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USAID-Funded Nepal Hydropower Development Project (NHDP)

Presentation on Local Shares

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What are local shares

- Local shares are a subset of the public shares of an HPC set aside for communities
- There has been an outburst of interest from communities to invest in local shares
- A right that is now enshrined in the Constitution of Nepal
- Different perspectives:
 - Local Communities: Entitlement and an opportunity to invest
 - Investors: Source of capital and management of risk

Evolution of local shares

- **The story of the 22.1 MW Chilime... and 456 MW Upper Tamakoshi**
- **The uniqueness of Chilime**
 - Favorable power purchase agreement
 - Paid off its debt within few years of operation
 - Project was already giving out dividends
 - SEBON was not fully sure how to regulate the new phenomenon

Deconstructing Local Shares

Themes	Description	Major Policy Question
Amount of allocation	Total shares set aside for local communities	What is the appropriate amount of shares that should be allocated to communities?
Process of allocation	Process of distributing shares to individuals	Does the share distribution process consider the special aspects of issuing shares in rural locations?
Eligibility	People eligible for local shares, including categorization of eligibility	Should affectedness be a criterion for share issuance?
Timing	Time of issuance of local shares	Should shares be issued before or after commercial operation?
Price	Price at which shares are made available to local people	Should local shares be offered at par value or at a premium?
Financing	Financing the purchase of local shares	What instruments and options are available for financing local share purchases?
Delivery model	Institutional mechanism for offering shares to local people	Should the mechanism for delivering local share ownership be direct or indirect?
Holding and divestment	Retention and liquidation of local shares	How do people retain or divest their local shares?



Amount of Allocation

- Securities Regulation: up to 10% of issued capital for local shares
- 10% rule is becoming a politically accepted benchmark for local shares



Process of Allocation

- Process guided by Securities Issuance and Allotment Guideline: share allocation process for all public listed companies
- National practices: 3 versions of allotment guidelines (1994, 2008, 2017)
- Introduction of new technologies: ASBA, Demat, and C-ASBA

Eligibility

- The Constitution of Nepal gives local communities the priority to make investment in the use of natural resources. In 2016, SEBON direct all HPPs to define eligibility as per the project EIA
 - However, the definition of affectedness is not consistent across EIAs
 - Defining who qualifies for local shares is less technical and more political
- Unit of eligibility first defined by Chilime:
 - affected VDCs and
 - rest of the district
- Lack of clarity with respect to the eligibility of communities affected by ancillary infrastructure

Timing and Pricing

- The Securities Regulation (2016): specifies the conditions that need to be fulfilled prior to issuance of public shares
 - does not specify when local shares need to be issued; only implies that it must be issued before public shares
- The Securities Regulation (2016): establishes that the IPO of shares for publicly listed companies must be done at a par value of Rs. 100
 - There is also a provision under its Securities Issuance and Allotment Directive (2017) that allows for companies to issue shares at a premium
 - To date, all listed hydropower companies have issued local shares at par value, except Chilime
- Other pricing provisions being considered:
 - Arun-3 PDA - 50% within COD+1 year at par value and the remaining 50% between COD+2&3 at premium value (no more than 2.5 times its par value)

Financing

- General people have the capacity and willingness to invest “small” amounts
 - Sources: savings, loans from friends and relatives, or selling off smaller tradable assets OR loans from informal lending institutions at higher interest rates (sometimes up to 60% per annum)
- Chilime HPP: only company to arrange financing for local shares through banks
- Lack of knowledge among communities on financing and its associated risk
- BFIs are reluctant to finance local shares



Delivery Models

- To date, this issuance has been through the direct shareholding model
 - Need to find alternative delivery models for local shares due to the interest of several private investors, particularly foreign-based, who do not want to be listed publicly, but are willing to comply with the legal and political requirement of local shares
- Local communities unanimously prefer direct shareholding model

Delivery Models

	Special Purpose Vehicle			Cooperative	Collective Investment Scheme	Trust
	Private	Public - not-listed	Public - listed			
Ability of delivery model to hold shares	Able and cost effective to set up	Able but higher set up costs	Able but higher set up costs	Unable in current law; reform needed	Legally possible but limited by its current structure	Able to do so
Ability of locals to participate in ownership	Allows but limited to 101 shareholders.	Allows wide participation of community members				
Ability to hold and maintain investment	Additional costs involved in maintenance				Even higher additional costs	Additional costs involved in maintenance
Ability to participate in decisionmaking	All delivery models allow this under existing law					
Ability to efficiently distribute income	Since it is assumed that these models will hold their total shares for the lifetime of the project, there is no associated income from trading. All models allows for dividend income to be passed on to the local participants and are equally tax efficient					
Ability of locals to divest investments	Does not allow for a price-efficient exit	Allows for exit but not as efficiently as direct ownership	Does not allow for a price-efficient exit	Does not allow for a price-efficient exit	Allows for exit but not as efficiently as direct ownership	Does not allow for a price-efficient exit

Holding and Divestment

- SEBON requires a lock-in period of three years for local shares from the date of IPO.
- Benefit mainly in the form of cash dividend, stock dividend and right issues in case if anybody decides to hold the shares.
- Divestment through NEPSE's trading platform.
- Even after the end of lock-in-period, there is high retention of local shares in Chilime
 - View that share is a valuable asset,
 - Limited understanding of how to take advantage of the stock market, and
 - High transaction cost associated with divestment

Shares at the end of Concession

- There are two approaches that companies have taken to project development in Nepal:
 - a company owns one project, e.g., Himal Power Limited (60MW Khimiti HPP)
 - the value of the company shares, in theory, will approach zero towards the end of the project's license period
 - a company owns multiple SPV projects, e.g., Chilime Hydropower Company Limited (22.1MW Chilime, 102MW Middle Bhotekoshi, 42.5MW Sanjen, and 111MW Rasuwagadi HPPs).
 - the expiry of the license period of one's project should only affect the price of the company share to the extent of the value of that project and the price of the company then should reflect the economic value of other remaining assets.
- Legally, the Electricity Act (1992) allows for a company to, at the end of its project's concession period, enter into a new agreement with the government for the further operation and maintenance of the said project. Relevant institutions have different opinions on this, but have not discussed

Concluding Thoughts

- Chilime – the outlier
- The rise (and fall) of mass speculation
- A market yet to mature
- Minimizing risks of local communities
- Strengthening traditional forms of benefit sharing

THANK YOU!

**USAID's NEPAL Hydropower Development Project
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