



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to inform the Congress of our intent to provide funding of up to \$350,700,000 under a Millennium Challenge Compact with the Republic of Malawi.

Obligation of funds may be incurred on or after 15 days from the date of this notification.

The attached notification is being sent to Congress on January 7, 2011.

Sincerely,

T. Charles Cooper
Vice President
Congressional and Public Affairs

Enclosure:
As stated

CONGRESSIONAL NOTIFICATION
January [], 2011

PROGRAM: Eligible Countries

APPROPRATIONS CATEGORY: Fiscal Years 2009, 2010, and 2011
Program Funds

OBLIGATION AMOUNT: \$350,700,000, using \$4,000,000 of
fiscal year 2009, \$205,910,759 of
fiscal year 2010, and \$140,789,241
of fiscal year 2011 funds

Pursuant to (i) sections 7015(c) and 7057 of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2009 (P.L. 111-8); (ii) section 7015(c) and the heading, “Millennium Challenge Corporation” of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2010 (P.L. 111-117) and (iii) section 101 of the Continuing Appropriations Act, 2011 (P.L. 111-242), as amended by the Continuing Appropriations and Surface Transportation Extensions Act, 2011 (P.L. 111-322) the Millennium Challenge Corporation (“MCC”) wishes to notify the Congress of its intent to sign a Millennium Challenge Compact (the “Compact”) with the Republic of Malawi (“Malawi”), through which MCC will grant up to a total amount of \$350,700,000 under the Millennium Challenge Act of 2003, as amended (the “Act”). In order to accelerate implementation of the Compact, MCC intends to obligate up to \$9,120,000 (“Compact Implementation Funding”) of the overall grant under section 609(g) of the Act, using fiscal year 2010 funds, when the Compact is signed by the parties. MCC intends to obligate up to \$341,580,000 under section 605 of the Act, using \$4,000,000 of fiscal year 2009 funds, \$196,790,759 of fiscal year 2010 funds, and \$140,789,241 of fiscal year 2011 funds when the Compact enters into force. After the Compact enters into force, Compact Implementation Funding that is not needed to accelerate implementation of the Compact may be deobligated, and up to an equivalent amount of funding may be obligated under section 605 of the Act. Such funding is included in the total amount of MCC funds under the Compact and will not increase total Compact funding.

Compact funding will support a power sector revitalization project, which is described along with other key elements of the Compact in the accompanying summary.

SUPPLEMENTAL INFORMATION

MILLENNIUM CHALLENGE COMPACT BETWEEN THE UNITED STATES OF AMERICA, ACTING THROUGH THE MILLENNIUM CHALLENGE CORPORATION, AND THE REPUBLIC OF MALAWI

The Millennium Challenge Corporation's Board of Directors has approved a five-year, \$350.7 million compact with the Government of Malawi (the “GOM”) aimed at reducing poverty through economic growth (the “Compact”). The Compact focuses on revitalization of the Malawi power sector, and is intended to: (i) increase investment and employment income by raising the profitability and productivity of enterprises; (ii) expand access to electricity for the Malawian people and businesses; and (iii) improve delivery of social services.

I. Project Overview and Activity Descriptions

To advance the Compact goal of reducing poverty through economic growth, the Compact will fund a Power Sector Revitalization Project (the “Project”) that aims to improve the availability, reliability, and quality of the power supply by: (i) increasing the throughput capacity and stability of the national electricity grid; (ii) increase efficiency of hydropower generation; and (iii) create an enabling environment for future expansion by strengthening sector institutions and enhancing regulation and governance of the sector. The Project consists of two activities (i) the Infrastructure Development Activity and (ii) the Power Sector Reform Activity (the “Activities”).

Infrastructure Development Activity (*estimated \$283 million*)

The Infrastructure Development Activity focuses on the rehabilitation, upgrade and modernization of those generation, transmission and distribution assets of the Electricity Supply Corporation of Malawi (“ESCOM”) in most urgent need of repair, in order to improve the capability of the transmission system and increase the efficiency and sustainability of hydropower generation. Because maintaining the current generation assets and expanding generation capacity are necessary to ensure realization of the full benefits of the Infrastructure Development Activity, the GOM is committing to maintain current generation assets, and to invest in new generation by completing the construction of the 64 MW Kapichira II hydropower plant during the term of the Compact. By the end of the Compact term, MCC expects that the Infrastructure Development Activity will result in the preservation and expansion of capacity of a 24 MW power plant to 27-30 MW (which, combined with planned Government of Malawi investments, capacity will increase from 286 MW to 356 MW), increased network throughput capacity (from 260 MW to 410 MW) and enhanced distribution capability (from 868 megavolt amperes (MVA) to 1,118 MVA), as well as a reduction of technical losses of the power system (from 20-25% to 18%).

The Infrastructure Development Activity consists of the following four sub-activities:

(a) Nkula A Rehabilitation Sub-Activity: This sub-activity will provide funding to rehabilitate and modernize Malawi’s oldest major hydropower plant – Nkula A – at the Nkula

Falls Hydroelectric plant. The objective of this proposed investment is to improve the availability of power in Malawi by reducing outages caused by the condition of assets, and maximizing the power output of generators. The rehabilitation is necessary to assist ESCOM and to avoid the good probability that at least a portion, if not all, of the plant could fail by the end of the Compact without MCC's investment. Such a loss in generation output would have a significant adverse affect on the Malawi economy, and severely compromise the potential utilization and returns on MCC's investment in the transmission and distribution upgrade and rehabilitation.

(b) Transmission Network Upgrade Sub-Activity: This sub-activity will upgrade the backbone of the transmission network in order to: (i) improve the quality and reliability of supply in the northern, central and southern regions of the country; (ii) increase the capacity to move power from the south, where 98 percent of Malawi's power is generated, to the central and northern regions; (iii) reduce technical losses on transmission lines; and (iv) provide a secure transmission link between the southern and central regions.

(c) Transmission and Distribution Upgrade, Expansion, and Rehabilitation Sub-Activity: This sub-activity includes investments in the southern, central, and northern power systems of the Malawi power network in order to: (i) upgrade existing network connections (33-kilovolt (kV), 11kV); (ii) extend existing substations; (iii) upgrade transformers in existing substations; (iv) develop new substations; (v) install and/or repair improved protection systems; (vi) provide new network extensions and connections; and (vii) install a new system control and data acquisition system.

(d) Environment and Natural Resource Management (ENRM) Sub-Activity: The objective of the ENRM sub-activity is to help the GOM and other relevant stakeholders address the growing problems of aquatic weed infestation and excessive sedimentation in the Shire River, which cause costly disruptions to downstream power plant operations. The ENRM sub-activity intends to address these issues by: (i) mitigating the impact of the weeds and sedimentation by providing dredgers and weed-harvesting equipment for use at existing hydropower plants and the Liwonde Barrage, and expanding use of upstream biological control measures; and (ii) developing and implementing an Environmental and Natural Resource Management Action Plan (ENRMAP) that sets the course for an improved understanding and action on environmental, social (including gender), and economic factors that cause or contribute to weed infestation and sedimentation in the Shire River.

Power Sector Reform Activity (*estimated \$25.7 million*)

The Power Sector Reform Activity complements the Infrastructure Development Activity by providing support for the GOM's policy reform agenda, and aims to build capacity in pivotal sector institutions: ESCOM, the Malawi Energy Regulatory Authority (MERA), and the Ministry of Natural Resources Energy and Environment (MNREE). Currently, ESCOM suffers from significant financial, governance and operational challenges. In addition, inadequate GOM policies and sector governance continue to hinder development of the power sector. To address these challenges, MCC and the GOM have developed two sub-activities under the Power Sector

Reform Activity: the ESCOM Turnaround sub-activity and the Regulatory Strengthening sub-activity.

(a) ESCOM Turnaround Sub-Activity. The objectives of this sub-activity are to restore ESCOM's financial health and rebuild ESCOM into a strong, well-managed company. MCC funding will support three main areas of the turnaround: finances, corporate governance and operations.

(i) *Finances*: MCC funding will support the provision of technical assistance and equipment to ESCOM, including: (1) development of a detailed financial plan for 2011-2016; (2) deployment of a "financial turnaround team"; (3) development of a loss reduction study; (4) assistance in rapid billings and collections improvements; (5) strengthening of internal controls; (6) rebuilding of the customer database; (7) pursuit of debt collection; (8) development of a new automated financial management system; and (9) assistance with tariff applications.

(ii) *Operations*: MCC funding will support change management efforts, designing human resources strategies, strengthen ESCOM's procurement division, and other operational assistance.

(iii) *Corporate Governance*: MCC funding will seek to improve corporate governance and support ESCOM's turnaround, including: (1) recruitment services; (2) twinning/mentoring arrangements or management contract support; (3) a performance management system; and (4) board strategic planning. MCC funding will provide technical assistance on corporate performance standards, including a study on best practices and benchmarks for corporate governance of electric utilities with regional, continental and international benchmarks and recommendations for ESCOM by the end of the second year of the Compact term.

(b) Regulatory Strengthening Sub-Activity. The objective of this sub-activity is to provide support for the GOM's policy reform agenda by building capacity in pivotal sector institutions such as MERA and MNREE, and to develop a regulatory environment, consistent with best practices in independent power utility regulation, which will promote potential private sector investment in generation and grid capacity at an affordable cost.

(i) *Tariff Reform*: MCC funding will support a cost of service study to determine appropriate tariff levels and schedules to achieve full cost recovery, more efficient utilization of electricity, and achievement of social objectives. Based on the results of this study, the GOM commits to a phased implementation of full-cost recovery tariffs and schedules to be completed by the end of year three of the Compact.

(ii) *MERA Capacity Building*: MCC funding will support capacity building at MERA to improve its regulatory oversight activities and operations including training and mentoring and development of peer relationships with other regulatory bodies.

(iii) *Enabling Environment for Public and Private Sector Investment*: MCC funding will support the GOM's efforts to implement a suitable market model which will include

efforts to: (a) study and design a single buyer model to be implemented during the Compact; and (b) develop the building blocks of a bilateral power trade market.

II. Administration

The Compact also includes program administration costs estimated at \$33 million over a five-year timeframe, including the costs of administration, management, auditing, and fiscal and procurement services. In addition, the cost of monitoring and evaluation of the Compact and integration of MCC's gender policy is budgeted at approximately \$9 million.

III. Economic and Beneficiary Analysis

By reducing power outages and technical losses, enhancing the sustainability and efficiency of hydropower generation, and increasing the potential kilowatt hours of throughput to electricity consumers, the Compact will reduce energy costs to enterprises and households, improve productivity in agriculture, manufacturing, and services sectors, and support the preservation and creation of employment opportunities in the economy. Assuming the Compact is implemented as planned, MCC and the GOM expect the Compact to result in the following benefits and distribution thereof:

- An estimated 5.9 million individuals¹ will benefit during the period from entry into force of the Compact through year 20 after the Compact term, through reduced domestic and enterprise energy costs, increased employment income, and increased profits;
- An estimated present value of US\$3.1 billion in income benefits to Malawi when discounted at an annual rate of 10 percent;
- An estimated 40 percent of beneficiaries are currently extremely poor, and 60 percent are poor²; and
- Extremely poor beneficiaries will gain an average of approximately US\$248 of benefits in purchasing power parity (PPP) terms, and poor individuals will gain an average of US\$325 (estimates based on recent employment and electricity connection patterns, and incorporate effects of a modest rise in tariffs, to partly finance expanded access).

¹ Malawi's current population is estimated at 13.6 million and is projected at 24 million in year 20 after the Compact term.

² "Extremely poor" is defined as living on the equivalent amount in 2010 of less than US\$1.25 per day (2005 purchasing power parity (PPP)- adjusted dollars), and "poor" is defined as living on less than US\$2.00 per day (2005 PPP adjusted dollars).