Summary of David Jacoby's Comments to PowerGen's Strategic Power Track
In Doha, Qatar on October 5, 2010

With Distinguished Co-Panelists:
Fohad Hammad Al-Mohannadi, General Manager, QEWC, Qatar
Eng. Yousuf Ahmed Janahi. Corporate Planning & Business Development Department Manager, Kahramaa, Qatar
Gerhard Scheffer, VP Energy Solutions Middle East, Siemens, Germany
Andrea Lovato, ACWA Power, Saudi Arabia
Mark Raymont and Jed Savager, Pinsent Masons LLP, UAE

The various panelists talked about design risks, cash flow, liability, and financial risks, including the use of convertible lump sum and two-stage tendering, and the possibility to hedge by agreeing on a guaranteed maximum price and a target cost with a gain-share for coming in below it. They also talked about the financial risks, noting that investors are accepting lower rates of return (15%, decreasing to 8% for the off-taker) in exchange for stable revenue streams. It was mentioned that we need to increase competition in the local market (Qatari nationals get free power and water), and build local content, and suppliers must help that to happen.

Clearly, there are several different types of risk: design, political (e.g., nuclear bans, and bans on offshore drilling), technical (turbine failure), financial (exchange rates), and economic (demand, supply, and price fundamentals being different than forecast).

My role on the panel is to outline the various types of significant economic risks, such as: 1) In the Financing and Planning stages, the demand or revenue forecast risks being wrong; 2) in the Construction stage, estimates of materials and services costs may be off; and 3) in the Operation phase, volume, seasonality, and growth curves may not be on target.

The change toward the IPP model has reduced these risks noticeably. It has resulted in on-time construction instead of delays, projects being completed on time and budget (e.g., Ras Laffan C); high commercial availability rates; and committed core suppliers. As a result, the sector has been able to get financing despite a difficult external financing environment.

How have GCC power and water authorities achieved these successes? At the Financing stage, they have split ownership models to limit exposure to multiple risks; 2) pre-negotiated milestone events such as stages of production and capacity to provide predictability and stability of revenue flows; 3) co-financed and used credit guarantees, financial hedging, and insurance to reduce risk; and 4) instituted gain-sharing between owners and contractors.

Their success is a model for other countries, regions, and industries. Oil and gas concerns in the region have adopted some of the approaches. For example, IOCs and NOCs have formed joint production sharing agreements (like in Iraq, Qatar and Oman), and major oil companies have partnered with equipment manufacturers. However, oil and gas companies could take note of other techniques. So-called "long-term" purchase and sale agreements are still frequently short term (one-off purchases or 1-2 year agreements) and supplier relationships are often fragmented. Most importantly, there is a large opportunity to restructure agreements to be performance-based and to focus on system availability and performance (most are still based on unit price).

Ironically, as we look toward the future, the largest economic risks are of growth that is too fast. In a fast growth scenario, supply limitations could delay aggressive timetables as the economy heats up again. Tools such as BSI's market outlook service can monitor these conditions and provide early warning that leaves ample time for reaction, thereby keeping the risk profile low and the financial returns stable.

David Jacoby is President of Boston Strategies International (BSI), a management consulting firm that helps oil, gas, power, and water companies reduce the total cost and risk of capital asset ownership through advanced procurement and contract analysis, modeling, and advisory services. For more information visit www.bostonstrategies.com.