SUPPLEMENTAL IMPLEMENTATION COMPLETION AND RESULTS REPORT
(Credit Number 3411-UG)

ON A

CONTINGENT CREDIT

IN THE AMOUNT OF SDR 5.48 MILLION

(US$ 8.27 MILLION EQUIVALENT)

TO

REPUBLIC OF UGANDA

FOR A

COMPONENT E UNDER PRIVATIZATION AND UTILITY SECTOR REFORM PROJECT, SUPPORT TO UMEME LIMITED

December 5, 2014

Eastern Africa Country Cluster 1 (AFCE1)
Energy and Extractive Practice Group
Africa Region
CURRENCY EQUIVALENTS

(Exchange Rate Effective May 28, 2014)

Currency Unit=Shilling (Uganda)
US$ 1.00 =Shilling 2,550

FISCAL YEAR 2015

ABBREVIATIONS AND ACRONYMS

CAS  Country Assistance Strategy
EDP  Enterprise Development Project
ERA  Electricity Regulatory Agency
FDI  Foreign Direct Investment
GDP  Gross Domestic Product
GoU  Government of Uganda
IDA  International Development Association
MFPED Ministry of Finance, Planning and Economic Development
PCU  Project Coordinating Unit
PE  Public Enterprise
PPI  Private Participation in Infrastructure
PU  Privatization Unit
PUSRP Privatization and Utility Sector Reform Project
SPP  Special Provision Period
UEB  Uganda Electricity Board
UEDCL  Uganda Electricity Distribution Company Ltd
UEGCL  Uganda Electricity Generation Company Ltd.
UJAS  Uganda Joint Assistance Strategy

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Country Director: Philippe Dongier
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Practice Manager: Lucio Monari
Practice Manger (Guarantee): Pankaj Gupta
Project Team Leader and ICR Team Leader: Robert Schlotterer
ICR Primary Author: Ada Karina Izaguirre Bradley
UGANDA
COMPONENT E UNDER PRIVATIZATION & UTILITY SECTOR REFORM PROJECT
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### A. Basic Information

<table>
<thead>
<tr>
<th>Country:</th>
<th>Uganda</th>
<th>Project Name:</th>
<th>Privatization &amp; Utility Sector Reform</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project ID:</td>
<td>P050439</td>
<td>L/C/TF Number(s):</td>
<td>IDA-34110, IDA-3411A, IDA-B0070</td>
</tr>
<tr>
<td>ICR Date:</td>
<td>09/03/2014</td>
<td>ICR Type:</td>
<td>Core ICR</td>
</tr>
<tr>
<td>Lending Instrument:</td>
<td>SIL</td>
<td>Borrower:</td>
<td>REPUBLIC OF UGANDA</td>
</tr>
<tr>
<td>Original Total Commitment:</td>
<td>XDR 4.48</td>
<td>Disbursed Amount:</td>
<td>XDR 0.0</td>
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</tbody>
</table>

**Environmental Category:** B  
**Implementing Agencies:**  
Ministry of Finance, Planning and Economic Development  
**Cofinanciers and Other External Partners:**

### B. Key Dates

<table>
<thead>
<tr>
<th>Process</th>
<th>Date</th>
<th>Process</th>
<th>Original Date</th>
<th>Revised / Actual Date(s)</th>
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<tbody>
<tr>
<td>Concept Review:</td>
<td></td>
<td>Effectiveness:</td>
<td>02/27/2005</td>
<td>03/02/2005</td>
</tr>
<tr>
<td>Approval:</td>
<td>12/14/2004</td>
<td>Mid-term Review:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Closing:</td>
<td></td>
<td>02/28/2015</td>
<td>03/30/2014</td>
</tr>
</tbody>
</table>

### C. Ratings Summary

**C.1 Performance Rating by ICR**

- **Outcomes:** Satisfactory  
- **Risk to Development Outcome:** Modest  
- **Bank Performance:** Satisfactory  
- **Borrower Performance:** Satisfactory

**C.2 Detailed Ratings of Bank and Borrower Performance (by ICR)**

<table>
<thead>
<tr>
<th>Bank</th>
<th>Ratings</th>
<th>Borrower</th>
<th>Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality at Entry:</td>
<td>Satisfactory</td>
<td>Government:</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Quality of Supervision:</td>
<td>Highly Satisfactory</td>
<td>Implementing Agency/Agencies:</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Overall Bank Performance:</td>
<td>Satisfactory</td>
<td><strong>Overall Borrower Performance:</strong></td>
<td>Satisfactory</td>
</tr>
</tbody>
</table>

**C.3 Quality at Entry and Implementation Performance Indicators**

<table>
<thead>
<tr>
<th>Implementation Performance</th>
<th>Indicators</th>
<th>QAG Assessments (if any)</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Potential Problem Project at any time (Yes/No):</td>
<td>No</td>
<td>Quality at Entry (QEA):</td>
<td>None</td>
</tr>
</tbody>
</table>
Problem Project at any time (Yes/No): No
Quality of Supervision (QSA): None
DO rating before Closing/Inactive status: Satisfactory

D. Sector and Theme Codes

<table>
<thead>
<tr>
<th>Sector Code (as % of total Bank financing)</th>
<th>Original</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central government administration</td>
<td>52</td>
<td>55</td>
</tr>
<tr>
<td>Other social services</td>
<td>48</td>
<td>45</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Theme Code (as % of total Bank financing)</th>
<th>Original</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulation and competition policy</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>State-owned enterprise restructuring and privatization</td>
<td>50</td>
<td>50</td>
</tr>
</tbody>
</table>

E. Bank Staff

<table>
<thead>
<tr>
<th>Positions</th>
<th>At ICR</th>
<th>At Approval</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vice President:</td>
<td>Makhtar Diop</td>
<td>Gobind Nankani</td>
</tr>
<tr>
<td>Country Director:</td>
<td>Philippe Dongier</td>
<td>Judy M. O’Connor</td>
</tr>
<tr>
<td>Practice Manager:</td>
<td>Lucio Monari</td>
<td>Demba Ba</td>
</tr>
<tr>
<td>Project Team Leader:</td>
<td>Robert Schlotter</td>
<td>Lucy Fye</td>
</tr>
<tr>
<td>ICR Team Leader:</td>
<td>Robert Schlotter</td>
<td>Robert Schlotter</td>
</tr>
<tr>
<td>ICR Primary Author:</td>
<td>Ada Karina Izaguirre Bradley</td>
<td></td>
</tr>
</tbody>
</table>

F. Results Framework Analysis

Project Development Objectives (from Project Appraisal Document)
The project's development objective is to improve the quality, coverage and economic efficiency of commercial and utility services, through privatization, private participation in infrastructure (PPI) and an improved regulatory framework.

Component E was fully in-line with the Development Objective of the umbrella operation (P050439 and IDA-34110) as it was designed to help finalize the concessioning of the electricity distribution services. But as it was transaction specific, its development objective was limited to electricity distribution services.

Revised Project Development Objectives (as approved by original approving authority)
The PDO was not revised.
(a) PDO Indicator(s) related to Component E of the Project

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Baseline Value</th>
<th>Original Target Values (from approval documents)</th>
<th>Formally Revised Target Values</th>
<th>Actual Value Achieved at Completion or Target Years</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Indicator 1</strong>: Coverage Rate (% of population with grid-based connections) in Electricity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value quantitative or Qualitative</td>
<td>3.8 % (1999)</td>
<td>7 % (2005)</td>
<td>15% (2013)</td>
<td></td>
</tr>
<tr>
<td>Date achieved</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comments (incl. % achievement)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Indicator 2**: Losses in power sector (units billed as % of units produced)

| Value quantitative or Qualitative | 34 % (1999) | 25 % (June 2005) | 24.3 % (2013) | |
| Date achieved | | | | |
| Comments (incl. % achievement) | Actual losses were higher than initially reported at the onset of the operation. The operation was successful at reducing losses. | | | |

(b) Intermediate Outcome Indicator(s) related to Component E of the project

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Baseline Value</th>
<th>Original Target Values (from approval documents)</th>
<th>Formally Revised Target Values</th>
<th>Actual Value Achieved at Completion or Target Years</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Indicator 1</strong>: The privatization of distribution assets being finalized and remaining in place throughout the life of the operation.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value quantitative or Qualitative</td>
<td>IDA support to the distribution Concession was a condition of effectiveness under the Privatization Agreements signed on May 17, 2004.</td>
<td>Arranging the IDA support to meet the contractually agreed transferred date set for the distribution assets; December 2004.</td>
<td>IDA support was extended until the end of the SPP period, but no later than February 2014.</td>
<td>Privatization completed in March 2005.</td>
</tr>
<tr>
<td>Umeme investors were willing to enter into the distribution business for an 18 month “trail” period at the end of which they would decide to stay or terminate the Concession.</td>
<td>Privatization remained in place by the end of IDA support (March 2012).</td>
<td></td>
<td>Privatization remained in place by end of the operation.</td>
<td></td>
</tr>
<tr>
<td>Date achieved</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comments</td>
<td>The Special Provision Period (SPP) was set up to take into account the impact of the power</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
supply crisis on Umeme. Indicators were fully achieved. It should be noted that the concession survived a challenging environment due to a power supply crisis, and was delivering solid operational and financial results by the Project closing. Little risk of cancellation by end of IDA support period.

Indicator 2: ERA approving tariff adjustments according to the tariff methodology.

<table>
<thead>
<tr>
<th>Value (quantitative or Qualitative)</th>
<th>Date achieved</th>
<th>Comments (incl. % achievement)</th>
</tr>
</thead>
<tbody>
<tr>
<td>To keep tariffs in line with market conditions and cost reflective, ERA was responsible for making annual adjustments using the tariff methodology (including key parameters) set at the onset of the Concession.</td>
<td></td>
<td>Indicator was successfully achieved. ERA adjusted tariffs between 2005 and 2012 in a professional and technical manner for the most part; following the methodology agreed at the onset of the concession. ERA followed similar approach for setting values of key parameters the new tariff period 2013-2018.</td>
</tr>
<tr>
<td>Tariffs to be adjusted between 2005 and 2012 according to methodology approved at the onset of the Concession.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In 2006, tariffs started to be adjusted quarterly to take into account the impact of power supply crisis.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tariff adjustments between 2005 and 2012 followed the agreed methodology and parameters set at the onset of the Concession.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>By end of 2012, ERA was also able to set methodology and operational targets for a new tariff period (2013-2018).</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

G. Ratings of Project Performance in ISRs

<table>
<thead>
<tr>
<th>No.</th>
<th>Date ISR Archived</th>
<th>DO</th>
<th>IP</th>
<th>Actual Disbursements (USD millions)</th>
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<tbody>
<tr>
<td>1</td>
<td>02/12/2001</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>0.00</td>
</tr>
<tr>
<td>2</td>
<td>05/22/2001</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>0.76</td>
</tr>
<tr>
<td>3</td>
<td>06/28/2001</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>0.97</td>
</tr>
<tr>
<td>4</td>
<td>12/18/2001</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>1.44</td>
</tr>
<tr>
<td>5</td>
<td>05/16/2002</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>2.77</td>
</tr>
<tr>
<td>6</td>
<td>12/20/2002</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>10.43</td>
</tr>
<tr>
<td>7</td>
<td>05/30/2003</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>12.61</td>
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<tr>
<td>8</td>
<td>10/24/2003</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>15.45</td>
</tr>
<tr>
<td>9</td>
<td>05/27/2004</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>18.18</td>
</tr>
<tr>
<td>10</td>
<td>11/19/2004</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>20.32</td>
</tr>
<tr>
<td>11</td>
<td>06/24/2005</td>
<td>Satisfactory</td>
<td>Moderately Satisfactory</td>
<td>22.77</td>
</tr>
<tr>
<td>12</td>
<td>12/28/2005</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>24.50</td>
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<tr>
<td>13</td>
<td>06/26/2006</td>
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<td>Satisfactory</td>
<td>31.16</td>
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<tr>
<td>14</td>
<td>01/23/2007</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>31.28</td>
</tr>
<tr>
<td>15</td>
<td>06/28/2007</td>
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<td>Moderately Satisfactory</td>
<td>31.28</td>
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<tr>
<td>16</td>
<td>12/20/2007</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>31.28</td>
</tr>
<tr>
<td></td>
<td>Date</td>
<td>Rating 1</td>
<td>Rating 2</td>
<td>Score</td>
</tr>
<tr>
<td>----</td>
<td>---------------</td>
<td>------------------</td>
<td>------------------</td>
<td>-------</td>
</tr>
<tr>
<td>17</td>
<td>06/02/2008</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>31.28</td>
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<tr>
<td>18</td>
<td>12/17/2008</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>31.28</td>
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<td>19</td>
<td>05/04/2009</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>31.28</td>
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<tr>
<td>20</td>
<td>12/17/2009</td>
<td>Moderately Satisfactory</td>
<td>Satisfactory</td>
<td>31.28</td>
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<td>21</td>
<td>06/08/2010</td>
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<td>Moderately Satisfactory</td>
<td>31.28</td>
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<td>22</td>
<td>03/28/2011</td>
<td>Moderately Satisfactory</td>
<td>Moderately Satisfactory</td>
<td>31.28</td>
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<td>23</td>
<td>12/04/2011</td>
<td>Moderately Satisfactory</td>
<td>Moderately Satisfactory</td>
<td>31.28</td>
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<td>24</td>
<td>06/30/2012</td>
<td>Moderately Satisfactory</td>
<td>Moderately Satisfactory</td>
<td>31.28</td>
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<td>25</td>
<td>03/17/2013</td>
<td>Moderately Satisfactory</td>
<td>Moderately Satisfactory</td>
<td>31.28</td>
</tr>
<tr>
<td>26</td>
<td>09/17/2013</td>
<td>Moderately Satisfactory</td>
<td>Moderately Satisfactory</td>
<td>31.28</td>
</tr>
<tr>
<td>27</td>
<td>04/01/2014</td>
<td>Moderately Satisfactory</td>
<td>Moderately Satisfactory</td>
<td>31.28</td>
</tr>
</tbody>
</table>
### H. Restructuring (if any)

<table>
<thead>
<tr>
<th>Restructuring Date(s)</th>
<th>Board Approved PDO Change</th>
<th>ISR Ratings at Restructuring</th>
<th>Amount Disbursed at Restructuring in USD millions</th>
<th>Reason for Restructuring &amp; Key Changes Made</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/14/2004</td>
<td>N</td>
<td>S</td>
<td>S</td>
<td>To incorporate a guarantee support for Umeme concession. Credit 3411-UG was at the end of its implementation and had undisbursed funds. It was an innovative way to use an IDA allocation to structure a support that had the same PDO of an existing operation. More importantly the decision was responsive to the needs of the GoU to expedite the approval of the IDA support. GoU up to nine months to put place IDA support, which was a condition of effectiveness for the Transfer of the Umeme Concession. The decision was cost-effective as the preparation cost of a restructuring was more commensurable to the amount of guarantee support (US$5.5 million).</td>
</tr>
<tr>
<td>11/27/2006</td>
<td>N</td>
<td>S</td>
<td>S</td>
<td>To expand and extend the IDA guarantee support to Umeme in a manner deemed necessary to maintain the viability of Umeme Concession after Uganda started facing a major power supply crisis. Section 2.2 explains the crisis and its impact on the project.</td>
</tr>
</tbody>
</table>


I. Disbursement Profile
1. Project Context, Development Objectives and Design

1.1. Context at Appraisal

Country background

1. At the time of appraisal in 2005, Uganda had transformed from a nearly failed state to a country achieving consistently high economic growth rates and significant reductions in poverty. The country’s GDP grew at an average annual rate of 6.9% in the 1990s and 5.5% in early 2000s. The proportion of the population living below the poverty line declined from 56% in 1992 to 34% in 2000. Such progress was the result of the Government of Uganda (GoU) reform policies that pursued macroeconomic stability and promoted economic liberalization and private sector-based, export-led growth.

2. Prospects of further growth and poverty reduction, however, were hampered by the poor performance of public enterprises and their high dependency on subsidies. The power sector was one of the worst performers, suffering from a number of problems: Extensive and increasing load shedding, inadequate investment to maintain and expand the power network and supply, collection rate of less than 50% of power generated, losses varying between 30% and 40%, high account receivables driven by non-payment of government entities, low productive, and a national access rate of 5%. Power losses in Uganda were the highest in Africa while the access rate was the lowest. By 2000, the power sector was close to insolvency.

Sector Background

3. In this context, the Government viewed the public enterprise sector reform and privatization program as a central piece of its long-term growth strategy. The program aimed to (i) reduce the role of the State in the economy; (ii) improve the quantity, quality, and efficiency of public services; and, (iii) reduce the financing burden that public enterprises posed on public finances. In the power sector, the GoU approved a reform strategy in June 1999 that called for developing Uganda’s hydro power resources through Independent Power Producers, and adopting a commercially-oriented approach to increase power access and improve performance. The main function of Government became to create an enabling environment for private investment by levelling the playing field for private sector participants, creating a regulatory framework that supported private investment, setting cost recovery tariffs, and establishing transparent subsidy transfer and financing mechanism. To implement this strategy, the GoU passed a new power act in November 1999; established the Electricity Regulatory Authority (ERA) as independent sector regulator in April 2000; unbundled the national utility Uganda Power Board (UEB) into generation, transmission, and distribution in March 2001, and, took measures to correct government agencies’ billing arrears in late 2001. ERA raised and rebalanced power tariffs in line with long run marginal cost effective in June 2001.
4. In the new sector strategy, the concessioning of the distribution assets was considered fundamental to the underpinning of the commercial viability of the power sector, and to support future new generation investment, including Bujagali Hydropower Plant. The primary objectives of the distribution concession were to improve the commercial power distribution operations and increase electrification.

5. The GoU launched international tender processes to select strategic investors for its generation and distribution assets in 2001. Eskom Uganda Ltd, a whole-owned subsidiary of South African Eskom Enterprises, was selected as the concessionaire for the existing generating assets. The state-owned holding company for generation assets (UEGCL) signed a 20 year concession with Eskom Uganda Ltd in November 2002. The handover of generation assets was completed in April 2003.

Project Context and Design

6. The concessioning of distribution assets, which was the first one for an unbundled distribution network in Sub-Saharan Africa, proved to be more challenging. Developments in the international market reduced the risk appetite of potential investors. At the beginning of the tender process, about 5 to 6 companies showed interest in Uganda’s power distribution assets, but the interest later declined due to the collapse of US Enron and the re-assessment of the potential for profit in small markets such as the Ugandan. By the end of the tender process, the Government received only one bid from Umeme, a joint venture between Eskom Enterprises (44%) and Globeleq Ltd of Bermuda (56%), a wholly-owned subsidiary of UK based Globeleq Ltd. Eskom provided technical expertise to manage a distribution business, while Globeleq brought commercial and financial expertise.

7. While Umeme recognized that GoU had made remarkable progress in reforming the power sector, it still perceived power distribution services as prone to political intervention. The sector regulator, ERA, had yet to build a track record of independent and technical decision making relative to tariffs; public entities had yet to prove that they would pay their bills in a timely manner; and, the government had yet to build a record of honouring its payment obligations in a timely manner. After a year of protracted negotiations, it was clear to the GoU that IDA support was required to secure the Umeme’s commitment.

8. The IDA team opted for helping GoU structure a security package to mitigate the perceived political and regulatory risks by including in it an IDA Guarantee to backstop key government payment obligations. The Privatization Agreements between GoU and Umeme were concluded on May 17, 2004 and made IDA support a condition of effectiveness for the Transfer Date of the Concession. The IDA Guarantee became effective on March 3, 2005.

9. The IDA team opted for designing the guarantee support as an additional component (Component E) to the Privatization and Utility Sector Reform Project (P050439 and Credit 3411-
UG), which was towards the end of its implementation period. The IDA contingent credit for Umeme was a natural fit to Credit 3411-UG, which had been supporting the privatization of public enterprises and sector reforms in infrastructure services since 2000 (Section 2.1). The four other components of Credit 3411-UG closed in January 2006 and their respective Implementation Completion Report was submitted to the Board in July 2006.

10. Therefore, this is a supplemental Implementation Completion Report that covers Component E (US$5.5 million contingent IDA credit to support Umeme concession) as indicated in the credit restructuring paper approved in December 2004. For the evaluation of the other Project components, please see the ICR dated July 31, 2006 Report No: ICR-000041.

Rationale for Bank Assistance

11. The IDA contingent credit support was fully in line with the Country Assistance Strategy (CAS) at the time of appraisal and aimed to contribute to two CAS objectives: (i) reduce poverty through broad-base economic growth led by the private sector; and (ii) improve the welfare of the entire population by improving the quality of, and access to infrastructure services. By facilitating the concessioning of distribution assets, the IDA contingent credit was helping to secure private participation in distribution, which aimed to improve service provision, and channel at least US$65 million in private investment in the first five years of the concession.

12. MIGA also supported Umeme Concession by providing an insurance coverage for up to US$45 million for equity and shareholder loans to cover termination payments in 2005. The combination of IDA guarantee support and MIGA coverage gave enough comfort to Umeme investors to undertake the 20-year distribution Concession.

1.2. Original Project Development Objectives (PDO) and Key Indicators

13. According to the Development Credit Agreement, the original objectives of the Credit were “to support the Borrower in carrying out of its policy to improve the quality, coverage and economic efficiency of commercial and utility service through: (a) the divestiture and restructuring of the remaining Public Enterprises; (b) increased private sector participation in the provision of infrastructure in sectors such as telecommunications, energy, water and rail transport; and (c) the strengthening of the regulatory framework and institutions required to carry out the said policy”. The PDO remained unchanged when Component E was introduced as this component was designed to complete an outcome under Component B of the umbrella operation (P050439 and IDA-34110) as indicated in the Project Design Summary of the original PAD. Component E was to help finalize the concessioning of the electricity distribution services. As the component was transaction specific, the development objective was limited to electricity distribution services.

14. The two performance indicators set for the power sector in the original PAD were also
kept as those indicators were a good proxy for measuring the achievement of the PDO. The two indicators were:

(i) To increase access rate to grid connection from a baseline of 3.8% of population in 1999 to 7% in 2005; and

(ii) To reduce power losses (units billed as % of units produced) from a baseline 34% in 1999 to 25% in 2005.

15. The target values of those indicators were not revised because of the lack of reliability of available data, and the understanding that the concession agreement would supersede any revision of the baselines and targets (see paragraph 34).

16. During the implementation support phase, the project team added two intermediate indicators to the monitoring and evaluation arrangements to better assess the performance of the operation. The new indicators were:

(i) The privatization of distribution assets being finalized, and remaining in place; and

(ii) ERA approving tariff adjustments according to the tariff methodology.

17. These two intermediate indicators became highly relevant to guide the implementation support of the IDA contingent credit as Umeme concession faced challenging circumstances during its first years due to a major power supply crisis in the country as explained sections 2.2 and 6.1.b.

1.3. Revised PDO (as approved by original approving authority) and Key Indicators, and reasons/justification.

18. There were no revisions.

1.4. Main Beneficiaries

19. The beneficiaries of Component E were similar to those of the Original project. The original PAD of 2000 identified three broad target groups as main beneficiaries for the original Project. When applied to the power distribution business, the expected beneficiaries were:

(i) The Private Sector: the business community was expected to enjoy investment opportunities through privatization. It was also to benefit from better quality of utility services and reduced costs of production factors which would lead to increased competitiveness.

(ii) Local Population: In the short run, the workforce of a privatized company was expected to be downsized as a result of retrenchment of excess staff. However, in the medium term, the Project would lead to reduction in unemployment through more rapid growth of concessioned distribution business, and its indirect effect on the creation of more employment opportunities in
the private sector. The population with access to the grids was also to gain from improved access as well as more quantity and better quality of services resulting from improvements in operational efficiency and network extension.

(iii) **Government:** By helping the GoU implement its privatization and sector reform program, the Project was to lead to lower fiscal and administrative burden of power distribution on the GoU.

20. In addition, the Amendment to Credit 3411-UG stated that the principal benefits of the new component were to: (i) help secure a private investor for the concessioning of the country’s power distribution assets; (ii) lead to a more effective delivery of power services through agreed operational performance milestones; and, (iii) catalyze at least US$65 million of investments in the first five years of the concession for the expansion of services.

1.5. **Original Components (as approved)**

21. As mentioned under Section 1.1, this report only evaluates Component E of the Project that availed of the US$5.5 million contingent IDA credit to support the Umeme concession.

22. Through the credit restructuring approved in December 2004 and the subsequent amendment of Credit 3411-UG in November 2006, Component E was added to the Project and consisted of a US$5.5 million IDA contingent credit to support a liquidity facility for the benefit of the private power distribution concessionaire, Umeme Ltd. The IDA contingent credit behaved like a Guarantee with no expected disbursement until the closure of the Project. Such IDA support was a critical element of the Security Package requested by Umeme Ltd. to undertake the power distribution business in Uganda.

23. The Security Package aimed to mitigate important political and regulatory risks regarding the ability of the government to fulfil its contractual obligations and government interference in sector operations; the regulator’s ability to follow the new regulatory framework particularly regarding tariff adjustments; and the ability of government entities to pay their power bills in a timely manner. Under the Privatization Agreements, GoU and Umeme agreed to the Security Package that would give Umeme the right to access funds to be compensated for losses of revenue that occurred under the following six events:

(i) Failure by ERA to approve tariff adjustments according to the Tariff Methodology in the Distribution and Supply License.

(ii) Non-payment by GoU entities of their Power bills.

(iii) Early Termination of the Concession by Umeme resulting from a breach of the Privatization Agreements by GoU or its entities during the first 18 months of the Concession.
(iv) Early Termination of the Concession by Umeme for reasons related to the company during the first 18 months which would entitle Umeme to a US$2.5 million compensation for the initial investment of US$5 million.

(v) Refunds made by Umeme of the Concession Fee and Security Deposit provided by customers of UEDCL prior to the transfer date.

(vi) Termination of the Concession due to UEDCL or GoU Events of Default, and political or other force majeure events.

24. The Security Package consisted of the following support measures: (i) monthly lease rents, (ii) an Escrow Account, (iii) a Letter of Credit (L/C) Facility; and (iv) IDA Contingent Credit that backstopped the L/C Facility. The L/C Facility and the IDA Contingent Credit were accessible to Umeme only for the first three events listed above, and after preceding mitigation measures were exhausted from monthly lease rents and the Escrow Account. Each component of the Security Package was structured as follows:

- **Monthly Lease Rents**: Umeme had to pay a monthly lease rent to UEDCL calculated based on an agreed methodology. The monthly lease rent was paid into the Escrow Account.

- **Escrow Account**: UEDCL provided an initial funding of US$2.5 million and, the monthly lease rent payments provided additional funding up to a cap of US$20 million. The Escrow account was in place for the duration of the Concession.

- **L/C Facility**: UEDCL issued a Standby Letter of Credit (L/C) from a local bank in favor of Umeme with initial value of US$2.5 million and US$5 million after the first year. UEDCL agreed to maintain the L/C effective for seven years following the privatization. If needed, the L/C would be replenished through either a claw-back from lease fee payments deposited in the Escrow Account or direct payments by GoU or UEDCL during the twelve months of L/C Repayment Period. UEDCL would have to pay to the L/C bank any balance after the Repayment Period.

- **IDA Contingent Credit for the L/C Facility**: In the event that UEDCL failed to make the required repayment by the end of the L/C Repayment Period, the L/C issuing bank was entitled to claim from IDA the repayment. The IDA support was made available for 8 years and 25 days to cover the L/C period plus the repayment and cure periods.
1.6. Revised Components

25. There were no revisions.

1.7. Other significant changes

26. In November 2006, the IDA credit was amended to (i) extend the maximum end date of IDA support to the L/C Facility from March 2013 to February 2015; (ii) include IDA coverage for termination payments as a first loss, to MIGA’s cover for GoU breach of its commitments relating to minimum energy supply and payments related to losses; and (iii) backstop the risk of timely tariff on a quarterly basis per sector requirements instead of annual adjustments as initially agreed.

27. Those changes were deemed necessary to maintain the viability of Umeme Concession after Uganda started facing a major power supply crisis. Section 2.2 explains the crisis and its impact on the project.

2. Key Factors Affecting Implementation and Outcomes

2.1. Project Preparation, Design and Quality at Entry

28. Soundness of Background Analysis: There was an extensive project preparation work done before the design and approval of Component E. IDA was involved since the inception of power sector reform in Uganda. The groundwork was put by three operations implemented in the late 1990s and the first years of the 2000s. Enterprise Development Project (Credit 2315-UG), closed in June 2000, carried out an assessment of power sector structure options. The Power III Project (Credit 2268-UG), closed in December 2001, financed the Transaction Advisor and Investment Banker for the privatization of power assets. Power IV Project (Credit 35450-UG and IDA 35454A-UG), closed in March 2008, and assisted the Ministry of Energy and Mining Development and ERA to develop their capacity to manage sector reform and privatization.

29. The Privatization and Utility Sector Reform Project (Credit 3411-UG), as initially approved, provided in-depth preparation. Its four initial components were designed to support Uganda’s policy reforms regarding: (i) the privatization of public enterprises and related labour retrenchment; (ii) competition, legal and regulatory reforms in power and other public utilities; and (iii) the financial context for public utilities such as tariff and subsidies policies. Except for the Security Package discussed in this ICR, the support to design and implement power distribution concession was undertaken under the first four components of Credit Number 3411-UG; for which the ICR was approved in July 2006. Such ICR rated the overall project and the Bank and Borrower performances as satisfactory. The ICR concluded that the project had a significant positive impact on the economy; the Bank project was adequately designed and supervised to engender major benefits to Uganda; the implementing agencies performed well; and, the GoU was committed to the reform agenda despite its interference in some transactions.
30. Under the distribution Concession, the Concessionaire was contractually obligated to invest minimum of US$65 million by the end of fifth year. With that, the company was expected to provide up to 60,000 new connections, reduce total losses from 33.0% to 28%, and improve collection rates from 75% to 92.5%. Umeme, however, could request ERA to revise those targets within two years of the Transfer Date because there was not reliable data to set baseline values for those indicators when Concession was signed. The only reliable information at that time was that the revenues collected represented only 50% of the electricity generated. Umeme was also required to agree with ERA on an investment plan to ensure that it was cost effective. Power was supplied to the Concessionaire by UETCL, which in turn purchased power from UEGCL and other private providers. The bulk supply price was determined on a quarterly basis and was allowed as a pass-through for the calculation of retail tariffs. The distribution component of the tariff included: (i) O&M cost, (ii) allowance for technical and non-technical losses, and (iii) a return on investment of 20% in US dollars during the 20-year Concession. The Concessionaire’s lease rent payments to UEDCL were considered a pass-through cost for the calculation of retail tariffs.

31. The GoU and Umeme agreed to an 18-month preliminary operating and investing period in which Umeme’s investment obligation was limited to US$5 million of the total US$65 million. Umeme would have the right to withdraw from the Concession during this preliminary period under the terms and conditions agreed in the Government Support Agreement.

32. **Assessment of Project Design:** Component E was appropriately designed and innovative. IDA designed an operation that specifically helped to mitigate the key political and regulatory risks for a private Concessionaire who committed to improve power distribution services (section 1.5). Structuring IDA support as a guarantee enabled IDA to be engaged in monitoring the Government performance and the regulatory regime during the first years of the Concession when it was most susceptible to political interference. The investors believed that this latter role of IDA was essential for them to proceed with the concessioning of Umeme and invest substantial long term resources in Uganda’s power distribution.

33. The design of the Project had one shortcoming: The lack of indicators that could assess the actual performance of the Contingent Credit. Such gap was addressed by the team by adding two intermediate indicators: (i) the privatization of distribution assets being finalized and remaining in place; and (ii) ERA approving tariff adjustments according to the approved methodology.

34. This operation was a pioneer in the World Bank, and among IFIs, by being the first one to backstop regulatory risk. Romania’s Banat & Dobrogea Electricity Distribution Privatization Partial Risk Guarantee, which also pioneered the backstopping of regulatory risk, was approved by the Board of Executive Directors in the same month as the Contingent Credit for Umeme, December 2004.
35. Restructuring an existing IDA operation (Credit 3411-UG) by adding a guarantee component was an innovative way to use an IDA allocation to structure a support that had the same PDO of an existing operation. Credit 3411-UG was at the end of its implementation period and had undisbursed funds for US$8.27 million equivalent. The decision was also cost-effective as the preparation cost of a restructuring was more commensurable to the amount of guarantee support (US$5.5 million). More importantly, the decision was responsive to the needs of the GoU to expedite the approval and implementation of the IDA support. The Privatization Agreements signed on May 17, 2004, gave GoU up to nine months to put place IDA support, which was a condition of effectiveness for the Transfer of the Concession. The IDA Guarantee was added to Credit 3411-UG through a restructuring approved in December 2004 and became effective on March 3, 2005.

36. The Project was undertaken in close coordination with MIGA, which also supported Umeme’s Concession from the outset, to ensure that support from both entities complemented each other and the WBG support was optimized. MIGA signed four contracts to cover up to US$45 million of equity and shareholder loans from Eskom and Globeleq against the standard political risks (transfer restriction, expropriation, war and civil disturbance and breach of contract) in March 2005. MIGA later adjusted its coverage to support the Concession renegotiation in 2007 (see section 5.1).

37. The availability of the Security Package gave Umeme the comfort that its cash flow would be protected against GoU interference and lack of regulatory compliance with tariff adjustments. Such comfort also facilitated Umeme access to debt financing from new sources and on more competitive terms. For instance, Umeme obtained a US$25 million loan from IFC with a longer tenor. Umeme expanded its shareholder base through a successful initial public offering (IPO) on Uganda Securities Exchange in 2012 (see section 3.5.c). Umeme raised long term finance to support its medium term investment plans in 2013 (see section 4.1). IFC actively participated in the IPO and long term finance.

38. Adequacy of Risk Assessment. The project team identified two key risks (operational and a call on the guarantee) and appropriately mitigated them. The operational risk (Umeme is unable to improve distribution performance and decides to exit at the end of the 18 months) was mitigated by the Government’s continued support and commitment to the power sector reform and improving sector efficiency. The risk of a call on the guarantee was mitigated through the design of the Security Package by providing minimal IDA support and as last resort. The amount of IDA support (a US$5.5 million contingent credit) was a fraction of the estimated amount of annual lease rent (over US$12 million) and the cap on the Escrow Account (US$20 million). In addition, the L/C Facility provided a twelve month repayment period which allowed sufficient time for IDA to work with UEDCL and GoU to resolve any issues and ensure that UEDCL would be in a position to make any required repayment.
39. As indicated in the Proposed Amendment to the Legal Agreements of December 2004, this operation did not address the supply risk (insufficient power supply) because such risk was being addressed by other IDA interventions at that time such as Power IV Project (Credit 3545-UG). Uganda ended up facing a major power supply crisis soon after Umeme Concession began.

40. Adequacy of Government’s Commitment, Stakeholder Involvement and Participatory Processes: The GOU demonstrated its strong commitment to the Project and its objective (see Section 6.2.a). The key stakeholders (GoU and Umeme) were closely involved in the design and preparation of the Project as described above. Given the preparatory work done under the sector reform and targeted and specific nature of this operation, no further stakeholder consultation was required for Component E.

2.2. Implementation

41. The first four years of Umeme were characterized by limited improvements in a context of a major power crisis. When Umeme took over the concession in May 2005, Uganda had tariffs close to cost reflective levels and stable power supply. However, the situation started to change a few months later due to a drought; and a year later the power supply was reduced by more than 25%. The consequent power shortages were further aggravated by a rapidly growing demand and major delays in adding new generation capacity, primarily from Bujagali Hydropower Plant. By 2006 Uganda entered into an unprecedented power crisis and faced persistent rolling blackouts during peak demand hours. The GoU took measures to reduce power shortages, including importing power from Kenya and contracting out emergency supply from rental plants. While these measures reduced load shedding, they raised the cost to unsustainable levels. The cost and tariff of bulk supply rose by more than 300% in 2006. Retail tariffs were raised by 140% between April 2005 and November 2006. The GoU provided subsidies (US$50 million a year) to avoid further tariff increases due to competitiveness and political concerns.

42. Despite the challenging environment, Umeme stabilized the distribution business in the first twelve months of operation. It reportedly reduced losses from a high of 40% to around 34%, improved the revenue collection from 80% to 84%, and invested US$11 million in distribution network improvement.

43. The timing of the power crisis, however, placed Umeme and GoU in a complicated situation. While performance improvements were a prerequisite to reduce the impact of the power crisis and the success of the power sector reform, Umeme’s shareholders started to reassess their investment in Uganda. In March 2006, the Boards of Globeleq and Eskom decided not to invest further in Umeme. They had until July of that year to exercise their exit option. Under these circumstances, the GoU decided to renegotiate key concession terms to prevent Umeme from exercising its exit option. In the renegotiation, Umeme sought contractual reassurance that it would be protected from operational losses caused by the crisis, and that such protection would be backed by a risk mitigation measure from the WBG.
44. Under the restructuring, GoU agreed, during the Electricity Sector Stabilization Period (ESSP), to compensate Umeme for: (i) energy supply shortages leading to a shortfall in revenues; and (ii) revenues shortfalls resulting from an increase in losses due to sharp and more frequent tariff increases. The ESSP started on January 1, 2007 and continued until the earliest of:

- two years from the end of the Special Provision Period (SPP); or
- 270 days after the commercial operation date of new generation capacity of at least 150 MW at a weighted average price of no more than US$0.12 kWh; or
- seven years from the ESSP Effective Date. The SPP began on the ESSP Effective Date and ending on the earlier of (a) the date on which the Company, at its sole discretion, terminated the SPP, and (b) the date on which defined tariff and supply conditions were satisfied. IDA, as provider of the contingent credit, reviewed the concession amendment and, once considered it reasonable, provided its consent for the amendment and extended the term of its guarantee support as well as risk coverage to include power supply risk.

45. The concession amendment was signed in November 2006. Nevertheless, Eskom decided to exit while Globeleq opted to continue and purchased Eskom’s equity stake. To support the restructuring, MIGA adjusted its termination coverage for Globeleq to include the risk of lack of power supply and support the Security Package in 2007.

46. Umeme continued to invest, expanded access and improved collection rates, but had less success with power losses. Umeme invested US$46 million and increased its customer base by 7% to 313,000 by the first half of 2009.\(^1\) The collection rate improved from 85% in 2005 to 92% in the first half of 2009. Conversely, total losses oscillated between 31% and 35% without a discernible pattern. Despite lack of progress on loss reduction, Umeme was never in breach of its performance targets as the 2006 amendment gave it the right to have temporary spikes (increases) in total loss levels during the SPP.

2.3. Monitoring and Evaluation (M&E) Design, Implementation and Utilization

47. When Component E was introduced in 2004, the Results Framework of the original Project was adopted and remained unchanged. The ICR for the Original Components A to D, prepared and approved in 2007, assessed the design of the M&E arrangements as “relatively well-designed, detailed key performance indicators of output and outcome were identified at the beginning of the project and were regularly updated by the Project Coordinating Unit (PCU).

\(^1\) This customer growth reflects the adjustments made by Umeme after correcting its customer database from dormant, duplicated or inexistent customers in the first half of 2008.
The project was exceptionally good in terms of the quality and quantity of tracked indicators, which assisted in monitoring progress.”

48. At the partial closure of the Project in 2007, when the implementation of all the Project’s components except for Component E was accomplished, most of the Project’s PDO and Intermediate Outcome Indicators were achieved or became irrelevant for monitoring purposes, when they related to the then already closed Project Components A-D. Consequently the team continued monitoring only the outcome indicators relevant to the Component E supported electricity distribution concession activities.

49. Taking into account the specific risks covered by the contingent credit structure under Component E, the team added couple of intermediate indicators (privatization of distribution assets being finalized and remaining in place; and ERA approving tariff adjustments according to the tariff methodology) to better measure the distribution concession’s outcomes during the supervision phase.

50. Umeme collected Quality data for Component E throughout implementation. Data reporting was also done effectively and comprehensively by Umeme and was satisfactory overall.

2.4. Safeguard and Fiduciary Compliance

Safeguards:

51. The Component E was introduced to the Project in 2004 without invoking any of the Bank’s Safeguards Policies. For the duration of the lease, Umeme was obliged to carry out any investments into the distribution network in compliance with Uganda’s environmental policies, laws, regulatory and administrative frameworks. In addition, at the onset of the Concession and during the Bank’s supervision of the Project’s Component E, Umeme developed and subsequently implemented an environmental management plan for the distribution network that was consistent with Ugandan Law and that was also reviewed and cleared by the Bank. During the implementation of Component E, the Bank team further carried out an audit of Umeme’s compliance with the Ugandan Environmental Laws as well as its compliance with the Environmental Management Plan. The assessment concluded that the arrangements established by Umeme were satisfactory and compliant with the relevant laws. No major environmental or social issues were reported during the implementation of this project component.

Fiduciary:

52. The nature of the Project’s Component E, a contingent credit, implied that no disbursements occurred under this component as long as no payment had to be made to the L/C bank as a result of UECDL repayment default. Since the Component E supported L/C was never triggered during Project implementation no disbursements under this Component occurred.
during implementation. The FM arrangements therefore were restricted to the supervision of the Project’s annual external audit reporting arrangements. Financial management aspects of this Component E were continuously rated Satisfactory or Moderately Satisfactory throughout project implementation.

53. There was no procurement for Component E as it did not entail any IDA financing for investments.

2.5. Post-completion Operation/Next Phase

54. Uganda had been able to significantly improve performance of its grid power distribution services through Umeme Concession (see section 3.2). The performance improvements are expected to continue as Umeme agreed to aggressive but realistic targets on loss reduction and collection rates for the 2013-2018 tariff review period. Such targets will (i) push Umeme to continue obtaining efficiency gains to remain profitable; and, (ii) allow transferring part of the efficiency gains to consumers through lower power distribution charges.

55. Going forward Uganda has the challenge to speed up its grid expansion rate to increase the national electrification rate, which at 15% in 2013 remained below the average for Sub-Saharan Africa overall (32%). Expanding access through private financing alone would be constrained by affordability issues due to higher cost of private financing. However, combining private sector efficiencies in network rollout and operation with the lower cost of donor financing could accelerate access expansion.

3. Assessment of Outcomes

3.1. Relevance of Objectives, Design and Implementation (at the ICR time)

Rating: High

56. The operation was highly relevant and reflected a proper diagnosis of a developmental priority for Uganda. At the time of appraisal, the project’s objective was critical for Uganda, as indicated in the Joint Assistance Strategy (JAS) of FY05-FY09. The bottlenecks in the power sector had become major constraints for economic growth. Only 7% of the population had access to power in 2005 and those with access had very unreliable services. Ugandan firms perceived the lack of reliable power as the greatest threat to their competitiveness with 45% of them reporting insufficient and unreliable electricity supply as major or very severe. By supporting the improvement of power supply, IDA and other development partners helped to reduce the cost of doing business and linked isolated populations or areas of the country to the broader economy. The project’s objective remained relevant under the CAS of FY11-15, which had as one of its goals to improve the reliability of power services to sustain economic growth. The IDA continued to support projects that expand generation capacity and increase access in Uganda.
57. The Project was designed to mitigate the political and regulatory risks for a private concessionaire that committed to improve the performance of power distribution business and increase investment. The implementation of the project consisted of closely monitoring the risks covered by IDA to prevent a call on the guarantee, and thereby sustain the Concession. Such monitoring was critical to identify emerging disagreements between the Concessionaire and the GoU and support their timely resolution by playing an honest broker role. In that regard the Project indicators were appropriate to support the implementation phase and flexible enough to adapt to changes.

3.2. Achievement of Project Development Objectives

Rating: High

58. The PDO of improving the quality, coverage and economic efficiency of utility services, through privatization, private participation in infrastructure (PPI) and an improved regulatory framework was successfully achieved. By structuring and supporting a Security Package for the Umeme Concession, Component E helped to secure private concessionaires for Uganda power distribution assets. The private operation of power distribution assets led to a more efficient delivery of services and brought in levels of private investments much higher than initially anticipated.

59. Before the Project, electricity losses were 34%, collection rate was 80%, and national access rate 7%. By the end of the IDA operation, Umeme reported a declining trend on power losses, reaching the level of 21.6% in June 2014 (figure 1), collection rate reached 100.3% in 2013 and 96.6% in 2014 (figure 2), and the national access rate was 15% in 2013. Umeme has more than doubled its customer base that it had at the onset of the Concession, reaching 613,000 connections in June 2014 (figure 3). Umeme invested US$224 million in the distribution network during the life of the operation (Figure 4). The Concessionaire also reported a solid financial position with a healthy operating profit margin of over 10% and strong sales growth (figure 5).

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2 The collection rate of 100.3% in 2013 includes drawdowns from the Escrow Account to clear GoU arrears (unpaid bills from the army, police, prisons, and health sector and education institutions).

3 It is equal to operating income divided by net sales. The operating margin measures what proportion of a company's revenue is left after paying for O&M costs.
Many factors contributed to the performance turnaround. First, the stabilization of power supply and the end of the SPP in October 2009 created the conditions to move from a crisis management to a performance improvement approach. Improvements in power supply was achieved through committed interventions by GoU and its sector entities such as undertaking an emergency thermal program and implementing Bujagali Hydropower Project as a private independent power producer. Second, Umeme hired a Chief Operating Officer from the Electricity Supply Board of Ireland and filled other managerial positions with experienced personnel to reinforce its management team. Third, the end of the SPP implied that: (i) Umeme and ERA had to agree on new loss reduction and collection targets, and (ii) the downside protection to Umeme for not being able to meet its contractual targets ended. Fourth, after extensive negotiations ERA succeeded at making Umeme commit to ambitious but realistic regulatory targets under the 2012 tariff review (table 1). As part of this tariff review, ERA increased the average retail tariff by 52% in January 2012 to bring it to cost recovery level. Fifth, although ERA and UMEME had contentious relations, they showed the willingness to tackle difficult issues through a collaborative approach, while negotiating at arm’s length. For instance, they had monthly meetings to discuss the progress of the loss reduction plans and define the government actions required. They also set up a Special Tariff Committee to discuss the different components of the tariff methodology. The Committee was informed by independent advisory firms that guided the discussions and negotiations of both parties.
Other key factors to achieve the turnaround were the GoU’s commitment to sector improvement, IDA’s honest broker role, and IFC’s financial support. Due to the poor payment records of GoU’s entities, Umeme often offset GoU entities’ payment arrears against lease payments and drawdowns from the Escrow Account. Despite disagreements over arrears offsetting, GoU ensured that resources, as stipulated in the Security Package, were available until 2012. The GoU’s decision to ease the path to cost reflective tariffs through subsidies during the crisis also helped Umeme by preventing even higher commercial loss spikes than those experienced during this period. The financial discipline introduced to the sector allowed the GoU to gradually phase out its subsidy program, which was eliminated in 2012 after Bujagali Hydropower plant was commissioned. Through its guarantee support, IDA was able to engage with GoU and Umeme on sector policy dialogue and played an honest broker role when disagreements arose to ensure that both parties remained engaged in negotiations to resolve issues (section 6.1.b). Given that IFC and MIGA also provided support to Umeme, the WBG coordinated its engagement when and as required.
Table 1: Umeme’s Agreed Regulatory Targets

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
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<tr>
<td>Energy Losses (%)</td>
<td>23.5</td>
<td>20.5</td>
<td>18.6</td>
<td>17.1</td>
<td>15.9</td>
<td>14.9</td>
</tr>
<tr>
<td>Revenue collection (%)</td>
<td>97.3</td>
<td>97.5</td>
<td>97.7</td>
<td>97.9</td>
<td>98.2</td>
<td>98.5</td>
</tr>
</tbody>
</table>

Source: Umeme 2013 report to shareholders.

62. The Project helped to set a successful example of a Public Private Partnership that improved operational performance of a power distribution company in a country perceived as risky and with no track record on private investment in the sector. The project has also highlighted the challenges of improving performance in poorly maintained distribution systems and the importance of an appropriate incentive structure to do so. Aside from the power supply crisis, Umeme was faced with unreliable information on customers and the real status of the distribution network as well as a dilapidated distribution network which needed an almost complete overhaul to reduce technical losses to international standards and to minimize electricity theft. Designing and implementing a business solution to those problems and building the required capacity within the company and with local suppliers took much longer than anticipated at the inception of the Project. Subsequently, Umeme was able to significantly improve its operational performance. In this context, the two years given by the Concession Agreement to revise the performance targets facilitated the negotiations between ERA and Umeme on that topic as both entities understood that major work was required before being able to set realistic targets as it was done in the 2012-2018 tariff review.

3.3. Efficiency

Rating: Satisfactory

63. Detailed economic and financial analysis of the project was not carried out at the appraisal stage of Component E as the component was designed to finalize a reform program supported by the umbrella operation (Credit Number 3411-UG). The economic and financial rational of the umbrella operation was undertaken during its appraisal and Board approval in 2000. The substantial improvement in operational performance and solid financial situation of Umeme confirmed that the financial and economic benefits achieved by Component E have been substantial.

64. **Financial performance of Umeme:** The utility has had positive operating income and cash flows since the beginning of the Concession. It has also reported operating profitability with a growing EBITDA\(^4\) and solid EBITDA ratio\(^5\) (figure 6). The current projections indicate EBITDA will continue to grow while EBITDA ratio will stabilize around 13% to 14% between

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\(^4\) EBITDA stands for Earning Before Interests, Taxes, Depreciation, and Amortization.

\(^5\) EBITDA ratio is EBITDA divided by total revenue.
2014 and 2018. The main drivers of this financial performance have been operational improvements, capital investments, and sales growth. Such performance has allowed Umeme to access to the financing it requires to undertake its investment program.

65. **Economic analysis**: The main economic benefit was the incremental power supplied to consumers as a result of power system investments, specifically in access expansion and reduction in power losses. The ultimate benefits thus derive from end-user (household, commercial or industrial) consumption on account of new connections or on account of greater electricity being available due to loss reduction. The costs included were the investment and operating costs incurred by Umeme and the cost of additional power generation required to supply to the additional demand. These costs were subtracted from the delivered benefits to derive the net economic gains associated with the project.

![Figure 6 Umeme EBITDA](image)

66. Even using very conservative valuation of benefits and costs, the project is found to have been economically viable with an NPR of US$ 108 million and economic rate of return (EIRR) of 21%. The table below shows the main assumptions and results for the IRR and NPV.

<table>
<thead>
<tr>
<th>Assumptions</th>
<th>0.17</th>
<th>$/kWh/kWh/mont</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average price of electricity</td>
<td>*</td>
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<td>Average Consumption</td>
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<td>h</td>
</tr>
<tr>
<td>Generation cost of electricity</td>
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<td>$/kWh</td>
</tr>
<tr>
<td>Discount Rate</td>
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<td>Per cent</td>
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</table>

<table>
<thead>
<tr>
<th>Baseline Results</th>
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<th>108</th>
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</thead>
<tbody>
<tr>
<td>EIRR</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NPV (M US$)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note**: *Calculated as the weighted average across all consumer types – using 2012 consumption figures and 2014 tariff structure.*
3.4. Justification of Overall Outcome Rating

Rating: Satisfactory

Based on sections 3.1-3.3, the overall outcome is rated as Satisfactory. The Project was relevant to the Government’s National Development Strategy, and the last three Country Assistance Strategies. The Project successfully met its development objective, has set up a replicable and successful example of a Public-Private Partnership in the power distribution sector, and was well justified based on reasonable economic and financial performance.

The ICR team acknowledges the mismatch between the Satisfactory rating given to the Overall Outcome in this ICR and the “Moderately Satisfactory” Development Outcome rating of the ISRs from 2010 until the Project’s closing. The mismatch reflects the fact that the Task Team used the ISR ratings as a tool to strengthen the ongoing sector dialog and bring into the GoU’s attention Umeme’s sector issues. This approach helped to influence the Bank’s sector dialogue and long term sustainability of the operation; a wider sense than the one foreseen by the rating mechanism in the ISR template. In the absence of a “Risk to Development Outcome” rating category in the ISR, Task Team expressed an opinion on the long-term sustainability of the Concession, rather than just focusing on the achievement of immediate development objectives of the contingent credit operation. The main issues causing the moderately satisfactory rating relate to legal amendments to the Concession approved by ERA and changes to the funding mechanism of the Escrow Account in the Security Package as they posed a threat to the long term sustainability of the Concession (see Section 4 below). The Task Team used the ISR rating tool to signal ongoing issues to Bank management and the Government of Uganda. The proposed evaluation and rating assessment as provided in this ICR is more adequate to reflect the full achievement of the Project’s objectives.

3.5. Overarching Themes, Other Outcomes and Impacts

(a) Poverty Impacts, Gender Aspects, and Social Development

No direct analysis provided under this operation due to its targeted nature and limited scope

(b) Institutional Change/Strengthening

The component helped ERA to establish a track record as a regulatory agency that for the most part applied tariff methodologies in a technical and timely manner. While Component E did not include capacity building measures, it also supported indirectly a key institutional change in Uganda. The activities supported by this project component facilitated the GoU’s buy-in of the need of having the power sector on a commercial sound footing to operate and develop efficient. ERA has recognized the need to have a profit making power sector while public entities such as UETCL and UEDCL run their operations with a commercial view. Such commercial mind set in
the public entities should encourage further efficiency improvements and ameliorate potential political interference in the sector.

(c) Other Unintended Outcomes and Impacts (positive or negative)

71. In 2005, when Umeme took over the Ugandan distribution business, it was not certain that Umeme would be a profit making enterprise with a diversified shareholder base and an ambitious investment plan. Umeme listed its shares in the Uganda Securities Exchange (USE) through an Initial Public Offering (IPO) in 2012. The IPO was declared overwhelmingly successful, with over 35% over-subscription by investors in Uganda, East Africa, and internationally. There were thousands of retail applications in total, which was a good indicator that the IPO was well received by the general public in the three-week offer period. Umeme listed 622 million shares on the markets with more than 6,000 Ugandans buying the firm’s stock as well as African institutional investors, foreign equity funds, and venture capital funds.

72. The IPO was the first step of a new development and investment phase for Umeme under which it expects to substantially expand access and improve service quality. Funds raised from the IPO were used to reduce the company's interest-bearing debt and enable Umeme to secure additional commercial debt over the next few years to help finance its expansion strategy. The IPO was voted the Deal of the Year 2012 at the African Banker Awards and was nominated for the Africa Investor Awards.

73. Umeme’s shares were cross-listed at the Nairobi Securities Exchange (NSE) in 2013. The strategic investor Actis, previously known as Globeleq, became a minority shareholder by reducing its equity participation to 14% in May 2014. Given the progress made in building a capable and motivated management team and workforce as well as a well-run distribution company, Umeme did not expect that Actis’ reduced stake would impact its day-to-day operations. Listing a utility company whose shares are actively traded in African stock exchanges also contributed to the deepening of the financial market in the region. By May 2014, the top shareholders of Umeme were Investec Asset management, Actis (previous known as Globeleq), National Social Security Fund, Farallon Capital, Coronation Funds, Allan Gray Africa Funds, IFC, Utilico Emerging Markets, Patrick Bitature, and Everest Capital.

74. The Project also helped to set up a successful example of how to facilitate sustainable private sector participation in power distribution business in Sub-Saharan Africa. Until now most attempts to bring private sector efficiencies into power distribution business in the region have proven to be difficult to sustain. Of the 33 contracts to bring the private sector into power distribution business in Sub-Saharan Africa signed between 1990 and 2013, only 11 remained operational by end of 2013. Of these, only two other contracts were for stand-alone distribution services: Reho serving Rehoboth in Namibia and PN Energy Services serving Kayelitsha Township in South Africa.
3.6. Summary of Findings of Beneficiary Survey and/or Stakeholder Workshops

75. There was no beneficiary survey or stakeholder workshop undertaken by the project.

4. Assessment of Risk to Development Outcome

Rating: Modest

76. The cost-reflective tariff levels have naturally led to some controversies between Umeme and the GoU as well as the general public. The GoU had the perception that electricity tariffs in Uganda were significantly higher than those of neighbouring countries. Umeme challenged that perception by showing tariff data on a cost reflective basis. That is excluding subsidies, which continued to be significant in some neighbouring countries. By that measure, Uganda’s tariffs were in line with those of its neighbours. Umeme also demonstrated that the share of the distribution margin in the tariff revenue requirements decreased over the years; while other cost drivers, like generation costs, fluctuated frequently. Despite these, Umeme was still facing some criticism on tariff levels by the time this ICR was written. It will take time for Umeme and the GoU to convince the public that the sector and the country are better-off with cost reflective retail tariffs in the medium and long term.

77. Uganda has good prospects to be able to reduce tariff levels in the medium to long term without the need of subsidizing the sector. Umeme has agreed to lower distribution charges by committing to significant improvements in loss reduction and collection rate within the next 5 years. Towards that aim, Umeme has developed a network refurbishing plan to tackle all issues in a district by district approach to minimize power losses. Following the GoU’s request, Umeme has also opted for installing only pre-paid meters from October 2014 onwards, thereby phasing out post-paid billing systems. If those improvements are combined with a least cost investment in generation, the overall cost of the power sector will diminish, and, therefore, the required tariffs at cost reflective levels will also be lower.

78. Umeme is well-positioned to ramp up its electrification efforts as the constraints that prevented it from fully focusing on network expansion had been eliminated. Until 2012, Umeme focused on developing an effective business plan to tackle all operational issues, and becoming a credible operator with access to medium and long term finance. In addition, Umeme operated in an environment of major power supply shortfalls so additions of new customers had to be managed to deliver what the network could serve. After the power supply crisis ended, Umeme announced plans to invest US$382 million in revamping its network and expanding it with 50,000 new connections a year. The funding for that investment was secured through an IPO and commercial loans. During the ICR mission in May 2014, Umeme indicated its willingness and ability to increase its customer base at a faster rate than currently planned if ERA include the required capital expenditure in the tariff formula.

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6 Pre-paid metering had proved to be highly successful with Umeme’s customers.
79. Successfully increasing the electrification rate, however, will also depend on timely additions of new generation capacities to be contracted by UETCL. Such addition will be critical in helping Umeme to further improve its brand and perceived service reliability. Another generation crisis would be a major set-back for Umeme as experience shows. Despite major improvement in grid reliability over the last couple of years, customers continue to perceive grid power as unreliable and firms continue to indicate that the greatest threat to competitiveness was the shortage of reliable power supply. The number of power outages in a typical month fell from 38.6 in 2003 to 6 in 2013 while the share of firms reporting electricity constraints as major or very severe fell from 44.5% in 2003 to 24% in 2013. The reactions from Umeme’s consumers show the sensitive environment in which Umeme operates and the need for a strong partnership with the GoU and UETCL to avoid future power supply crises.

80. Finally, it would be important that the GOU honours its contractual obligations by reinstating the elements of the Security Package that it legally agreed to maintain for the life of the Concession. GoU started to unilaterally and progressively undo the Security Package by the time the IDA Guarantee expired, and the associated L/C Facility was closed. First, ERA disallowed the lease rent from the 2012 tariff review. Then UEDCL didn’t replenish the balance of the Escrow account even though it has been zero since October 2013. The GoU’s view that the Uganda’s track record on power sector reform permits it to unilaterally dismantle the Security Package is at the core of the politically and regulatory risks from which investors look to protect themselves.

81. The issues regarding additional generation capacity and GoU’ reinstating obligations, however, do not compromise the development outcomes achieved under the Project. The operational and financial improvement of Umeme was achieved through structural changes in the way that power distribution services are managed in Uganda. The structural changes included revamping business practices on customer management and network refurbishing, creating a motivated workforce, and building a reliable network of local providers.

82. Through its energy sector dialogue in Uganda, the Bank continues to discuss those pending issues with the Concession’s stakeholders and aims to facilitate their resolution as well as the resolution of any other issue that may emerge. The Bank also continues to support the sustainability of what was achieved through this innovative contingent credit by supporting the sector with investment operations in power generation and access expansion. Given the still active involvement of IFC and MIGA in the Concession, it is also recommendable to envisage a well-coordinated World Bank Group approach on the issues at hand to ensure that the remarkable results of the Concession achieved throughout the years remain valid and sustainable in the long term.

5. **Assessment of the Guarantee in support of the Project**

5.1. **Impact of the guarantee in mobilizing private sector financing.**
83. The fact that IDA support was a condition of effectiveness for the Concession showed that Umeme would have not invested in Uganda’s distribution services without political and regulatory risk cover. The impact of the guarantee on Umeme’s ability to mobilize private capital can be broken down as follows:

(i) Umeme had the confidence to invest over US$65 million in the distribution network in the first five years of the Concession and US$224 million by the time the guarantee expired.

(ii) Umeme was able to raise financing for its investment program even during the power supply crisis. IFC provided a badly needed US$25 million loan to Umeme in 2009.

(iii) Umeme was able to expand its funding sources by increasing its shareholder base through an IPO (see section 3.5.c.) and obtaining longer term debt financing. In 2013, Umeme secured a US$190 million (Ushs 485 billion) commercial loan to support its investment program. The commercial debt was the largest-private sector corporate financing in Uganda to that date and comprised of:

- A US$170 million term loan priced at LIBOR (London Interbank Offered Rate) plus 5%, with IFC and Standard Chartered Bank each providing USD$70 million, and Stanbic Bank providing US$30 million; and

5.2. **Role and value of the guarantee in addressing critical risks and improving the overall sustainability of the transaction.**

84. IDA helped investors to make the Concession sustainable by underpinning its cash flow through a regulatory risk guarantee. Thus, the guarantee improved the overall sustainability of the Umeme Concession. The guarantee support also facilitated IDA’s ongoing involvement in the sector, through regular supervision and mediation, at critical moments ensured the sustainability of the distribution Concession (see section 6.1.b).


5.3. **Key issues or events that may arise in the future that could lead to a potential call on the guarantee.**

86. None. The guarantee expired in 2012.
6. Assessment of Bank and Borrower Performance

6.1. Bank Performance

(a) Bank Performance in Ensuring Quality at Entry

Rating: Satisfactory

87. IDA’s performance in ensuring quality at entry was satisfactory. Prior to this operation, IDA undertook the preparatory work for supporting the power sector reform, including the concessioning of the distribution business in Uganda. The IDA team focused on identifying and guaranteeing the key issues that discouraged private investors to undertake the distribution Concession in a context of the ongoing power sector reform in Uganda. The WBG support was closely coordinated to achieve a complementary risk mitigation package. IDA, because of its close involvement with the sector and its monitoring ability through regular supervision, backstopped the policy and ongoing revenue-related risks critical to project sustainability. MIGA mitigated the political risk for equity investment.

(b) Quality of Supervision

Rating: Highly satisfactory

88. IDA’s supervision was highly satisfactory. Sufficient budget and staff resources were allocated, and the project was adequately supervised with the right skills mix. The project team followed up the project implementation progress and results achievement through regular missions, teleconferences with relevant entities, and with the support of staff based in Kampala. There were also joint missions with MIGA, and IFC and close coordination to define a WBG position when required.

89. IDA support to Umeme was managed within the overall IDA engagement in the Uganda’s power sector which also included support for expanding power generation and ensuring financial sustainability of the sector. When the power supply crisis emerged, IDA worked with GoU to reduce short-term power shortages and financial imbalances, and facilitate orderly longer-run expansion of electricity service. The Power Sector Development Operation (IDA-42970), which provided fiscal support, and Bujagali Private Power Generation Project (Guarantee No. B0130-UG), which supported generation expansion, were the main IDA interventions to attenuate the impact of the crisis. The IDA interventions in the sector complemented each other and were designed to benefit from each other achievements.

90. The IDA team provided timely support GoU to help overcome several crises, including:

- **2006:** By the end of the initial 18-months “trial” period, Umeme’s shareholders were ready to exercise their termination rights due to the power supply crisis. IDA strongly encouraged both parties to renegotiate the Concession, and extended its guarantee in support of the Concession restructuring. The
Concession was amended to adjust it to the circumstances created by the power crisis. IDA undertook the corresponding due diligence of the proposed amendments, found them reasonable and provided its consent as required per the Guarantee Agreement. IDA also provided financial support to help Uganda to finance emergency power to mitigate power supply shortages.

- **2008**: Umeme and GoU entered into a dispute concerning the compliance by both parties with contractual obligations. While GoU acknowledged that it could have been more supportive of Umeme’s efforts to reduce non-technical losses, its perception was that Umeme’s management was not doing enough in accelerating its efforts in other areas. IDA, through its supervision and its honest broker role, monitored the situation and convinced both parties to agree on a detailed action plan with shared responsibilities. Those actions led to renewed efforts on both sides to resolve outstanding issues. Umeme also brought on board a new management team in early 2009.

- **2009**: A new Minister of Energy and some Parliamentarians tried to unilaterally terminate the Umeme Concession on allegations of non-performance. IDA joined forces with MIGA and IFC to prepare a report that showed the progress and situation of Uganda’s distribution network since the onset of the Concession. The highest level of GoU acknowledged that despite certain “mixed” performances, Umeme improved distribution services and a new Minister of Energy was appointed.

- **2011/2012**: There was a deadlock in the negotiations of the performance targets for the 2013-2018 regulatory period. IDA supported ERA and GoU on hiring an independent advisor to help ERA overcome its initial difficulties to engage in meaningful negotiations with Umeme. In addition, IDA in coordination with IFC and MIGA (though fully respecting potential conflict of interest situations) liaised between ERA and Umeme to help them resolve disagreements throughout the negotiations.

91. In summary, the IDA risk mitigation support and related honest broker role as well as the Bank’s overall strong engagement in Ugandan power sector through several operation and strong policy dialogue, gave IDA the critical leverage for helping to resolve each crisis.

(c) Justification of Rating for Overall Bank Performance

Rating: Satisfactory

92. Based on IDA’s performance during the appraisal and supervision phases as discussed above, the overall IDA Performance is rated as Satisfactory.

6.2. Implementation Entity Performance

(a) Implementation Entity Performance in implementing the project
Rating: Satisfactory:

93. Umeme made limited progress on operational performance during the first four years of the Concession, but since then it has improved significantly. Umeme built a strong local management team and developed a good business process to reduce technical losses, improve distribution network reliability, as well as enhance service quality and customer management in a sustainable manner. It also showed the ability to raise the required funding to expand its operations and the willingness and ability to invest in network expansion.

6.3. Government Performance

(a) Government Performance

Rating: Satisfactory

94. The government through the Ministry of Finance and Ministry of Energy generally fulfilled its obligations and created the environment for the private concessionaire to operate efficiency. When issues emerged, the corresponding government entity was, at the end, willing to discuss and find a workable solution with the private concessionaires. However, since the Contingent Credit expired, the government has showed less willingness in finding solutions to outstanding issues such as government payment arrears and honouring the Security Package.

(b) Implementing Agency or Agencies Performance

Rating: Satisfactory

95. For most part, ERA demonstrated its competence in doing professional and technical work on setting the tariffs. After the Contingent Credit expired, however, ERA has showed more susceptible to the political pressures relating to tariff adjustments. Removing the lease payment from the tariff methodology and modifying the growth factor has been perceived by Umeme as politically motivated. At the time the ICR was written, it was unclear the course that these disputes would take.

96. Generally GoU fulfilled its obligation to maintain the Security Package created to deal with arrears of GoU entities during the life of the guarantee. After the expiration of the guarantee, however, it unilaterally started to dismantle the elements of the Security Package that were agreed to maintain during the life of the Concession (Lease Fees and Escrow Account).

(c) Justification of Rating for Overall Government Performance

Rating: Satisfactory:

97. Based on GoU and associated entities’ discussed above, the Overall Government Performance is rated as Satisfactory.
7. Lessons Learned

There are a number of lessons learned from this Project:

(i) If properly structured, it is possible to successfully implement a private sector project that brings private capital, private sector efficiencies, and first rated investors into an underdeveloped power distribution subsector such as that of Uganda in 2004 and reap substantial economic benefits for the country and the sector. Given that GoU was undertaking a power sector reform and showed strong commitment to sector reform, the guarantee support focused on the remaining political and regulatory risks. The guarantee helped to underpin the cash flow of the Concession by backstopping critical risks. Such support gave investors the incentive to conclude the Concession and undertake investments much larger than initially envisioned. As a result, there had been substantial benefits for the sector and the country.

(ii) Loss reduction in chronically poorly managed utilities is very challenging and takes significant time and effort to tackle it, particularly in countries with limited capacity. In these countries, strategic investors have to focus on identifying the real status of the network, designing an effective overhauling plan, revamping the customer database, creating a motivated and well-trained workforce, and ensuring that there is an adequate network of local suppliers before being able to show sustainable performance improvements. It is also critical to set ambitious but realistic targets for strategic investors to perform. In this context, a transitional period to allow for creating reliable baselines for performance improvements—such as the 18-month initial period given to Umeme—is beneficial for then setting realistic targets that can create the right incentives to improve performance.

(iii) PPP/Concessions are long-term arrangements that need flexibility and commitment from all involved parties to be able to adjust to unforeseen circumstances, remain in place, and being successful. The Government's long term commitment to sector reform made it possible for the Project and the Concession, to weather major challenges (e.g. power supply crisis). Government commitment to stay its course on sector reform ultimately led to the longer term benefits to the sector, once the power crisis was over. Long term commitment and competence of the private sector were a pre-requisite to develop the local workforce's capabilities at all levels. In addition a sound approach to sustained performance improvements and a solid financial performance were equally important attributes. Identifying private partners that have a long-term view and can weather significant challenges throughout the implementation phase are particularly attractive in such projects, which could help guide the criteria for procuring private sector concessionaires in future. The Bank's involvement in such an operation is not limited to the provision of a financial instrument (guarantee), but it also offers the Bank's convening power, which can make a tangible difference during a crisis.
(iv) There is a fine balance to be struck between reducing the perceived risks for the private sector and creating the incentives to tackle sector issues. In the case of Uganda, the risk of non-payment by GoU’s entities illustrates the case. The historic poor payment record was perceived as a risk that needed to be fully mitigated at the time the Concession was granted. While that risk is still relevant for some public entities (such as security forces, police, and prisons), it may no longer be the case of other public entities. GoU’s view is that Umeme did not do all that it could to minimize the arrears of GoU’s entities because it could offset GoU’s arrears with the resources from the Security Package. Umeme always contested this view by GoU as it should be GoU’s responsibility to ensure that Government entities pay their bills.

(v) Low income countries may need donor funding to facilitate faster increase in access than private financing can bring. In those countries, expanding access through private financing alone is usually constrained by affordability issues due to higher cost of private financing. Combining private sector efficiencies in network rollout and operation with the lower cost of donor financing could accelerate access expansion.

(vi) The commercial mindset of the public entities is critical to ensure the long-term sustainability of the sector performance improvement. Such commercial mindset was instilled in Ugandan public entities through the GoU’s long-term commitment with the sector reform. To the extent that such commercial mindset is absent in another operation, there is value in providing capacity building support to help develop a commercial attitude when engaging with the private sector.

(vii) Projects supporting Public Private Partnerships in power distribution required active supervision to ensure timely resolution of emerging issues before they start to negatively affect the project. Continued engagement by the Bank was critical for the success of Uganda’s distribution Concession. By virtue of the IDA guarantee, on-going supervision helped the Bank team to play an effective honest broker role at key moments (contract amendment, disputes over performance and tariff review) which prevented disputes from escalating and facilitated mutually agreed resolutions. In the case of guarantees, projects should allow for adequate monitoring and supervision during the life of the guarantee to ensure risks covered are appropriately managed.

(viii) Designing the IDA support as a credit restructuring was innovative, cost-effective, and, more importantly, responsive to GoU’s needs. By adding the guarantee support as a restructuring in an almost complete operation that had the same PDO and outcome but for a broader set of companies, the IDA team was able to expedite the approval of the guarantee support and deliver the support needed by GoU in a timely manner. Under the Privatization Agreements for its power distribution services, GoU had nine months to put in place an IDA support to backstop its obligations. Such approach also reduced the transaction cost of a small operation (US$5.5 million).
The innovative approach, however, became a burden during supervision as the Bank’s processes and systems were not prepared to handle the innovative aspects of it. The nature of the operation (a contingent credit with no planned disbursement, if successful and with an end date defined based on reaching certain market conditions) implied that the project team had to (i) work with processes and systems that were unable to adequately reflect the operation’s performance and status; and, (ii) periodically write ad-hoc reports to explain that the operation was not underperforming.

8. Comments on Issues Raised by Implementation Entity/Implementing Agencies/Partners

(a) Implementation Entity

99. Umeme Ltd, the project sponsor in its own ICR has raised several issues:

(i) There is a risk of insufficient power supply. The challenge in the sector is that demand for electricity has to be matched with power generation growth. It is important that Government plans to increase power generation, involving construction of new power hydro plants, like Karuma, are kept on track.

(ii) The Escrow Account is currently not funded. The lease payments to UEDCL, which were formerly used to fund the Escrow Account from time to time, have been excluded from the retail tariff by ERA. Notwithstanding the removal of the lease payments from the tariff, UEDCL is nevertheless obliged to fund the Escrow Account to the required minimum balance, in accordance with UEDCL’s obligations under the Lease and Assignment Agreement.

(iii) The Electricity Regulatory Authority (ERA) passed and implemented Amendments No. 2 (disallowing rapid depreciation) and No.4 (adjusting the growth factor in the tariff methodology) to the Umeme Electricity Supply Licence. The Legality of these amendments has been challenged by Umeme through an appeal filed with the Electricity Dispute Tribunal (EDT), which is awaiting resolution.

(iv) The Parliamentary Ad-hoc Committee on Energy established in July 2011 undertook a review of Umeme’s activities and tabled its final report for parliamentary debate in March 2013. The report made a number of recommendations including termination of the Company’s concession. Umeme disputed the Committee’s findings and the Government of Uganda is not bound by the Parliamentary resolutions. Government has reassured Umeme that it is fully committed to encouraging private sector investment in Uganda and will be highly unlikely to initiate any actions that deter investment in Uganda’s energy sector.

100. The Bank shares Umeme’s concerns and has duly noted them in the Assessment of Risk
to Development Outcome (section 4). The Bank also continues the dialogue on these issues with Government as part of its sector dialogue.

(a) Government/Implementing Agencies:

101. The GoU in its inputs has expressed appreciation for the success achieved by Umeme and the role played by the IDA and its Contingent Credit.

(b) Lenders, Co-financiers and/or Co-Guarantors: Lender’s comment not received.

(c) Other partners and stakeholders

102. None
Annex 1: Project Costs and Financing

Financing plan (US$) and IDA Contingent Credit

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<td>(Contingent Credit)</td>
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Annex 2: Outputs by Component

103. As indicated as section 1.5, the Project had one component: A Security Package to compensate Umeme for losses caused by defined political and regulatory risks. This annex provides a detailed description of the Security Package and the IDA backed risks.

104. Under the Privatization Agreements, the GoU provided a Security Package consisting of the Escrow Account and the L/C Facility to be in place for seven years following the privatization. The Security Package was designed to provide compensation to Umeme for any loss of revenues resulting from non-compliance of certain UEDCL/GoU undertakings specified in the Privatization Agreements. Any loss of revenues would be recovered by UMEME in the following order: (a) a rent offset; (b) a draw-down from the Escrow Account; and (c) a draw-down from the L/C Facility. In addition to providing funds for Umeme’s loss of revenue, the Escrow Account was available to pay any Buy Out Amounts due to Umeme which were not paid by the GoU. The L/C Facility was only accessible for up to US$2.5 million to cover a Buy Out Amount during the initial eighteen month period if termination resulted from a breach of the Privatization Agreements by the GOU and its entities.

105. **Escrow Account:** UEDCL deposited an initial US$2.5 million in the Escrow Account at the Transfer Date which was supplemented by monthly deposits of rent payable by UMEME, estimated at the equivalent of US$1.35 million. Any time the amounts in deposit in the Escrow Account plus the balance in the L/C Facility exceeded the “Required Amount” (an amount equal to US$5 million or its equivalent at the Transfer Date, increasing to US$8 million 12 months after the Transfer Date and rising to a cap of US$20 million or its equivalent), then any surplus became payable to UEDCL each month by the Escrow Agent. The Escrow Account was agreed to be in operation for the duration of the Concession.

106. **IDA Backed L/C Facility:** To supplement the cash deposit in the Escrow Account, UEDCL was required to establish a Standby Letter of Credit for an initial amount of US$2.5 million at the Transfer Date, increasing to US$5 million at the first anniversary thereof, and then remaining at that amount (unless reduced by a drawing which is not replenished). The L/C was required to be in effect for seven years following the privatization. Because of certain Ugandan regulatory requirements, the initial term of the L/C was three years to be renewed twice for two year periods for the balance of the seven year term. In the event the L/C was not renewed or replaced beyond its initial term, such that the L/C ceases to be in effect for the full seven year period, the GOU has agreed that UMEME could draw from the Credit, for deposit into the Escrow Account, an amount equal to the amount that would have been available for draw under the L/C prior to its expiration.

107. UMEME was entitled to draw any revenue shortfall amounts from the L/C upon the occurrence of the “IDA-Backed Events” covering loss of revenues, if there were insufficient funds in the Escrow Account to satisfy the amounts claimed after rent offset. As part of the L/C
arrangements, the L/C issuing bank entered into a L/C Reimbursement and Credit Agreement with UEDCL. Under this agreement, UEDCL agreed to repay the L/C issuing bank the amounts drawn, plus accrued interest, within a period of up to 12 months (the L/C Repayment Period). First, however, the L/C was to be replenished during the L/C Repayment Period through a claw-back from rent payments deposited in the Escrow Account by UMEME. Alternatively, the GOU or UEDCL could choose to replenish the L/C from its own resources. If by the end of the L/C Repayment Period, however, the amount of the drawing was still outstanding, then UEDCL would be obligated to make the necessary repayment to the L/C issuing bank, in US dollars, to the designated account stipulated in the Reimbursement and Credit Agreement. Repayment would normally be required to be made to the L/C issuing bank’s account in Uganda. If because of Ugandan restrictions, UEDCL were unable to make payments in US dollars to such account, or UEDCL were unable to transfer payments made to such account outside Uganda, UEDCL was required to make payment to the designated account of the L/C issuing bank outside of Uganda. Following a repayment from any of the above sources, the L/C would be reinstated by the amount of the repayments.

108. In the event UEDCL failed to make the required repayment by the end of the L/C Repayment Period, the L/C issuing bank would be entitled to claim from IDA the repayment of the due amounts plus accrued interest. Following a submission of a valid claim to IDA for payment, IDA would repay the L/C issuing bank through a disbursement from Credit 3411-UG up to an amount not exceeding US$5.5 million. Following a repayment by IDA to the L/C issuing bank, on behalf of UEDCL, neither the L/C nor the amount of IDA’s support would be reinstated for such amounts. The figure on the next page shows how the Escrow and IDA backed L/C worked to compensated Umeme if the covered risks materialize.
Risks Underpinned by the Security Package

109. Undertakings under the Privatization Agreements, seven events in the UEDCL/GOU contractual gave UMEME the right to offset rent payments and draw from the Escrow Account to compensate revenue losses and satisfy GOU’s obligation for the Buy Out Amount in the event of termination of the Concession. Of these events, only the first three ((a ), (b) and (c) below) were “IDA-backed Events” that entitled UMEME to access the IDA-backed L/C Facility following a rent offset and a draw from the Escrow Account.

(i) Failure by the ERA to approve tariff adjustments according to the pre-agreed Tariff Methodology set forth in the Distribution and Supply License.

(ii) Non-payment by GOU entities of their Electricity Bills.

(iii) Early Termination of the Concession by UMEME resulting from a breach of the Privatization Agreements by GOU and its entities during the initial 18 month period. In this case, UMEME would be entitled to receive compensation of US$2.5 million (the “Early Termination Amount”) if other funds available to UMEME (cash and unutilized investment funds in the Company Escrow Account) were insufficient to recover the full Early Termination Amount.

(iv) Early Termination of the Concession by UMEME for reasons relating to the company, within the initial eighteen month period, which would entitle UMEME to a compensation of US$2.5 million for the initial investment of US$5 million.
(v) Refunds made by UMEME of Connection Fee and Security Deposits provided by customers of UEDCL prior to the Transfer Date.

(vi) Indemnification obligations to third parties and property damage resulting from the condition of the Distribution System, within the first eighteen months of the Transfer Date.

(vii) Termination of the Concession due to UEDCL or GOU Events of Default, and Political or Other Force Majeure Events.

Description of the “IDA-backed” Risks

The “IDA-backed Events” were.

110. Non-Compliance by ERA of the Regulatory Framework: This covered the failure of the ERA to adjust retail tariffs in accordance with the Distribution and Supply Licenses within 45 days of a legitimate claim from UMEME, in accordance with the pre-agreed Tariff Methodology (contained in Annex A of the Supply License), which resulted in a corresponding loss of revenue to UMEME, including interest on any overdue amounts. Under the Licenses, UMEME would be required to make an annual tariff submission to the ERA at least 30 days prior to the effectiveness of the tariff. Tariffs might be adjusted quarterly on an automatic basis to reflect changes in bulk tariff supply costs, inflation and exchange rate movements.

111. The retail tariff, as calculated in accordance with the agreed Tariff Methodology consisted of two elements: (a) the Power Supply Price determined on a quarterly basis for each twelve month period beginning on the Transfer Date; and (b) the Distribution Price determined annually for each Tariff Year. The Distribution Price consisted of the following components: (a) operation and maintenance costs which will be fixed at the bid cost plus indexation for inflation; (b) the Return on Investment fixed in accordance with the bid proposal; and (c) Lease Rent payable to UEDCL. The US dollar components of the Distribution Price were identified in the Distribution License and were provided in the tariff at prevailing USh/US$ exchange rates. Since the components in the tariff were generally pre-determined in terms of either being fixed or outlined in a contract such as the Lease and Assignment and Power Sales Agreements, the probability of risk of disputes on interpretation to appear fairly limited. In the event that interpretation disputes between UMEME and the ERA, the License and Privatization Agreements provided for a dispute resolution mechanism through recourse to an expert’s determination on an expedited basis. If either party were to disagree with the expert’s determination, it could resort to binding arbitration. The GOU and UEDCL recognize that if UMEME draws on the L/C Facility for an IDA-backed Event, pending a dispute, UEDCL was not be relieved of its obligation under the L/C Reimbursement and Credit Agreement to repay the L/C issuing bank after the 12-month Repayment Period. If arbitration was ongoing at the end of that period and an L/C draw should result in a claim to IDA, any disbursements under the
Credit will have remained a GOU obligation even should a later arbitral award be issued in favor of UEDCL/GOU. In this case, UEDCL/GOU’s recourse would be to seek reimbursement from UMEME under its contractual obligations if the Concession is continuing, through refunds into the Escrow Account; and under the award and at law if the Privatization Agreements were terminated and an improper Buy Out Amount (or early Termination Amount) had been paid prior to the award having been rendered.

112. **Non-Payment by GOU Entities of Electricity Bills:** This dealt with the failure of Government entities to pay their electricity bills within 60 days from the due date, which results in a loss of revenue for UMEME including interest on the overdue amounts. In the event that the relevant GOU entity made a payment of the due amounts following a drawing of the amounts by UMEME from the Escrow Account or L/C Facility, UMEME had to repay all such amounts into the Escrow Account plus interest equivalent to the prevailing LIBOR rate plus 3 percent. The amounts deposited in the Escrow Account had first to be applied first to replenish the L/C Facility to the extent it had been drawn.

113. The largest single UMEME customer at the time the concession was granted was the Government and its entities, whose monthly electricity bills of around US$800,000 accounted for about 10% of sector revenues. Assuming that no payments were received from the Government and its entities, such monthly electricity bills would be offset by the monthly rental payments and the Bulk Supply Tariff payments, before any recourse to the security package could be made.

114. **Payment of Early Termination Amount Resulting from a Breach of the Privatization Agreements by GOU and its Entities:** UMEME was entitled to access the L/C Facility in the event of a termination within the initial eighteen months of the Concession for a breach of the undertakings provided by the GOU, UEDCL, or UETCL, under the Privatization Agreements. For this event, the Early Termination Amount was capped at US$2.5 million.

115. **Failure of L/C Facility to Remain in Effect for Seven Years after Privatization because of Non-Renewal or Inability to Replace:** Under Uganda regulations, the maximum initial term of the L/C Facility could exceed three years. Hence, there was a risk (although low) that the L/C Facility might not be renewed or be capable of being replaced through a substitute bank up to the full seven year period. If this risk were to materialize, UMEME was able to draw directly under the IDA Credit in an amount equal to the amount available under the L/C Facility, immediately prior to its expiration, for the purpose of placing such amounts in the Escrow Account.
Annex 3: Economic and Financial Analysis

116. The economic analysis of the project follows a standard cost-benefit approach. The stream of costs and benefits are compared to determine the net economic value in present value terms and the internal rate of return. The primary beneficiaries are the customers in Umeme’s area of operation. Households gain from electricity in the form of increased productivity, the lengthening of working/studying hours, reduced ill health, and increased connectivity (cell phone, TV and radio) and entertainment. Commercial and industrial entities gain from electricity though better lighting, storage and productivity enhancing electrification of processes.

117. The project component being analyzed provides a risk guarantee to Umeme, to enable it to raise capital to invest in improved operations and maintenance targeted towards reducing energy losses and enhancing connection capacity. The main benefits delivered by the project are thus in the form of reduction in electricity losses and greater connection of new households by Umeme. The ultimate benefits thus derive from end-user (household, commercial or industrial) consumption on account of new connections or on account of greater electricity being available due to a reduction in losses. The latter implies that economic benefit will only derive from a reduction in technical losses and not commercial loss reduction which is merely a transfer of resources.

118. The costs included are the investment and operating costs incurred by Umeme and the cost of additional power generation required to supply to the excess demand. These costs are subtracted from the delivered benefits to derive the net economic gains associated with the project.

119. The benefit from reduced technical losses is derived from the additional electricity available in the system which is ultimately consumed by the customers. The consumed electricity is valued at the consumption-weighted average of the price paid by Umeme customers (domestic, commercial and industrial). The underlying assumption is that the customer mix has remained the same through the period. Valuing energy consumed at the marginal tariff paid by customers can be regarded a lower bound for the economic benefits delivered to customers and thus a conservative valuation of benefits.
The diagram shows that energy losses fell rapidly and are projected to do so in the medium-term. Technical losses have fallen at a much slower rate and are expected to remain stable around 17 percent in the near future. Thus implying that most of the loss reduction is on account of reduced commercial losses.

120. The benefit from additional connections, similarly, is valued at the consumption-weighted average tariff. The assumed consumption per customer is the average consumption across all Umeme customers in 2012.

121. Even using very conservative valuation of benefits and costs, the project is found to have been economically viable with an NPR of US$ 108M and economic rate of return (EIRR) of 21 percent.

The table below shows the main assumptions and results for the IRR and NPV.

<table>
<thead>
<tr>
<th>Assumptions</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average price of electricity</td>
<td>0.17* /kWh</td>
</tr>
<tr>
<td>Average Consumption</td>
<td>315* kWh/month</td>
</tr>
<tr>
<td>Generation cost of electricity</td>
<td>0.12 /kWh</td>
</tr>
<tr>
<td>Discount Rate</td>
<td>12 Per cent</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Baseline Results</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>EIRR</td>
<td>21%</td>
</tr>
<tr>
<td>NPV (M US$)</td>
<td>108</td>
</tr>
</tbody>
</table>

Note: *Calculated as the weighted average across all consumer types – using 2012 consumption figures and 2014 tariff structure.
## Annex 4: Bank Guarantee and Implementation Support/Supervision Processes

### (a) Task Team members

<table>
<thead>
<tr>
<th>Names</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lending</strong></td>
<td></td>
</tr>
<tr>
<td>Karen Rasmussen</td>
<td>Co-TTL</td>
</tr>
<tr>
<td>Lucy M. Fye</td>
<td>Co-TTL</td>
</tr>
<tr>
<td>Farida Mazhar</td>
<td>Lead Financial Specialist</td>
</tr>
<tr>
<td>Pascal Tegwa</td>
<td>Sr. Procurement Specialist</td>
</tr>
<tr>
<td>Patrick Piker Umah Tete</td>
<td>Sr. Financial Management Specialist</td>
</tr>
<tr>
<td>Serigne Omar Fye</td>
<td>Sr. Environmental Specialist</td>
</tr>
<tr>
<td>Suman Babbar</td>
<td>Consultant</td>
</tr>
<tr>
<td>Atsuko Okubo</td>
<td>Counsel</td>
</tr>
<tr>
<td>Susan Maslen</td>
<td>Counsel</td>
</tr>
<tr>
<td><strong>Supervision</strong></td>
<td></td>
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<tr>
<td>Robert Schlotterer</td>
<td>TTL</td>
</tr>
<tr>
<td>Suman Babbar</td>
<td>Consultant</td>
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<tr>
<td>Gulam H. Dhalla</td>
<td>Consultant</td>
</tr>
<tr>
<td>Ju-Sung Park</td>
<td>Financial Analyst</td>
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<tr>
<td>Paul Baringanire</td>
<td>Power Engineer</td>
</tr>
<tr>
<td>Somin Mukherji</td>
<td>Senior Energy Specialist</td>
</tr>
<tr>
<td>Farida Mazhar</td>
<td>Lead Financial Officer</td>
</tr>
<tr>
<td>Janine A. Speakman</td>
<td>Operation Analyst</td>
</tr>
<tr>
<td>Teuta Kacaniku</td>
<td>Consultant</td>
</tr>
</tbody>
</table>
(b) **Staff Time and Cost (from SAP)**

<table>
<thead>
<tr>
<th>Stage of Project Cycle</th>
<th>Staff Time and Cost (Bank Budget Only)</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Staff</td>
<td>Weeks</td>
<td>US$ Thousands (including travel and consultant costs)</td>
</tr>
<tr>
<td><strong>Lending</strong></td>
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<tr>
<td>FY2004</td>
<td>15</td>
<td>160,610*</td>
<td></td>
</tr>
<tr>
<td>FY2005</td>
<td>17</td>
<td>171,558*</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Supervision/ICR</strong></td>
<td></td>
<td></td>
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<tr>
<td>FY2006</td>
<td>23</td>
<td>144,380*</td>
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<tr>
<td>FY2007</td>
<td>13</td>
<td>32,587</td>
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<tr>
<td>FY2008</td>
<td>6</td>
<td>29,730</td>
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<td>FY2009</td>
<td>8</td>
<td>22,552</td>
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<td>FY2010</td>
<td>10</td>
<td>43,085</td>
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<td>FY2011</td>
<td>7</td>
<td>43,888</td>
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<tr>
<td>FY2012</td>
<td>5</td>
<td>45,384</td>
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</tr>
<tr>
<td>FY2013</td>
<td>3</td>
<td>31,811</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td></td>
<td>725,586</td>
</tr>
</tbody>
</table>

* Data include budget spent on the four other components of the Privatization and Utility Sector Reform Project (P050439 and Credit 3411-UG).
Annex 5: List of Supporting Documents

1. IFC (2009) Umeme Limited Project No. 25788 The Republic of Uganda


6. Electricity Regulatory Authority (2012 and 2013) Correspondence of Amendments of Umeme Ltd License No. 48 for the supply of electricity Amendments 2 and 3.

7. Umeme Ltd Correspondence of Amendments of Umeme Ltd License No. 48 for the supply of electricity Amendments 2 and 3 from 2011 to 2013.

8. Electricity Regulatory Authority Correspondence of Amendments of Umeme Ltd License No. 48 for the supply of electricity Amendments 2 and 3 from 2011 to 2013.


12. Umeme Project Agreements.


17. IDA (2004) Memorandum and Recommendation of the President on the proposed amendments to the legal agreements of the Privatization and Utility Sector Reform Project (Credit 3411-UG) in the Republic of Uganda.


Map

Umeme footprints in 2009 and 2014