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**PRIVATIZATION PLAN FOR THE  
GEORGIA POWER SECTOR**

**Georgia Power Sector Reform  
Contract No. LAG-I-00-98-00005-00  
Task Order No. 4**

*Final Report*

*Prepared for:*

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## PRIVATIZATION PLAN FOR THE GEORGIA POWER SECTOR

This is the Privatization Plan called for by Subtask D of Contract No. LAG-I-00-98-00005-00, Task Order No. 4. Subtask D directs Hagler Bailly to develop a plan "for increasing private sector participation and private investment in the sector, with special attention to attracting foreign investment and management to increase the efficiency of enterprises." The plan draws upon the following:

- The work plan for Subtask D of Task Order 4, submitted to USAID for review and comment in draft form in November, 1998;
- The Assessment of the Status of Privatization of the Georgia Power Sector, submitted to USAID as a Final Report on 3 March 1999; and
- Hagler Bailly's work and experience under Task Order 4, which began in September 1998 and has continued to date.

Of necessity, Hagler Bailly's work under this Subtask relates to and must be integrated with our work under each of the other Task Order 4 Subtasks, particularly Subtasks A (Restructuring), B (Legal/Regulatory Reform), and C (Commercialization). This Privatization Plan therefore refers to activities under the other Subtasks, as appropriate.

This Plan identifies and discusses each of the major items of work that Hagler Bailly has been implementing and/or will implement under Subtask D for the duration of Task Order 4. In general, the plan lists the items of work in order of importance to the privatization effort.

### **Background**

In December 1998 the Government of Georgia (GoG) and AES Silk Road Holdings, an affiliate of the American AES Corporation, executed an agreement under which AES purchased a controlling interest in Telasi, the electric distribution enterprise serving Tbilisi. GoG and AES closed the transaction in early January 1999, thus commencing privatization of the electric sector in Georgia.

GoG has agreed to a condition with the World Bank's International Development Association under which it will offer additional electric assets for sale, to qualify for an Energy Sector Adjustment Credit. Under the relevant condition, GoG will

offer for sale all remaining electricity distribution companies (consolidated in two packages), and offer for sale all generation plants of greater than 15 MW installed capacity for sale (more than 50 % of equity in each company) or for long-term concession (more than 25 years). This strategy is to be reflected in a Presidential Decree and the individual offers for sale/concession are to be reflected in requests for proposals issued to potential investors \* \* \*.

On 14 February 1999, in partial fulfillment of the condition, President Shevardnadze issued Decree No. 58, "Regarding Action Program for Rehabilitation and Development of Electricity Distribution Companies and Generation Assets," which among other things orders the Ministry of State Property Management (MoSPM) and the Ministry of Fuel and Energy (MFE) to work with Merrill Lynch Investment Bank, GoG's financial advisor for privatization, in preparing generation and distribution assets for privatization.

Task Order 4 acknowledges the role of World Bank (and other donor organizations) in directing Hagler Bailly "to advise and assist the GoG on implementation of the Privatization Plan" "[i]n cooperation with the multilateral banks and other donors". Hagler Bailly has designed this Implementation Plan to complement the privatization effort now underway by GoG, with the advice and assistance of Merrill Lynch.

### **1. Support for the GoG/Merrill Lynch privatization initiative.**

Merrill Lynch proposes to gather information on generation and distribution assets to be offered for sale or long-term concession, in order to provide the necessary data with which to prepare an Information Memorandum or Information Memoranda. Hagler Bailly will support the data-gathering effort as and when requested by Merrill Lynch. We will also provide such written materials as Merrill Lynch or its associate, Kantor Consulting, requests.<sup>1</sup>

**Timing:** Hagler Bailly submitted text on electric sector regulation and the new wholesale electric market for use in the Information Memorandum(a) to Kantor Consulting in mid-April 1999. We will continue to provide information, as and when requested by Kantor or Merrill Lynch, for the remainder of the Task Order.

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<sup>1</sup> Hagler Bailly's draft Privatization Plan, submitted in mid-March, proposed to support the privatization effort by providing a hydropower expert to gather and analyze data on the hydro plants proposed for privatization. Hagler Bailly duly sought to mobilize a hydropower expert. At a donor-sponsored meeting on electric sector privatization at the Ministry of State Property Management on 22 April, however, Merrill Lynch and Kantor indicated that they no longer required such support.

## 2. Proposed rates and margins for assets to be privatized.

In the process of privatizing Telasi, the allowable margin for the new distribution owner emerged as a problem. To begin with, in its bid for Telasi, Electricite de France apparently proposed a margin of 10 tetri/kWh, while in its bid AES proposed a much smaller initial margin of 2.1 tetri, rising over a period of years. EdF, however, proposed a much larger investment than did AES. Subsequently, after GoG selected AES as the winning bidder, the margin remained a stubborn issue. AES proposed a rate cap approach, under which its margin would escalate in increments every six months for five years, with a final margin of approximately 3.75 tetri/kWh. For some time, however, AES refused to provide the Georgian National Electricity Regulatory Commission (GNERC) with any cost data to support its rate proposal, which proved problematic because AES's rate cap proposal diverged from the cost-based approach to rates that GNERC had taken to that point. One solution to these problems is for GNERC, or MoSPM, or both, to set a margin--a target rate--against which all bidders may bid. This would eliminate a major variable (and ground for disagreement) from the bidding process, leaving cash price, debt retirement, and proposed level of investment as the principal variables for bidding. Hagler Bailly proposes to work with GNERC and Merrill Lynch in seeking to establish such rates ahead of time.

In the meantime, Hagler Bailly continues to work with GNERC on its long-term cost-based rate proceedings, which are due to be completed during 1999 and which will, when implemented, allow electric sector enterprises fully to recover their costs of operation.<sup>2</sup>

**Timing:** Hagler Bailly calculated proposed rates for hydropower projects, including a rehabilitation component, and for Gardabani, in December 1998 and January 1999. Hagler Bailly has also done considerable work on proposed margin for distribution assets. As to both generation and distribution assets, Hagler Bailly has worked with GNERC to secure its understanding of the methodology for calculating the generation rates and distribution margins. Hagler Bailly has offered this product to Merrill Lynch for use in privatization, and will work with Merrill should it decide to utilize the calculations. Hagler Bailly has worked with GNERC on long-term cost-based rates under the current Task Order since November 1998, and will continue with that work for the remainder of the contract.

## 3. Support for privatization of the distribution subsector.

As noted, Decree No. 58 directs MoSPM and MFE to work with Merrill Lynch to offer all of Georgia's distribution enterprises remaining after the sale of Telasi for sale or long-term

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<sup>2</sup> Hagler Bailly's work with GNERC on long-term tariffs also meets the requirement of Subtask B.4(viii), that we assist with "development of improved electricity tariff methodologies (drawing on previous tariff analysis studies), including developing a tariff model [and] training the staff in the use of the model".

concession to private investors. The Decree directs that the distribution assets be consolidated into two groups, East and West.

Some data have been gathered on distribution companies since 1996, including studies and reports offered by Hagler Bailly and Price Waterhouse (Hagler Bailly's subcontractor under Delivery Order 14). Substantial additional work must be undertaken, however, to support an offering memorandum. It currently appears that the most important financial data that can be gathered would include detailed information on the distribution enterprises' accumulation of long-term debt, including an analysis of receivables and payables. Recommendations as to the appropriate allocation and distribution of accumulated debt would also be appropriate. Finally, estimates of the value of these enterprises may be useful to GoG/Merrill as and when they prepare information memoranda or other offering documents.<sup>3</sup>

**Timing:** Hagler Bailly began the task of identifying distribution sector debt, and analyzing payables and receivables of distribution enterprises, in February, 1999. We anticipate continuing this effort (consistent with contract resources and the Task Order's termination date) for as long as GoG and Merrill Lynch have need of assistance in this area.

#### **4. Assistance to prospective purchasers of generation or distribution assets.**

After Merrill Lynch released the Information Memorandum on the Telasi distribution system in May 1998, numerous potential investors visited Georgia to perform due diligence respecting the offering. Many of these companies paid calls on Hagler Bailly to request information, and Hagler Bailly worked with them over the summer of 1998 to supply information and analyses to meet their needs.

Hagler Bailly proposes to offer similar assistance to potential investors in generation plants and distribution enterprises in connection with the current round of offerings. We will assist in data acquisition and analysis, to supplement the data in the information or offering documents. We believe that we can also offer useful background and evaluation of (1) GNERC and the scheme of electric regulation implemented by Georgia under the Electricity Law of 1997, and (2) the design and proposed functioning of the Wholesale Electric Market, including such important features as pricing for power and the collections and payments procedures.

**Timing:** Hagler Bailly will offer assistance to potential investors or other interested parties as and when GoG and Merrill Lynch formally offer the assets for sale.

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<sup>3</sup> We note that although this work appears more properly to relate to privatization of Georgia's electric assets, the Restructuring Subtask (Subtask A.2(iv)) also includes in its scope "Exploring options on how to handle and allocate sector debt, including processes and mechanisms for addressing accumulated debt among customers, power sector entities and fuel suppliers".

**5. Power sector contracts.**

Item 3(iii) of Subtask D calls for “support to private power companies in the development of power purchase contracts,” and item 3(iii) of Subtask C similarly provides for “the development of appropriate contracts for power purchases, sales, wheeling, etc.” We have identified no respect in which AES, or any other current participant in the electric sector, requires such assistance,<sup>4</sup> and it appears that Task Order 4 will expire before privatization of additional assets in Georgia is completed. GNERC has, however, requested technical assistance in the contract area, and Hagler Bailly will meet the request by providing technical assistance to the Commission on power sector contract fundamentals. This will promote GNERC’s understanding of such contracts, and enhance its capability to review such contracts as they are presented to the Commission in future for review and approval.

**Timing:** Hagler Bailly will conduct a workshop, seminar, or other appropriate training in contracts in June.

**Conclusion**

This Final Privatization Plan reflects information on the needs of GoG and Merrill Lynch as of the date that we submit it to USAID. Those needs may change, however, in coming months, and Hagler Bailly proposes to remain flexible in the assistance that it offers, in consultation and cooperation with all relevant parties.

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<sup>4</sup> We are advised that AES negotiated and executed several power purchase agreements in connection with its acquisition of Telasi. AES neither requested our assistance nor, so far as we can tell, required such assistance.