

Delivery Order (Russia) No. 05
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RUSSIA POWER RESTRUCTURING ANALYSIS AND RECOMMENDATIONS

By
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June 13, 1997

For
USAID Mission to Russia
Gene George
Office of Economic Reform
Energy and Technology Division
Moscow, Russia

Environmental Policy and Institutional Strengthening Indefinite Quantity Contract (EPIQ)

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Background

As a result of recent developments with the newly installed government and senior RAO EES Rossii management and their desire to move very quickly with reforms, USAID requested short-term policy advice related to the reform process. Interaction with UES, USAID contractors, other contractors, and donors providing input to UES and mission management was an integral part of the assignment. Policy assistance and analyses of the appropriateness of planned USAID technical assistance was required as part of the final report and is included later.

Task Reports

Interact with UES

UES Sr. Vice President, Mr. Brevnov, was not available for specific discussions throughout this period. He was in the process of being elevated to the position of President of UES, and this required much of his time. Meetings took place with IFC personnel Ms. Katherine Switz, and PHB, Mr. Hod Thornber. UES's primary short-term objective under Mr. Brevnov is to establish some form of wholesale market that can be replicated through Russia. (See attachment 1 for notes on the meeting with Ms. Switz.) UES appreciated the fast response that the USAID contractor, Hagler Bailly, was able to provide to technical questions regarding market formation and operation. UES intends to organize support for the formation of the wholesale market under the IFC team with the current lead contractor, Putnam Hayes & Bartlett (PHB). Other contractors are currently supplying services for free, i.e., Bain Link, probably with the expectation of getting a contract for World Bank-supplied loans for technical assistance. UES could not state clearly what further assistance it requires from Hagler Bailly; however, UES made it clear that it sees Hagler Bailly as an important part of the team. Initial assignments would be in the form of questions or analyses requiring short turn-around time.

Policy Assistance

Wholesale Market—An analysis of the wholesale market that Mr. Brevnov proposed was conducted. Several meetings were held with Rajiv Rastogi of USAID/W, Hagler Bailly, PHB, Bain Link & Co., and Price Waterhouse to understand and compare this new market proposal to the proposal developed between Hagler Bailly and UES. (See Attachment 2 for this analysis.) It is recommended that Hagler Bailly continue to be involved with the wholesale market work. Tasks should focus on areas already indicated in the Hagler Bailly work plan and only where these tasks support implementation of the market now being formed and as requested by UES.

Power Sector Pre-Feasibility Study—A paper was prepared that outlines a pre-feasibility study for a power project. TDA has indicated that requests for support for feasibility studies in Russia must be accompanied by a project-specific pre-feasibility study. (This outline is in Attachment 3.)

Far East Primorsky Region Energo Commercialization Diagnostic—UES requested that Hagler Bailly perform a diagnostic for Dalenergo in the Russian Far East relative to the Commercialization Task. The urgency of this task was due to the emergency in the region associated with frequent and prolonged brownouts. These brownouts are related to the non-payment crisis and lack of fuel without funds to purchase. (The position recommended to management is in Attachment 4.)

Energo Commercialization Task—This task is awaiting completion of all diagnostics by Hagler Bailly. Hagler Bailly has been requested to completed the diagnostics; determine the activities

and level-of-effort for each energo; and rank each energo according to its ability to utilize the commercialization work and its interest in sharing the effort by supplying offices, personnel and equipment as well as the actual need for a particular energo to have this work done in the initial phase. Following this, a final list will be prepared with USAID and UES management. It is worth noting, that this task area, one of the most difficult because of reluctance of UES and energo management to share information and its concerns about publishing the results, has shown significant breakthroughs when implemented. The pilot commercialization task at Lenenergo resulted in commercial follow-on work for the USAID contractor, and the Limited Review at UES, with all its difficulties, has finally brought an understanding of the importance of this work to management. UES has now retained an auditor, approved by the board of directors, and is seeking a financial advisor. It is recommended that commercialization remain a priority project.

Generator Commercialization—This task was given a low priority in the Hagler Bailly delivery order after funds were reduced. During the wholesale market work, Hagler Bailly will acquire much of the data required to begin looking at viable commercial arrangements for the UES generating units. The wholesale market will differentiate between generator costs and will begin to introduce competition to UES generators and to energo generators if they choose to sell to the market. This should introduce a favorable climate for looking at selling the generation units. USAID may want to reconsider this activity if funds are available.

Northwest Initiative—An EBRD initiative supported by USAID and the Finnish Government plans to look specifically at the North West Region of Russia and do a “least-cost study” to determine and rank needed projects. This activity will closely parallel the work done by JEPAS with a more narrow focus. Russian electricity consumption continued to decline in 1996. Consumption was at 811 billion kW, down from 843 billion kW in 1995 and 972 kW in 1992. Even considering exports, to serve this load, the system, including nuclear, operated at an average annual capacity factor of 46 percent. The peak load served versus capacity is not identified. The conclusion that can be easily reached with this information is that Russia does not need new capacity. There may be some need in some specific area; however, as was identified in JEPAS, transmission projects, which generally are less costly than power projects, will mitigate most problems. JEPAS identified at least three transmission and one dispatch control project for the Northwest region. At best, this new study will confirm the findings of JEPAS and at worst will introduce a new set of projects only leading to further studies to answer the “why” questions that will arise. Transmission projects, lower-cost life extensions, and efficiency improvement projects should be the focus of Russia’s near-term power sector future. The current capacity payment of the tariff is set to keep all generation in business, even though it is only 46 percent utilized. Dispatch of these units is not on a least-cost basis. Retirement dates are extended by low utilization factors thus pushing out the need for new capacity. There is a lot of unneeded capacity in the Russian power sector and new power projects will only increase the capacity costs of the system and add to the over-capacity already existing.

Attachment 1

MEMO

To: Gene George
From: Ronald Leasburg
Subject: Meeting with Katherine Switz at UES offices
Date: October 5, 1998

Michael Stepanov and I met with Ms. Switz Friday, May 24, from 4:00 until 5:30 pm. The following points were discussed:

1. Mr. Brevnov is not yet ready to set priorities for Hagler Bailly work. The general outlines of Hagler Bailly's contract with USAID seem well understood. He prefers to wait until after the meeting on the 30th before setting definite priorities.
2. Now, Brevnov needs some flexibility to use Hagler Bailly to answer question and do mini-reports on issues that he does not understand, such as the wholesale market. He appreciates very much Hagler Bailly's prompt response to his requests. Bahman D. was mentioned several times as being particularly effective.
3. Ms. Switz discussed World Bank loan plans. The WB is prepared to loan \$40 million to the GOR/UES and Mr. Brevnov is asking for an additional \$300 million. All of this is to be used in the restructuring of UES and not new facilities. The IFC will be instrumental in assisting UES to manage the \$40 million loan.
4. Ms. Switz discussed the need to do something immediately with UES and the plans to have some sort of wholesale market in the NN region composed of industrial customers. In discussions, I pointed out that they could go much further by putting all UES and Nuclear generators in the wholesale market immediately. This could be done by creating "profit center" clusters of generators, at least four from within UES plus whatever Nuclear would decide and having them act as independent profit centers within UES and Rosenergoatom. Brevnov is concerned that there are not enough UES generators to form wholesale generation companies. I explained that they have an almost ideal situation with the UES generators to form companies that may someday be spun-off or sold as the board may decide in the future. Non-payments eventually becomes the reason not to move forward. I pointed out that as long as the generators were still within UES, that getting them to focus on business-like operations and moving, at a minimum, to economic dispatch, could only improve the current cost situation. We discussed several alternatives for early structural reforms and wholesale market approaches, i.e., should energos be required to sell into the markets?
5. We discussed USAID's work in NN, partnerships that are focused on the energo and have also included the local regulators, the progress the regulators have had with the Illinois regulators, and the IRIS program. She was very interested in how the partnerships worked but was very focused on the regulatory issues in both the partnerships and the IRIS program. She claimed that Brevnov

would like to go slow on regional regulatory matters until the Federal Energy Commission has decided how the regions and the federal commissions should interact. Their focus is on getting the FEC up and running and having the FEC determine what and how the RECs should be. She would like to have USAID assistance in regulation directed to the FEC. She mentioned that a meeting with Andrew Baldwin was scheduled and I suggested that she discuss this with him. She would like to have a copy of the IRIS work plan. (Note: I did not mention the recent IRIS agreement with the Saratov REC. I assume this will come up when she meets with Andy.)

6. We discussed the Far East and it was not clear what priority Brevnov attaches to having a diagnostic done of the region. A diagnostic was certainly in order and would be further discussed with Hagler Bailly that evening. (Note: Hagler Bailly had already heard from Obratzov that they should go slow in the Far East.)

7. We discussed possible conflicts in the chain-of-command and who is in charge of the assistance programs at UES. She says Brevnov is definitely in charge and that we should maintain other contacts as in the past. But if we feel there are conflicts, by all means let her know. It was clear from the discussion that much resistance remains within UES to Brevnov's presence. She expects it will become more clear after the meeting on the 30th. I do not feel that he has many allies within UES currently.

8. We discussed the organization of assistance chart drawn up by PHB and the difficulty I saw in managing the work from this chart. She said that it was already revised and that she would fax a new copy to us.

9. Mr. Brevnov is expected to appoint a senior financial advisor to UES very soon. No indication whom this may be.

cc:

David Dod

Michael Stepanov

File:

Attachment 2

The Russian Wholesale Electricity Market

Status, Issues, and Concerns

Ronald H. Leasburg

October 5, 1998

1. INTRODUCTION

The United States Agency for International Development (USAID) has supported the Government of Russia's electric power restructuring program since 1994. Key elements of the support have provided guidance and recommendations as follows: restructuring of the power sector into competitive, market-based units; development of a wholesale power market; introduction of international accounting and financial standards; investment promotion; regulation; and training. The purpose of this paper is to examine the issues and concerns of the wholesale market approaches being presently considered.

2. STATUS

Various decrees, resolutions, agreements, and working papers of UES and government commissions, i.e., the Yasin Commission, have outlined a future structure for the Russian electric power sector and the electricity market that will operate in that sector. Recognition, and agreement, of the evolving power sector structure is necessary to define possible competitive wholesale market arrangements. If the system were, for example, to remain vertically integrated, Russia would not require a wholesale market. Prominent features of the evolving power sector structure include the following:

- # **Independent Distribution Companies**—UES will transfer Existing AO Energo shares held by RAO EES Rossii to stockholders.
- # **Independent Generation Companies**—UES will create several independent generation companies from existing generators, including some AO Energo generators, and shares will be transferred to stockholders. The generation sector will be based on market competition between companies.
- # **Independent Transmission Grid and Distribution System**—UES will become a transmission company selling wire services and recovering costs through access and use-of-system charges.
- # **Independent Federal and Regional Regulatory System**—A Federal Energy Commission (FEC) and several Regional Energy Commissions (RECs) will regulate the power sector natural monopoly functions, distribution and wire services. The FEC will oversee the development and operation of the wholesale market(s).

Independent Market Operator—An independent market operator and/or a system of regional market operators with an independent operator overseeing all operations will be established to control short-term market operations. Most studies propose an energy/capacity market.

Within the above market framework, many details regarding final structure and operation remain. How will UES divide the generators into independent companies and how many companies should be formed? When should the spinoff of generation and AO Energos through issuing stock shares occur? Should the market operator buy and sell energy and capacity or only ease transfers? Clearly, the final restructured power sector is still a long time in the future; however, the GORF has expressed its resolve to move toward a competitive, wholesale power market. This resolve is most evident in the urgent priority to establish an “Independent Federal Electricity Market” operating in parallel with the “directed contract arrangements” now administered by the Central Dispatch Unit (CDU) of UES.

3. WHOLESALE MARKET ISSUES

The USAID assistance program has examined several issues regarding the establishment of a wholesale power market in Russia. UES identified this work as a priority task to be included in the work plan. Hagler Bailly developed detailed papers, which taken as a whole, would define the formation, operation, regulation, management and financial aspects of an integrated, federal (national) wholesale power market. These papers were presented to UES who then reviewed and provided comments. UES maintained throughout the development of the market papers, and still maintains today at the working level, that the wholesale market should be a single national market, all generators more than 100 MWs must sell into the market, regional price differentiation would be minimal, and no selling would be allowed around or outside the market. UES did not present the papers to other government agencies, i.e., the Yasin Commission, but did allow the USAID contractor to make a presentation to this group along with other invited participants. At this meeting, UES did not show clear support for the plan. Nevertheless, UES did agree to continue development of the wholesale market concept. USAID support for wholesale market development continued with both UES and the Yasin Commission, often with reluctance from UES to share work developed for them with the commission.

Recent changes at the executive level in both the GORF and UES have brought new attention and urgency to beginning some form of wholesale market. A new market concept developed by consultants to UES, called the Federal Electricity Market,¹ is proposed to begin operation with a relatively small number of participants. Ten customers and four generators are proposed as the founding members of the market.² Salient features of the proposed market are:

¹Note: The names in this paper assigned to various segments of this market and functions within the market are subject to change and are changing, as the market description develops.

²It is rumored that the actual number of participants interested in being part of the market is less than half of the proposed number; however, UES plans to start this market by the end of June and have contracts in place by the first of July even with minimal participation.

- # A “nonprofit partnership” (REM)³ is to be created that will buy power from generators and sell power to customers.
- # REM will enter into Power Purchase Agreements (PPAs) with generators, initially with UES generators and if they choose to participate, with Rosenergoatom and surplus Energo generators.
- # Initially, customers may be any large industrial enterprise or AO Energo currently taking power from the UES grid.⁴ Customers will enter into PSAs with REM that requires weekly advance payments at rates anticipated to be below market rates.
- # A second tier of customers is proposed to include large industrial customers served by AO Energos, if the purchaser can obtain both the consent of the local energo and the local REC.
- # The tariff for power flowing through these contracts is the lesser of the REC tariff or the Market Purchase Price (MPP).⁵
- # Sales contracted through PSAs will be allocated proportionally to generators with PPAs.
- # Consumers who do not pay are out of the market.⁶

There are several interesting details in this approach. Starting a market on a small level may be easier and expand as they gain experience. This is a prudent business practice followed by many industries when introducing new products or ideas. Success resulting from a focused effort in a small market will draw the attention of a large segment and can be more easily replicated. Buyers and sellers participate in the proposed market because they want to be in and apparently can leave if they chose another alternative. The proposed market is open to all suppliers of power—UES, Rosenergoatom and energo generators—and by inference to new generators coming into the market. It is open to all customers who currently purchase power from the UES grid, including energos, and is planned to be offered to large industrial customers currently served by energos. This later feature is currently a characteristic of every wholesale market already formed or being formed in western markets.

4. WHOLESALE MARKET CONCERNS

³The proposed name for the market operator is Rosenergomarket or REM.

⁴UES has subsequently determined that REM will be responsible for securing wire services through both transmission and distribution networks to deliver power to customers.

⁵MPP is the sum of the system marginal cost, calculational methodology to be determined, and the Availability Paymen (AP), which is a capacity payment. The AP amount is also to be determined.

⁶UES has indicated that customers who do not continue to provide the required advance payment will resume their normal source of supply.

USAID support continues for the development of a wholesale market. Work continues with the UES internal group, and additionally, Mr. Brevnov assigns tasks to review specific position papers developed by other consultants. Clearly, much of the work already accomplished will be useful in the work now being done for UES executive management by other consultants; however, it is not so clear if continuing the USAID-supported wholesale market work has any endorsement outside the working group within UES. Current work by Hagler Bailly with the Brevnov market takes the form of reacting to the positions developed for UES by other consultants. It is important not to let two sides develop that will approach the issues in a contentious manner. The nature of reviews of the UES Brevnov position papers by Hagler Bailly indicates that this is a developing issue requiring attention. While it is understandable that this difference can arise, professional engagement must be fostered. UES and Hagler Bailly have invested much time and under the circumstances their reaction is natural. Thus, a major concern is the vagueness of UES's position. UES must make clear the wholesale market concept UES wishes to pursue. Agencies providing assistance can then decide how best to provide support, or if not in their individual interest, decide not to provide support.

Another problem that may impede the wide installation of wholesale markets concerns taxing authorities. Taxing authority is within a region or municipality. Electric generation and sales now occurs primarily within a single region and, therefore, tax on generated power and income from the power business remains within one political sphere. If a generator outside the region is allowed to sell power to an industry in this region, the taxing authority for the generated power moves to the generator's home and part of the income generated from the business activity also moves to a different region. While total tax for the power industry may be neutral, the tax flows to different taxing authorities. The political resistance generated by loss of tax revenues will be a major impediment to be overcome as wholesale markets are developed. The Federal Energy Market being developed by UES will consider tax offset payments as a temporary means to mitigate this problem. These offset payments will be based on contract sales price, and, therefore, the tax will be lower than on FEC approved tariffs.

5. RECOMMENDATIONS

Formation of a wholesale market within the Russian power sector has taken on an urgency that never existed until recently. The urgency has resulted from new appointments in both the GORF executive branch and UES executive management. UES is only pursuing one wholesale market concept, the Federal Electricity Market. The IFC and other consultants are advising Mr. Brevnov daily on the formation of this market. Hagler Bailly work is being used for various market issues, i.e., transmission losses, transmission charges, and marginal cost of generation. USAID through Hagler Bailly should continue to support the formation of the Federal Electricity Market. Work must be closely coordinated with UES and the implementation group formed under the IFC. The priorities for work will be determined by this group. As other donor and World Bank loan funds become available, USAID should develop an exit strategy from the wholesale market work. If the market develops as contemplated, basic issues should be resolved by the end of 1997. Beyond this time implementation to accommodate new entrants into the market will become the primary focus. Transmission trading issues and wire services, will also become more important as the market grows. If the market meets with little success, that will also become clear by the end of 1997.

The single most important issue facing the power sector, non-payments, will not be resolved by developing this market. Until this issue is resolved, financial health of the sector will not be restored and real market signals based on price, quality of service and availability will remain for future actions.

Attachment 3

Pre-feasibility Study, Sakhalin Island Power Generation Project

Background

This project is aimed at promoting the awareness of the need for investment in a power generation facility on Sakhalin Island, Russia, by conducting a pre-feasibility study. The US Trade and Development Agency (TDA) may fund feasibility studies for projects largely sourced in the United States; however, to provide a high level of assurance that a power project in Russia is viable, a pre-feasibility study is required when submitting the TDA application. The pre-feasibility study described in this paper does not comply with TDA application requirements. TDA applications must follow its model format. This study may be used to demonstrate project potential along with the proposal submitted to TDA.

Objective

The objective of this project is to promote the mitigation of significant power shortages currently existing on Sakhalin Island, Russia.

Statement of Work

The contractor will conduct a pre-feasibility study substantially in accordance with the outline in the task section below. It is expected that a specific project be identified in order to conduct this pre-feasibility study; however, it is not required that all technical and financial detail be finalized to the degree of a formal feasibility report. A reasonable degree of assurance must be established that there is a need for the project, there is substantial government and regulatory support for the project, a reasonable probability that the project will be environmentally acceptable, and that normal project infrastructure requirements exist or will be available.

Task Development of Pre-Feasibility Study

1. Executive Summary
 - (1) Provide a summary of the project, the significant findings of the pre-feasibility study, and conclusions/recommendations.
2. Project Description
 - a. Need for project, including project background
 - (1) The following issues should be addressed: current capacity available in the region/area, peak demand and ability to meet demand,

forecasted load growth, and forecasted plant retirements. If this project has been previously considered by the host government or others, what information is available to support this study?

3. Preliminary Technical Description of Project
 - a. Plant configuration
 - (1) Provide a preliminary outline of the plant buildings and structures.
 - b. Plant technology
 - (1) Provide description of technology being considered.
4. Preliminary Technical Feasibility
 - a. Site selection, characteristics, and access
 - (1) If a site already is identified, discuss site suitability for plant, including access for major equipment, or discuss site selection criteria to be used in feasibility study.
 - b. Fuel availability
 - (1) What is the primary fuel proposed for the project? Discuss long-term availability of fuel.
 - c. Transmission access
 - (1) Discuss access to transmission and availability and stability of transmission system being used.
 - d. Cooling water requirements and availability
 - (1) Discuss access to cooling water. Discuss permits required for use of water.
 - e. Environmental limits and ability to meet limits
 - (1) Discuss the environmental rules applicable to the project at federal, regional, and local levels. What information is available for environmental impact assessments? Present plan for required environmental studies to be conducted during feasibility study, including any public hearings. Based on preliminary plans for plant and information available, discuss opportunity for environmental compliance.
5. Government (Host Country Involvement)
 - a. Government's commitment to project
 - (1) Is the federal or regional government involved in the project, i.e., equity participant, guarantor of contracts or loans, tax relief or import duty relief, etc.? Discuss the importance of this involvement/commitment to project success.
 - b. Government's goals, budget (if any), and infrastructure activities relative to the project.
 - (1) If host country government is involved, submit any letters of commitment, project agreements or guarantees, etc., that have been provided.
 - c. Federal and regional regulatory oversight and involvement in project
 - (1) Who are the regulators of the project during permitting, construction and operation. Are concessions necessary to allow the project to be constructed? What is the regulatory position on the project?

6. Preliminary Project Economic and Finance Analysis
 - a. Preliminary project cost estimate and schedule
 - b. Tariff structure
 - (1) How does the tariff structure accommodate new projects entering the system? Are hearings required?
 - (2) Discuss the sensitivity of the project success to changes in fuel prices, tax changes, electricity demand, and *force majeure* events.
7. Proposed Project Agreements and Contracts
 - (1) In each area below, discuss the proposed form of agreement/contract and the parties to each agreement/contract.
 - a. Sponsor's agreements
 - b. Power purchase agreement
 - c. Fuel supply agreement
 - d. EPC contract or other arrangements
 - e. O&M provisions
 - f. Procurement plan and sources

Level of Effort and Cost Estimate

The level of effort for this task is estimated to be 60 person days. During this period, travel to Sakhalin will be required for two persons for 15 days. Cost for travel assumes travel from the United States to Moscow to Sakhalin to the United States.

Category	Days	Rate	Multiplier	Total
Labor	60	\$420.00	2.1	\$52,920.00
Travel		2 Round trips at \$4000 ea	<u>n/a</u>	\$8,000.00
Per diem	30	\$113/\$78 (Russia Other)	<u>n/a</u>	\$5,730.00
Local Transportation			<u>n/a</u>	\$500.00
Other, mail, reproduction, etc,			<u>n/a</u>	\$350.00
TOTAL				\$67,500.00

Deliverables

The contractor will deliver a draft copy of the pre-feasibility study to USAID/Russia for comment. After resolution of comments, the contractor will issue a final report, bound and with six copies.

Attachment 4

Comments: MFE Plan for Primorsky Region

Re: MFE Order No. 145 of May 20, 1997

First Deputy Prime Minister, Boris Nemtsov, has signed the above referenced order which establishes a high level “Working Commission” to ensure a stable power supply to customers and to develop options for structural reform within the fuel and energy sector in the region. An “on-site task force” chaired by Deputy Minister Kudryavy will have oversight as well as having the combined regulatory functions of the FEC, REC and the Regional Administration until a “territorial commission of the FEC” is established in the region. Hagler Bailly has been asked to comment on the plan and provide assistance in implementing these measures.

It is widely reported that electric supplies in the region are subject to prolonged daily brown-outs of 10 to 12 hours. It is also stated that the primary reason is the shortage of fuel to operate the power stations caused by non-payment to the fuel suppliers (it appears that the only sector not using cut-off as a means of enforcing payment is the power sector). This situation is exacerbated by the non-payment situation to the power sector.

The Working Commission has established plans (or has already began implementation of plans) to revoke the licences of the buyers-resellers of heat and power in the region and to transfer all assets and responsibility to Dalenergo. It is not clear what will be accomplished with this restructuring. Implied is that Dalenergo will have direct access to customers and the resulting cash flow. Concluding that customers may be more willing to pay Dalenergo remains a major question. A part of the responsibility of the Working Commission is to supplement agreements for power supply to customers to allow Dalenergo to unilaterally cancel their power supply agreement if payments are not paid when due more than twice. If uniformly implemented, this can only lead to improvements in the current crisis.

What support can or should Hagler Bailly provide? Below are the tasks identified in the MFE order and attachment.

Tasks Identified in the MFE Plan

1. Reorganization of assets of resellers into Dalenergo.
2. Organize electric and heat sales to former reseller customers.
3. Categorize debts existing between resellers and their customers and develop plan for collection of debts.
4. Develop long term organization for Dalenergo for operating the acquired resellers.
5. Develop cut-off provisions for power supply agreements.
6. Develop “economical” electric rates for customers.
7. Establish territorial agency of FEC in the region.

8. Combine the assets of AO LUTEK (an open pit coal mine) and Primorskaya TPP into a unified energy enterprise.

It would be easy for Hagler Bailly to become absorbed in all of these tasks. Task 1, 2, 4, and 6 all have elements of the commercialization task. But if HB is to participate in this work, a focused diagnostic of the “on the ground” situation needs to be made. It also needs to be clear that the MFE order is being implemented for the diagnostic to have any meaning. The commercialization task is primarily related to the financial management aspects of an organization and management training for the restructured power sector which are both critical for the success of this undertaking.

The MFE order does not discuss any Wholesale Market activities, therefore, it is not clear if this is to be a part of the effort in the Primorsky Region. Even if a regional wholesale market is to be established, it would be beneficial to work through the current emergency, stabilize the operation of the system and only then consider further reforms like a wholesale market.

Recommendation

For MFE, RAO and others to even begin measuring the impact or success of the changes that are being introduced in the Primorsky Region, a system of management financial and accounting reports should be in place. Balance sheets, income statements and cash flow statements should all be available for managements use. Budgets and goals should be established and the reporting system should measure progress against established targets. A team of 2 or 3 persons with corporate management and accounting/financial backgrounds should be dispatched as agreed with the Working Commission to perform a diagnostic. The diagnostic should focus on what information is already available to produce the required reports, what information is needed and what needs to be put in place to acquire needed data, how Dalenergo should organize the management of the task, and how Dalenergo plans and budgets for their operations. The diagnostic information should be used to write a work plan including the level of effort to put all elements in place, train as necessary to produce reports, assist management and the Working Commission to establish goals and targets and support Dalenergo in submitting the first reports. While much other commercialization work could be considered, the emergency condition existing in the region should receive management priority and the limited work suggested here will support management in this effort.