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PERFORMANCE CONTRACT
BETWEEN
THE GOVERNMENT OF []
AND
[Power Company]

This **PERFORMANCE CONTRACT** ("this Contract") is made this [] day of []

BETWEEN

THE GOVERNMENT OF [] ("Government") represented and acting through its **MINISTRY OF FINANCE ("MOF") AND MINISTRY OF ENERGY ("MOE")** of the one part
AND

[] ("Power Company") of the other.

WHEREAS

The Government is a shareholder in the Power Company through [].

Power Company is a state corporation within the meaning of [LEGISLATION] and as such falls within the official mandate of MOE.

AND WHEREAS

Government through MOF and MOE has agreed to enter into this contract with Power Company so as to enable Power Company attain maximum performance consistent with its role and objectives of generating electricity in [COUNTRY] at cost effective prices for sale to the [UTILITY].

NOW THEREFORE IT IS HEREBY AGREED AS FOLLOWS:

ARTICLE 1: DEFINITIONS

Wherever used in this Contract, unless the context shall otherwise require the several terms used herein shall have the following meanings:

- 1.1 "Government" means [] and includes the Ministry of Energy, the Ministry of Finance, as well as other Ministries, and/or departments, either acting jointly or severally.
- 1.2 "Power Company" means [].
- 1.3 The "Board of Directors" means the Board of Directors of Power Company as duly constituted under its registered Articles of Association in accordance with the relevant provisions of the [COMPANIES LEGISLATION].

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1.4 The "Management Team", means the Managing Director, Deputy Managing Director and all heads of divisions of the Power Company.

1.5 The "Corporate Plan" means the Power Company's three year rolling plan for meeting its managerial, operational and financial objectives.

1.6 The "Capital Structure" means a financial base which incorporates the equity, retained earnings and loans which would allow Power Company to meet its current and future objectives as articulated in Article 4 of this Contract.

1.7 "Commercial Product" means any product which Power Company produces at a price necessary for ensuring financial viability of the company.

1.8 "Performance Targets" means specific numerical indicators of Power Company's managerial, operational and financial performance expressed and contained under Article 5 of this Contract.

1.9 "Commercial Freedoms" means those changes to the current regime of decision making between the Government and the Power Company which allow Power Company to independently make decisions in its own best commercial interests.

ARTICLE 2: RESPONSIBILITIES OF THE PARTIES TO THIS PERFORMANCE CONTRACT

2.1 GOVERNMENT

2.1.1 GOVERNMENT recognizes the necessity to exempt Power Company from the provisions of [LEGISLATION] in order to achieve the purpose and objectives of this Contract. The exemption presently granted to Power Company from the provisions of [LEGISLATION] will thus remain in force for the duration of this Contract.

2.1.2 In signing this Contract, the Government hereby grants Power Company certain commercial freedoms as defined in Article 6 of this Contract.

2.1.3 The MoE

The MOE as a signatory to this Contract shall undertake to honour its obligations wherein they are specifically detailed in this Contract.

2.1.4 The MoF

The MOF as a signatory to this Contract shall undertake to honour its obligations wherein they are specifically detailed in this Contract.

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2.2 The Power Company

The Power Company as a signatory to this Contract shall undertake to honour its obligations as spelt out in this Contract.

ARTICLE 3: PURPOSE AND DURATION OF THE PERFORMANCE CONTRACT

3.1 Purpose

3.1.1 This Contract is Intended to:

- (a) encourage Power Company to attain maximum performance based on sound commercial principles consistent with its role and objectives as a parastatal company for generation of electricity in [country] at cost effective prices for sale to UTILITY.
- (b) enable GOVERNMENT to Institute changes in the management of the electric power generation assets with a view to enabling Power Company to effectively generate electricity at least cost consistent with the general economic performance of the domestic economy.
- (c) provide a mechanism for Power Company to plan and operate within a suitable managerial, financial and policy framework and a fair assessment of Power Company's performance. It is expected that this Contract will help to achieve the following results:
 - (i) establishment of a formal arrangement for the Government, as the sole shareholder in Power Company, to objectively assess the operational and financial performance of Power Company consistent with sound commercial principles;
 - (ii) development of an incentive system for Power Company management based on the achievement of good operational, economic and financial performance; and,
 - (iii) explicit and clear definition of Power Company's mission and objectives.

3.1.2 This Contract is not intended to exempt Power Company from any regulatory requirements imposed by any law, existing from time to time in [country], in respect of the operations of the electric power sub-sector.

3.2 Duration

3.2.1 This Contract shall remain in force for an initial period of three years (3) from the date of its signing by all the concerned parties.

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3.2.2 The GOVERNMENT and Power Company have the option to renew this Contract for a further period on such terms and conditions as may be mutually agreed upon between them.

ARTICLE 4: Power Company'S MISSION, OBJECTIVES AND SERVICES

4.1 Power Company's Mission

Power Company hereby declares its mission as follows:

"To efficiently generate electricity at least cost; to achieve the highest standards in the production of electricity; and to ensure its long term technical and financial viability".

The principal determinants of the Power Company's mission are:

- quality of service to the UTILITY, being the sole purchaser of electricity generated by Power Company;
- generation of electricity on the basis of sound commercial principles;
- effective pricing of electricity based on least cost supply criteria;
- technical viability and enhanced operational efficiency;
- financial profitability and solvency; and,
- high quality and efficient human resources.

4.2 Objectives

Power Company's Objectives are to:

- (a) to enhance operational efficiencies of its various generation plants by reducing auxiliary or in-house plant electricity consumption, operating and maintenance expenditures, and fuel consumption by its thermal power plants to acceptable international standards;
- (b) improve labour productivity by enhancing the ratio of:
 - installed capacity in megawatts per employee; and,
 - gross electricity sales per employee;

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- (c) financially restructure itself to achieve an appropriate balance between fixed and liquid assets;
- (d) improve financial performance as measured by:
 - operating costs per MWhr;
 - debt service (relative to debt obligations) as a percentage (%) of debt obligations; and,
 - improvement of both current assets to current liabilities and debt to equity ratios, respectively;
- (e) improve availability and reduce cost of electricity supply to UTILITY by:
 - reducing power outages to internationally acceptable standards; and,
 - enhancing capacity availability for hydro, geothermal and petroleum oil based plants to match internationally acceptable standards.

4.3 Services and Future Generation Capacity Expansion:

4.3.1 With the liberalization of the commercial generation of electricity in the country, Power Company's market share of electricity production will gradually decline as more and more independent power producers (IPPs) are licensed to generate electricity for sale to UTILITY through power purchase agreements (PPAs).

4.3.2 Power Company will have to compete with IPPs for new generation capacity, excluding future hydro power generation from multipurpose schemes, which will be put to open tender for development under international competitive bidding procedures (ICBP). No preference will therefore be given to Power Company in awarding power generation projects which will be selected for implementation from time to time in the future, on the basis of the least cost criteria.

ARTICLE 5: ASSESSMENT OF POWER COMPANY'S PERFORMANCE

5.1 Performance Targets

The performance of Power Company shall be measured by its success in meeting or surpassing a set of performance targets, which are set out in Table 1. For the purpose of assessing the overall performance of Power Company, these targets have been assigned weights and consolidated in order to give an aggregate weighted indicator.

5.2 Methodology for Assessing Power Company's Performance Indicators

- (a) Ratio of debt service as a percentage of debts due:

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This is the ratio of actual debts repaid to the debts due in any one financial year; and, is measured by dividing the total amounts of debts repaid by the total amounts of debts due in a given financial year.

(b) Maintenance and operating costs per megawatt-hour (MWhr) sold:

This is the cost incurred by the company for maintenance and operations per megawatt-hours sold; and, is measured by dividing Power Company's total recurrent costs (that is the sum of all administration, management and finance, commercial, generation expenditures) in a given year by the total electricity sales in megawatt-hours over the same period.

(c) Effective capacity to staff ratio:

This is the ratio of the combined effective capacity of all power plants to the total number of Power Company's employees.

(d) Plant availability percentage:

This is measured by dividing the number of hours per annum in which a plant is available to generate electricity, as required, by the total number of hours per annum (ie 8760 hours per annum).

(e) Operational efficiency:

This is a measure of the conversion efficiency of for example one form of energy (eg petroleum oil) to electrical energy using known international standards under a defined set of boundary operating conditions. For example, for an oil based thermal power plant efficiency could be measured by measuring the amount of fuel, of a given specific gravity, in grammes used to generate one kilowatt-hour of electricity under defined ambient conditions. Any variation in the amount of fuel consumed to generate a kilowatt-hour of electricity would then be used to determine whether efficiency is falling or rising. Similar efficiency measurement criteria could be developed for both hydro and geothermal power plants,

(f) Generation losses:

This is a measure of the amount of electricity despatched to UTILITY relative to the amount generated. The amount of electricity used in the station is counted as part of the generation losses.

(g) Labour productivity:

This is a ratio of the number of megawatt-hours generated and despatched to UTILITY per employee of Power Company; and the higher the ratio the higher is the productivity.

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Table 1 *PERFORMANCE INDICATORS FOR POWER COMPANY*

Performance Indicator	Base Performance (Actual)	Target per annum			Achievement of Target	Weight Assigned to Target	Performance [1] x [2]
Labour productivity							
Installed Capacity to staff Ratio (MW per employee)							
Thermal plants efficiency: Plant [A] (Grammes/KW hr)							
Geothermal plant [B] (Kga/MW hr)							
Ratio of debts serviced to debts due ¹							
¹ Maintenance and operating costs per HWht cold (in Ksh)							
Plant availability (%per annum):							
Hydro							
Kipevu Gila							
Turbine							
Geothermal							
TOTAL AGGREGATE PERFORMANCE						100%	

¹ This formula does not apply to debt serviced to debts due ratio, which is computed by multiplying the achieved ratio by the weight assigned.

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ARTICLE 6: Power Company COMMERCIAL FREEDOMS

Power Company shall operate as a commercial business concern in accordance with the relevant Laws of [country]. Power Company shall operate with commercial freedom in the areas enumerated below.

6.1 Staffing Decisions

Power Company shall be free to employ or terminate, promote or demote such employees as shall be necessary for the pursuit of its commercial objectives and efficient discharge of its functions as approved by its Board from time to time, subject to the provisions of the relevant statutes on employment.

6.2 Staff Remuneration

Power Company shall be free to determine and set levels of compensation and remuneration for its staff including the payment of performance incentives as provided in this contract and as shall be approved by its Board from time to time. However, such payments shall have to be consistent with Power Company's annual budget as approved by Government. Payments of bonuses under this contract will be made on the basis of an audit report on performance approved by a committee comprising the MoE and MoF representatives.

6.3 Commercial Contracts other than for Generation of Electricity

Power Company shall be free to award Contracts to suppliers based on a competitive tender system and with due regard to fair market prices, as shall be necessary for the proper discharge of its objectives and functions.

6.4 Electric Power Purchase Agreements

Power Company shall be free to negotiate power purchase agreements (PPAs) with UTILITY for all its power plants, as mutually agreed between the two companies and consistent with sound commercial principles.

6.5 Short Term Investments

Power Company shall be free to make short term investment decisions in accordance with the best commercial principles.

6.6 Disposal of Equipment or Assets

Power Company shall have the right to dispose of equipment and assets, which its Board may deem unproductive, inefficient or uneconomic to maintain.

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6.7 Borrowing

Power Company shall have the right to borrow from lending institutions, including providing security interest, Where a Government guarantee is required Power Company will seek the approval of the MoE and the MoF in that regard.

6.8 Negotiations with the Recognized Trade Union

It shall be a requirement that achievement of performance targets will form part of the Collective Bargaining Agreement and Power Company shall have the freedom to negotiate with the relevant trade union on the performance targets, as it may deem fit.

ARTICLE 7: GOVERNMENT OBLIGATIONS

7.1 Capital Structure

It shall be the responsibility of Power Company to sustain a sound debt to equity ratio in order to keep the financial risks of the company at the minimum, as the Government has no responsibility regarding the capital structure of Power Company. Any borrowings by Power Company shall be on the basis of commercial viability of the activities to be funded, taking into account the generation tariffs provisions in the PPAs.

ARTICLE 8: PERFORMANCE INCENTIVES FOR POWER COMPANY BOARD AND MANAGEMENT TEAM

8.1 Power Company has already been exempted from the provisions of the State Corporations Act and is therefore paying its Board members, the Managing Director and its employees competitive salaries and fringe benefits consistent with the private sector practices in [COUNTRY]. In addition to these attractive terms and conditions of service, Power Company shall pay its Board of Directors and its Management Team a Performance Incentive Bonus (PIB) within four months after receipt of annual audited financial and other reports demonstrating enhanced performance, based on the performance evaluation criteria enunciated in sub-article 8.2 below. The purpose of the PIB is to reward the Power Company Board and Management Team if they are able to generate "good" or "excellent" performance. The incentives will provide a system to motivate and guide the Board and Management Team to act in the interests of the company and public as a whole and achieve some of the benefits of private sector management, while remaining a strategic parastatal.

8.2 Criteria

8.2.1 Performance shall be measured by the achievement of the annual aggregate Indicator as specified in Article 5 of this Contract.

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8.2.2 In this Contract, "Poor" performance shall be defined as an achievement of an aggregate indicator value of any number less than 50%. "Poor" performance shall result in a formal review of the effectiveness of the job performance of the current office holders of the Board of Directors and management team. Subject to recommendations made in this review, a disciplinary action shall be taken against the Board and management team as detailed in sub-article 8.5.

8.2.3 In this contract "fair" performance shall be defined as an achievement of an aggregate indicator value of any number between 50% and 69%. No performance related bonus shall be awarded for achievement of a fair performance. However, salaries and allowances including other fringe benefits shall not be increased, until "good" or "excellent" performance, as defined in sub-articles 8.2.4 and 8.2.5 below is achieved.

8.2.4 In this Contract, "good" performance shall be defined as an achievement of an aggregate indicator value of any number between 70% and 85%. "Good" performance shall result in the award of an incentive bonus as specified in sub-article 8.3 of this contract.

8.2.5 In this Contract, "excellent" performance shall be defined as an achievement of an aggregate Indicator value of any number greater than 85%. "Excellent" performance shall result in the award of an incentive bonus as specified in sub-article 8.3 of this Contract.

8.3 Performance Incentive Bonus

Payment of Performance Incentive Bonus shall be a function of the achievement of the annual aggregate Indicator as specified in sub-articles 8.2.3 and 8.2.4, respectively. In the event "good" performance is achieved by Power Company, the amount of the bonus to be paid shall be equal to 5% of after tax profits of the company. "Excellent" performance shall qualify for bonus payment equal to 7.5% of after tax profits of Power Company. The bonus shall be distributed to the qualifying employees at the discretion of the Power Company Board.

8.4 Employees for Performance Bonus

All eligible employees who were employed by Power Company during the year under review and who were still in good standing with the company at the time that the performance related incentive bonus is payable, shall be eligible for payment of such bonus.

8.5 Disciplinary Actions and Penalties for Poor Performance

If upon a formal review of the effectiveness of the job performance of the current Power Company's office holders in the Board of Directors and of the management team, it is concluded that poor performance was due to general, collective or individual laxity and or lack of commitment to Power Company's business, the Government shall take punitive measures as set out below, against the Board and affected members of the management team.

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- (a) Board Members (for aggregate indicator performance of 39% and below):
Board to be replaced.
- (b) Board Members (for aggregate indicator performance between 40 and 69%):
Sitting allowances shall not be increased.
- (c) Management Team (for aggregate indicator performance of 39% and below):
Replace management team, as appropriate.
- (d) Management Team (for aggregate indicator performance between 40 and 69%):
Salaries and fringe benefits shall not be increased.

ARTICLE 9: AMENDMENTS AND REPORTS

9.1 Amendments

This Contract or any part thereof may at any time be modified or amended to in writing by mutual agreement of Power Company and Government.

9.2 Reports

Reporting on this Contract will be conducted during and at the end of each financial year that the Contract has been in force, as specified below.

9.2.1 Quarterly progress reports will be prepared by Power Company and submitted to the Government.

9.2.2 Four months after the end of the financial year under review, Power Company will submit a report to the MoE:

- (a) containing specific details on its operational achievements relative to performance indicators in accordance with the provisions of Article 5 of this Contract;
- (b) incorporating the results of a special audit report on the public service obligations including the rural electrification projects undertaken by Power Company which shall record all bills submitted to the Government and the expenditures on behalf of the Government for settlement. In addition to the aforementioned, the audit report shall comment on the performance of the Government in settling outstanding bills appertaining to services rendered by Power Company on its behalf during the year under review and Power Company's performance in delivering public services;
- (c) commenting on the performance of the Government in meeting its obligations under the Contract, including but not limited to:

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- i. enjoyment of commercial freedoms by Power Company as stipulated in Article 6; and
 - ii. the fulfillment of Government obligations in accordance with the provisions of Article 7;
- (d) comment on other matters relating to the performance and operation of the Contract including but not limited to amendments to the Contract.

9.2.3 Within one month after receipt of the Power Company report, the MoE will prepare a written response to the report:

- (a) rendering an opinion as to whether Power Company has or has not achieved the performance as stipulated in Article 5;
- (b) responding to Power Company's comments on the extent to which the Government has fulfilled its obligations; and
- (c) reacting to other issues relating to the Contract, including but not limited to amendments to the Contract.

9.2.4 Power Company and MoE shall submit to the MoF a copy of each of the aforementioned reports as specified in sub-articles 9.2.2 and 9.2.3. The MoF shall review these reports within one month and submit to the MoE and the Power Company written comments regarding the effectiveness by which both MoE and Power Company have implemented the Contract.

9.2.5 In the event that the report is acceptable to both MoE and MoF, then MoE will immediately communicate such a finding to Power Company Board so that payment of bonus is promptly effected.

9.2.6 In the event that the MoF establishes that the process for implementing this contract is not working effectively, it may in consultation with MoE commission an independent auditor or consultant to make recommendations for improvement in the implementation process. MoE may also initiate a similar action in consultation with MoF.

Executed on this day of [].

Signed _____ Date:
Power Company

Signed: _____ Date:
MoE

Countersigned: _____ Date:
Treasury