively priced energy services from diverse sources to support the social equitable development of Sri Lanka. National energy policy is founded mainly focusing on several aspects such as assuring energy security through continuity, adequacy and reliability, providing energy services at the optimum cost to the national economy, enhancing self-reliance, strengthening good governance in the energy sector among several others.
- The national energy policy identifies the liquefied natural gas (LNG) as the next fossil fuel option for the country to broaden diversity.
- The national energy policy clearly states that the LNG procurement shall be kept under state control, considering the impact to the national energy security.
- National energy policy further establishes that procurement of plant, equipment, crude oil and other fuels as well as power purchase agreements and similar concessions, will be made through a streamlined competitive bidding scheme ensuring transparency and accountability.

CEB's Initiatives for the Deployment of LNG for Electricity Generation in Sri Lanka

- In line with the national energy policy and the general policy guidelines on the electricity industry, CEB has already taken initiatives to deploy LNG for electricity generation in Sri Lanka.
- CEB has already developed a comprehensive road map for the deployment of LNG for Sri Lanka electricity generation through a detailed feasibility study funded by ADB.
- The intention was to deploy LNG for the Colombo based power plants initially with the actual LNG requirement determined carefully in accordance with CEB's generation plan as well as forecasted dispatch scenario.
- The tenders were separated for the procurement of LNG terminal, pipeline and LNG supply through competitive bidding process to secure the optimum economic benefits to the country while ensuring the transparency and accountability.
- International Competitive Tenders were called by CEB to procure LNG terminal (FSRU, mooring facility and other infrastructure) and by CPC to construct the pipe line network and the bids received are currently under evaluation.
- Bid documents to procure LNG through competitive bidding process are being prepared.

New Fortress Energy's Proposal

- New Fortress Energy (NFE), a USA based company has submitted an unsolicited proposal directly to the Ministry of Finance which has a huge direct impact to the LNG deployment in Sri Lanka.
- This NFE's unsolicited proposal was submitted disturbing the formal procurement process to procure LNG, terminal facility and pipelines to Sri Lanka through competitive bidding process where bids on terminal facility and pipelines are now in the final stage of evaluation.

- The salient features of NFE's unsolicited proposal are as follows,
 1. To purchase 40% of shares of West Coast Power Private Limited (WCPL) at a purchase consideration of USD 250 million.
 2. To execute LNG terminal project which includes Floating Storage Regasification Unit (FSRU), Mooring system and the Pipelines.
 3. Supply of Liquefied Natural Gas (LNG) to WCPL, Sobadhanavi Limited (SBL) and other plants which will come in Kerawalapitiya and with higher possibility the CEB plants at Kelanitissa as well.
 4. Inclusion of very high Take or Pay (TOP) gas volumes than the actual minimum requirement of the country with strict conditions that NFE should be paid irrespective of whether the contracted volumes are consumed or not.
 5. Contract term initially for 5 years with almost definite compelled further extensions.
 6. Exclusive rights of supplying LNG to Sri Lanka electricity generation.
 7. NFE being granted all tax exemptions/benefits/investment incentives available under Sri Lankan law.
 8. Any taxes/charges which are not exempted will be a pass-through cost.
 9. Governing law of the contracts is Laws of England and Wales.
- The Framework Agreement (FA) has already been signed between the GOSL and NFE on 07.07.2021.
- Recently, Cabinet has given approval to enter into the Gas Supply Term Sheet, Share Sale & Purchase Agreement (SSPA) of WCPL, Gas Supply Agreements with WCPL and SBL and subsequently media reports reveal that some of these agreements have already been signed.

Threat to the National Energy Security & Enormous Loss to the Country if NFE's Unsolicited Proposal is implemented

- The unsolicited proposal of NFE contradicts the provisions of the procurement policies and principles, National Energy Policy as well as Sri Lanka Electricity Act, where competitive bidding process should be adopted to procure electricity as well as fuels and also to keep the first LNG terminal and LNG supply under the state control.
- Exclusive rights of supplying LNG to Sri Lanka will be tied up with a USA company for 5 years initially with definite compelled extensions forever which is a great threat to national energy security. The Colombo based existing and future power plants can be controlled by a USA company through the LNG supply which will greatly hamper the country's electricity supply availability and reliability. Supply of LNG under this contract may not be limited to electricity sector but could also be extended to other sectors such as transport and domestic usage in the years to come which will give a huge controlling power to a foreign company.
- The contracts of LNG terminal, pipelines and LNG supply bundled together in a single unsolicited contract and handed over to a foreign company which is a severe threat to the national security as well as energy security and Sri Lanka will be in their custody forever.
- Majority of the countries in the world, the contracts of LNG supply and infrastructure development are not bundled together instead execute as separate tenders due to the concerns

of national security, energy security and to harness the maximum benefit of market competitiveness.

- Acquiring shares of WCPL and also SBL which is an absolute possibility as learnt, a USA based company will have the control over the electricity supply in the country.
- The transaction cost under the NFE's LNG supply contract could be in the range of USD 3000 million for 5 years and could go up to USD 6000 million for 10 years, given the fact that the country will be forced to buy LNG from NFE for the plants in Kelanitissa premises as well since there is no other alternative option. It is a huge crime meted out to the country if such a massive contract which could easily be the biggest contract of the country, is obtained through an unsolicited proposal without following due competitive bidding process.
- The offered pricing formulas for LNG supply are very much disadvantages to Sri Lanka. NFE could make enormous profits from this contract. It is like the infamous hedging deal of petroleum fuel supply which caused millions of dollar loss to the country. If this NFE proposal is implemented, GOSL will not have the opportunity to gain the advantages of price reductions of LNG in future. Further, GOSL will be deprived of benefitting to procure LNG on Government to Government (G to G) contracts from friendly middle east countries.
- Though in general, Take or Pay (TOP) clauses are typically not absolute and may include flexibility mechanisms for the buyer to adjust the contracted volumes, huge amount of TOP gas volumes with firm commitments of the buyers have been included in the NFE offer. The purchaser needs to pay the LNG supplier the cost of TOP gas volumes whether or not the purchaser uses the particular gas volumes. Hence, TOP gas volumes needs to be very carefully determined to the minimum value considering the plant factor, availability, dispatch scenario and availability of other low-cost energy sources like hydro, coal, wind and solar.
- However, the TOP volumes included in the NFE's LNG supply contract are extremely high. It can cause a huge additional financial burden on CEB and GOSL up to USD 400 million for 5 years including the additional undue gain from LNG pricing formula which is extremely high comparing to international competitive prices.
- With the government's simultaneous policy decision of 70% Renewable Energy integration for electricity generation, the usage of LNG could be even less and Take or Pay commitment of LNG will burden the country even more while benefitting NFE massively.
- What is more pathetic and beyond thinkable is that when it is unable to use the TOP LNG volume in a month, the purchaser has to pay the cost for TOP volume for that month and then subsequently has to pay again for the next month's actual usage of the same LNG which is stored in seller's facility. It is like selling the same LNG quantity twice. This is the extent of losing by the country if LNG supply contracts are signed for higher TOP volumes.
- Higher TOP contracts will also influence the merit order dispatching of power plants in the country and can lead to corruption practices.
- Under the NFE contract for terminal facility, CEB should pay a minimum of USD 253 million for 5 years for FSRU separately as the capacity charge in addition to LNG payment. However, with the previous unsolicited Korean offer under the Swiss Challenge basis, the FSRU was offered free of charge.
- In the Cabinet paper dated 06.09.2021 submitted by the Hon. Minister of Finance with regard to the NFE's unsolicited proposal, the capacity charge on the CEB executed tender for FSRU was compared to indicate that NFE's unsolicited proposal is more economical than offers received through CEB's competitive bidding process. This is a big lie and misrepresentation of real facts to misguide the Cabinet and the general public. NFE is granted all tax exemptions/benefits/investment incentives while bidders through CEB's competitive bidding process are subjected to payment of 24% of corporate tax and personal income taxes. In

addition, under the tender conditions, the pipeline system having 40 years of lifetime and mooring facility having 25 years of lifetime will be transferred to CPC and CEB respectively free of charge at the end of 10th year of the contract. Costs of these infrastructures contribute significantly to the tariff offered by bidders. Further, the tariff of the tender is inclusive of pipeline from FSRU to Kelanitissa power plant premises which is the most expensive and difficult part of the pipeline system. Hence, tendered prices can not be compared with NFE offered prices which is merely based on temporary infrastructures with limited scope.

- Further, NFE's capacity charge of USD 1.45 per MMBtu for FSRU, is just a cover up figure based on a high dispatch scenario whereas the actual dispatch would be much less and the actual capacity charge of NFE could exceed USD 5.50 per MMBtu.
- It is clear that real dominating factors with respect to financial feasibility are intentionally hidden in the submitted Cabinet paper. The cost of terminal facility and the pipelines is a minute figure of around USD 200 million when compared to the LNG supply contract of around USD 6000 million for 10 years. Nearly 95% of the total contract sum accounts for the LNG supply contract. Hence, it is the LNG supply contract which matters most for economic feasibility and not the terminal facility as misrepresented through the Cabinet paper. NFE has sensible enough to include all their undue profits in the LNG supply contract while misguiding the GOSL on terminal facility contract benefitted through undue access for the information of bids submitted through CEB's competitive tender process.
- FSRU agreements are extremely complex in nature. Off hire, warranty compensation, operations during turbulent oceanic conditions, commitment to availability of gas during May to September should be covered and none of these things have been discussed.
- The purchase consideration of USD 250 million for 40% stake in WCPL by NFE is said to be much less than the valuation of Chief Government valuer.
- NFE has determined a minimum plant factor of 70% for WCPL which is an extra cost to CEB while more profitable for NFE on return on shareholder investment as well as huge TOP LNG volumes.
- Changes intended to bring on heat rates during the impending amendments to the existing Power Purchase Agreement (PPA) of WCPL will bring enormous cost to CEB.
- As per the existing PPA of WCPL, coming years from 2022 onwards will be more profitable for shareholders as repayment of loan has almost been completed and hence NFE will be immensely benefitted.
- All existing shareholders of WCPL (Treasury-50%, EPF-27%, LECO-18%, LTL-5%) are local entities and return on equity is paid in LKR. However, when NFE becomes a shareholder, dividends on their investment will have to be paid in USD, a new avenue for forex outflow.
- What is another regretful fact for the country is that when the dividend payments are compelled to made in USD to NFE during the favorable years to come, the so-called incoming investment of USD 250 million through share purchasing will be wiped off within few years.
- Under the NFE's unsolicited LNG supply contract and the amendments to the existing PPA together with actual plant factor, the cost of electricity unit of WCPL could easily go up to such a level that sometimes it might be cheaper running the power plant on HFO under existing PPA.
- The Framework Agreement (FA) signed and what is doing now are two different things. FA is only for WCPL with a USD 9.9 Cents maximum price per kWh of electricity. Now, there is a Cabinet decision to amend the FA and increasing of the electricity unit cost is a definite occurrence.

- It is crystal clear that the main aim of NFE is not the mere USD 250 million investment in shares of WCPL but the securing of multi-billion dollar LNG supply contract without a competition and with exclusive rights of supplying LNG to the whole country with undefined extended duration beyond 5 years with massive controlling power on the country's national security and energy security and with guaranteed exorbitant profits.
- No official discussions or consultations were held with CEB or Ministry of Power on this unsolicited proposal and the Ministry of Finance single handedly managed the entire process.
- GOSL is going to sign agreements with NFE and not CEB as usually done hence it will be a strong binding and dispute resolution will be extremely difficult.
- The governing law of the contracts is the Law of England and Wales where Sri Lanka will be in a very much disadvantageous and powerless position.
- In the Cabinet paper dated 06.09.2021, the Minister of Finance has quoted and compared all figures from the financial proposal of the ongoing tender initiated by CEB. This is totally against the NPA procurement guidelines and good governance. This will set a very bad precedence on all types of procurement in the country and severely hamper the credibility, transparency and confidentiality. This will greatly discourage genuine investors coming to our country. This is a gross violation of the clause 3.8.2 of the national energy policy as well.
- NFE has taken all information from CEB floated tender for FSRU to formulate their offer and bundled with LNG supply also. All studies carried out by CEB for years have been obtained by NFE at no cost and submitted an unsolicited proposal.
- Implementation of NFE unsolicited contracts is the end of competitive bidding process for LNG supply, FSRU and pipelines as there are no other requirements than a single terminal facility and single LNG supply contract to Sri Lanka at the moment.
- The Ministry of Energy is working fast on exploration of natural gas in Mannar basin. This will be of no use locally as entire LNG supply of the country will be supplied through NFE contract.