

PN-ACJ-85'
106431



Academy for Educational Development

ARMENIA ENERGY TRAINING PROGRAM

Contract No. LAG-I-00-98-00011-00, Task Order Two

Technical Report

**Specification, Solicitation and Evaluation
of International Invitations to Bid**

August 4, 1999

Submitted to U.S. Agency for International Development

Submitted by the Academy for Educational Development
with Hagler Bailly Services

ARMENIA ENERGY SECTOR TRAINING PROGRAM
Technical Report
Course #11: Specification, Solicitation and Evaluation
of International Invitations to Bid

USAID Strategic Objective 1.5	A more economically sustainable and environmentally sound energy sector
Intermediate Result 2	Increased economic efficiency in the energy sector
Participant profile	Armenia's energy companies, government ministries and regulatory entities with competence over the energy sector

A. Course Purpose

The objectives of the AED seminar were to familiarize participants with relevant privatization experiences and lessons learned from other nations, improve participants understanding of the detailed steps involved in privatization and investment attraction, increase the awareness of the institutional strengths and weaknesses in Armenia that will affect the likelihood of success of the privatization efforts and identify ways to overcome weaknesses, and to enhance overall support for privatization of the Armenian energy sector.

B. Dates/Trainers/Attendees

The course was presented by Mr. Russell Harding on June 30 - July 2, 1999. Mr. Masoud Keyan, Chairman of the Georgian ERC Mr. Elizbar Eristavi, and Ms. Chkonia also taught sections of the seminar. The target course participants were Ministry officials, distribution company officials, officials of the ERC and Privatization officials. A daily list of attendees is attached.

Table 1: List of Participants

#	Name	Employer	June 30	July 1	July 2
1	Anahit Avetisyan	Energy Regulatory Commission	✓	✓	✓
2	Yuri Boudaghyan	Energy Regulatory Commission	✓	✓	✓
3	Hayk Yesayan	Energy Regulatory Commission	✓	✓	✓
4	Vardan Movsesyan	Energy Regulatory Commission		✓	
5	Areg Galstyan	Ministry of Energy		✓	
6	Rouben Margaryan	Ministry of Energy	✓	✓	✓
7	Svetlana Ganjumyan	Institute of Energy	✓	✓	✓
8	Rafaek Hambarzumyan	Institute of Energy	✓	✓	✓
9	Derenik Asatryan	Armenergo	✓	✓	
10	Feliks Hakobjanyan	Armenergo	✓		
11	Alexey Tumanov	Armenergo	✓	✓	✓
12	G. Abajyan	World Bank		✓	
13	Karen Harutyunyan	Yerevan Distribution Company		✓	
14	Ararat Hovhannisyan	Yerevan Thermo-power plant	✓		
15	Petros Kyalyan	Hrazdan Thermo-power plant	✓	✓	✓
16	Arevik Karapetyan	Ministry of Finances	✓	✓	✓
17	Rousanna Gabrielyan	Ministry of Finances	✓		✓
18	Tokmajyan Gagik	Ministry of Finances	✓	✓	✓
19	Naira Manukyan	Ministry of Privatization	✓	✓	✓
20	Oleg Markosian	Ministry of Privatization	✓	✓	✓
21	Ashot Armenakyan	Central Bank			✓
22	Lusine Avagyan	Ministry of Economy		✓	✓
23	Anna Pambakhsyan	Ministry of Economy		✓	✓
		TOTAL	16	19	16

C. Material Covered

This AED seminar was divided into three segments. The first dealt primarily with the question of how the energy sector of NIS countries can attract investment capital and issues of privatization focusing on various types of public-private partnerships. A decision tree "brainstorming" session was conducted which dealt with electricity as a commodity and identifying the steps, plans, and objectives necessary to accomplish electricity privatization. Participants also held a discussion

entitled "Risk and the Investor." In addition, class participants engaged in an exercise to identify the specific objectives of privatization in Armenia and how various objectives may compete with each other in structuring a transaction.

The second segment was spent discussing recent privatization efforts in Georgia. The Honorable Elizbar Eristavi, Chairman of the Georgian National Energy Regulatory Commission, and Bidzina Chkonia of Hagler Bailly Georgia, conducted a discussion of the recent events in Georgia, focusing primarily on the privatization of the Tbilisi distribution company and its purchaser, AES. The discussion and follow-up questions dealt with the various lessons learned and provided the class participants with a good insight into these privatization efforts and how they might apply to efforts in Armenia.

The last segment was devoted to review of specific aspects of the privatization efforts in Georgia, such as the privatization of distribution to AES. This discussion included a review of privatization efforts in Georgia and comparisons and contrasts between efforts in Georgia and those being undertaken in Armenia. In addition, there was a review of privatization efforts in other parts of the world to briefly to identify common themes.

D. Participant Evaluations

- All of the participants found the material useful and expect to be able to apply it to their work.
- The trainers were given good ratings in method, content, technical and training ability by all the participants.
- 87.5% of the participants planned to remain in touch with the trainers and would recommend the course to their colleagues.

E. Anticipated Outcomes

The seminar participants gained knowledge of what conditions should exist to attract private investment to the Armenia energy sector, the various public-private partnerships that could be considered, and how the legal, regulatory and transparency frameworks affect the level of risk a private investor would take into account in assessing a purchase. In addition, they were provided a perspective of the process of privatization in Georgia and the basic terms of the transaction for the sale of distribution to AES along with an analysis of lessons learned.

F. Conclusions and Recommended Follow-up

The next steps should include providing additional detailed information of other recent transactions for privatization of electric sector assets, particularly those that have occurred in countries similar to the conditions that exist in Armenia. Detailed discussions should be conducted on the political

issues, legal issues, how the contracts were structured, how the economics of the transaction were relevant to both buyer and seller, and what lessons/conclusions can be drawn from them. Participants would also benefit from a more detailed discussion of how investors consider projects and how the structure of privatization contracts can result in furthering the goals of both the buyer and seller.

APPENDIX A

Seminar Outline

Specification, Solicitation and Evaluation of International Invitations to Bid

Day One through Day Four

- Introduction and discussion of course objectives (Day one only)
- Introduction of that day's presenter

Note: The following outline will be used by each country presenter during day's one through four. Each country presenter will spend one day presenting the topics below.

Country Background

- General country statistics
- Infrastructure characteristics, especially for sectors privatized (or to be privatized)

Privatization Highlights

- Government's privatization priorities and why these priorities were established
- Goals and objectives of privatization in each country
- Summary of overall privatization progress (e.g., number, types of enterprises privatized, % of GDP now in private hands)

What Factors and Issues Exist which Encourage/Discourage Privatization

- Social considerations, if any
- Political concerns and objectives
- Economic concerns and objectives

Privatization Experience

- Technical structure(s) of the privatization process (e.g., auction, negotiated arrangement, vouchers)
- Privatization process used (or intended)
 - Government bodies responsible for the privatization process
 - Use of investment banker or other consultant
 - Regulatory oversight structure and role of regulatory agencies
 - Legislation supporting the privatization process
 - Transactions - structure of the asset sale
 - terms of bids (cash, debt, investment schedule, tariff requirements, exchange rate issues, etc.)
 - structure of ownership
 - structure of financing (guarantees, investment incentives, government participation)
 - timing
 - requirements of bidders

- requirements of buyers
- requirements of government
- contract administration
- constitutional limitations
- environmental issues
- real estate
- assumed and excluded liabilities
- employee issues
- revenue collection
- taxes

Lessons Learned

- What has worked well and what has not?
- What have been the results of the privatization process?
- Investment attraction
- Employee issues
- Public reaction
- What challenges lie ahead?
- What are the lessons learned from the privatization experience of each country?
- What should have been differently?

Day Five

Day five will involve a facilitated discussion led by Mr. Harding and Hagler Bailly personnel.

- Lessons learned for Armenia based on the prior four days of presentations (note: this may be supplemented by other country examples if needed to illustrate specific points)
- What factors will be most critical in ensuring a successful privatization?
- What are the likely areas of greatest difficulty for privatization in the power sector and how can these problems be ameliorated or protected against?
- What changes in the process used for privatization should be considered in light of the experiences seen in other nations?
- How important is the role of a proper legal and regulatory framework in ensuring a successful privatization process? What are the characteristics of a legal and regulatory framework that will support the privatization process? How does Armenia's legal and regulatory framework align with the idealized framework?
- What are the next steps for privatization in the Armenian power sector?
- Course wrap up and evaluation

APPENDIX B

Seminar Materials

Specification, Solicitation and Evaluation of International Invitations to Bid

The Important Issues

- Regulatory

Participants need to know what the rules of the game are and that they will not change frequently or arbitrarily

The Important Issues

- Legal

There must be a legal framework that allows for settlement of disputes in a fair and equitable manner

The Important Issues

- Transparency

Participants need to be assured that the possibility of gaming the system is minimized

Risk and the Investor

- Political Risk
 - expropriation
 - insurrection
 - political violence
- Changes in Law
 - tax laws
 - environmental laws

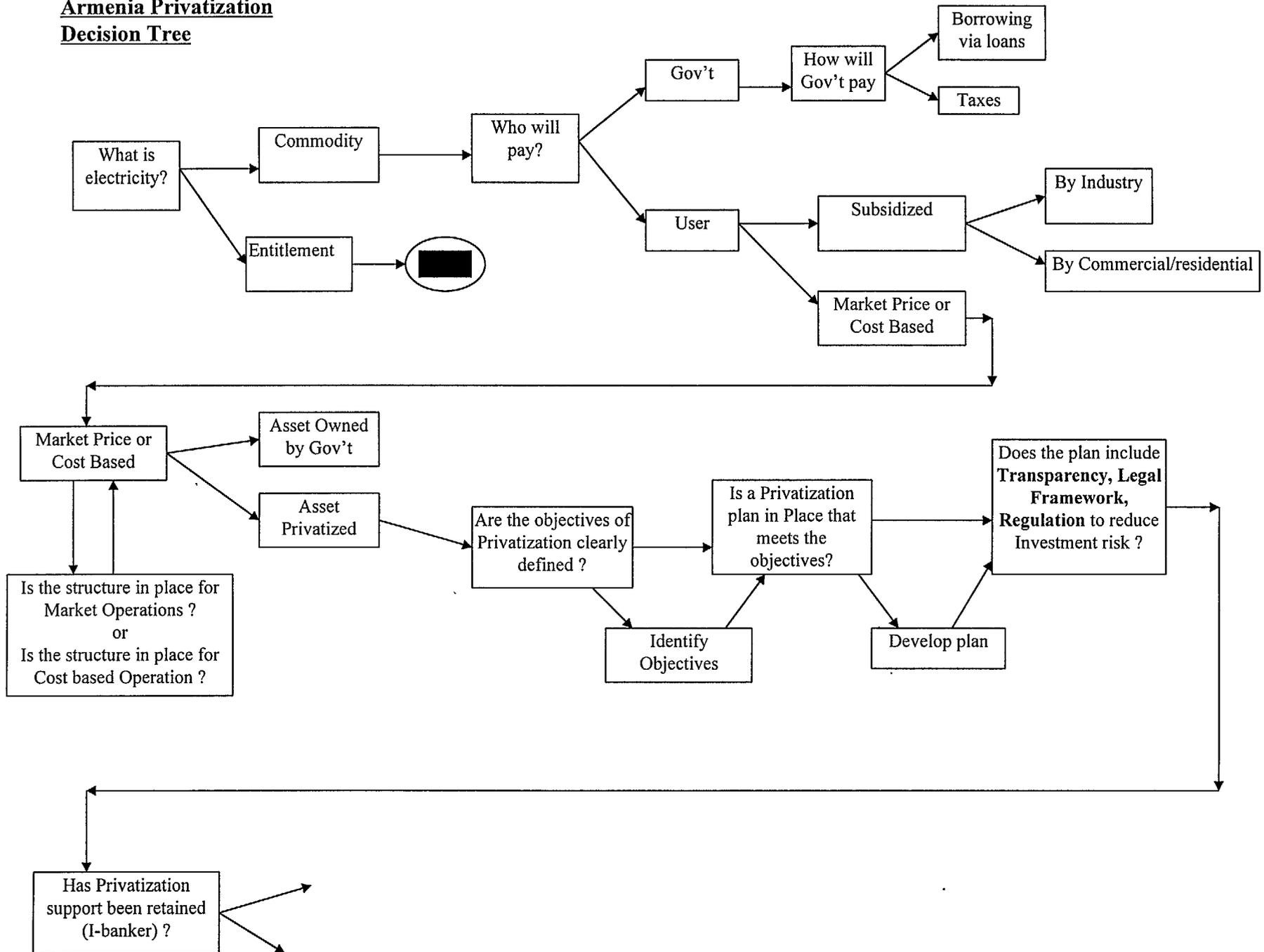
Risk and the Investor

- Foreign Exchange
 - exchange rates
 - convertibility
 - repatriation
- Inflation
- Fuel Supply and Price
- Third party contract performance

Risk and the Investor

- Management and workforce skills
- Employee relations
- Procurement
- Accounting
- Corrupt practices

**Armenia Privatization
Decision Tree**



15

Privatization

- Issues for Host Government

- The host government will want to identify whether the social benefit of a project exceeds its social cost as expressed on a present value basis.

Privatization - Issues for Host Government

■ Social Benefits might include:

- ① Construction of Infrastructure (eg. Roads, dock facilities, airport, electric system infrastructure)
- ② Education and training of local workforce
- ③ Construction of public facilities (schools, housing, fire stations)
- ④ Establishment or expansion of industrial base (can lead to further investment of service companies and other spin-off effects)

Privatization

- Issues for Host Government

■ Social Benefits (continued):

- ⑤ Generation of incremental tax revenues which can be used to finance public projects
- ⑥ The multiplier impact
- ⑦ Generation of incremental hard currency
- ⑧ Development of local capital markets

Privatization

- Investment Incentives

- ① Tax Holiday
- ② Grant of land free of charge or nominal rent or price
- ③ Assurances to availability of raw materials or feedstocks or power at competitive world prices

Privatization

- Investment Incentives

- ④ Provision of certain items of infrastructure at no cost to the project (or subsidized costs)
- ⑤ Cash subsidies
- ⑥ Support in arranging financing at concessionary interest rates, possibly including loan guarantees
- ⑦ Assurances as to availability of hard currency to make debt payments or repatriate profits

Privatization

- Investment Incentives

- Structuring government assistance often requires some financial engineering.
- Government entities are typically unwilling to make funds available to a private project at a below market cost if they believe that the implicit subsidy will result in the private sponsors' realizing above market rates of return.

Privatization - Investment Incentives

- The projects sponsors must be prepared to demonstrate to the host government that their expected returns are commensurate with the investment risks they are taking by investing their own equity in the project.

Privatization

- Tax Revenues

- Host government should consider the stream of future tax revenues the project is likely to generate. These can be particularly beneficial if paid in hard currency. Tax holidays must be taken into consideration. Use of present value should be used to determine the worth of these revenues.

Privatization - Project participation

- Host countries often require a carried ownership interest in the project.
- A carried ownership interest is an equity interest in the project that is supplied, free of charge to the host government in return for allowing the project to proceed.
- The magnitude of the carried ownership depends in large part on the expected return net of the carried ownership interest.

Privatization

- Project participation

- A fixed, high amount of carried ownership discourages private investment.
- A variable structure which is based on the risk-return characteristics of the project is likely to work better.

Privatization

- Impact on the availability of hard currency

- Potentially contentious issue.
- Project sponsors will require assurances that sufficient hard currency will be available from the project to service project debt and to enable them to realize an acceptable rate of return on their investments.
- Lenders will want assurances that sufficient hard currency is available to service the sponsors project debt in a timely manner.

Privatization

- Impact on the availability of hard currency

- The host country will want to maximize receipt of hard currency in order to further its development objectives.

Privatization

- Desirability of precedents

- Concern as to whether the project, and the manner which it is financed and structured might establish undesirable precedents that might adversely affect negotiations with other prospective co-sponsors of future projects.

Privatization

- Desirability of precedents

■ Particularly important are:

- tax holidays
- withholding tax provisions
- development incentives
- subsidized land
- guaranteed feedstocks
- allocation of hard currency generated by the project

Privatization

- Public-Private Infrastructure Partnership

- Joint ventures where each party applies their particular strengths to develop a project more quickly and more efficiently than the government could accomplish on its own
- These vary from full private ownership subject to government approval and oversight to public projects in which a private partner serves as a financial contributor to the government sponsored project.

Privatization

- Public-Private Infrastructure Partnership

- It is important to appreciate that these public-private partnerships are not unregulated monopolies.
- They are governed by negotiated agreements that specify public and private responsibilities, impose public regulation of safety, require quality of service, and often restrict user fees (or profitability).

Privatization

- Public-Private Infrastructure Partnership

- These projects also pay substantial new taxes to government treasuries.
- In addition to taxes, government often receive profit-sharing payments through ground leases (for example, by leasing government-owned land to a private project in return for a percentage of revenues) or through a contractual requirement that “excess” project profits be paid to the state.

Privatization

- Public-Private Financing Structures

■ Who will be responsible for:

- design and construction
- providing construction funds
- arranging financing
- hold legal title and for how long
- operate and for how long
- responsible for revenue sources

Privatization

- Public-Private Financing Structures

■ Perpetual Franchise Model

Privatization

- Public-Private Financing Structures

■ Build-Operate-Transfer (BOT) Model

Privatization

- Public-Private Financing Structures

■ Build-Transfer-Operate (BTO) Model

Privatization

- Public-Private Financing Structures

■ Buy-Build-Operate (BBO) Model

Privatization

- Public-Private Financing Structures

■ Lease-Develop-Operate (LDO) Model

Privatization

- Public-Private Financing Structures

■ Wraparound Addition

5/3

Privatization

- Public-Private Financing Structures

■ Temporary Privatization

Privatization

- Public-Private Financing Structures

■ Speculative Development

Privatization

- Public-Private Financing Structures

■ Value Capture

Privatization

- Public-Private Financing Structures

■ Use-Reimbursement Model

Privatization-

Legislative Provisions that can affect Public-Private Partnerships

- **Provisions that Discourage Partnerships**
- Common flaw: misallocation of high costs and significant risks. Without an appropriate sharing of risks and an opportunity for the private partner to earn a fair rate of return on its investment, a partnership is likely to fail
- Requiring formal legislative approval of project agreements after they have been negotiated by a government agency.

Privatization-

Legislative Provisions that can affect Public-Private Partnerships

- Requiring developer to post excessive bonds or obtain excessive amounts of private insurance
- Allowing relatively uninhibited competition from future government sponsored projects
- Uncertainty to future regulation of rates of return on investment.
- Requiring private developers to use government procurement methods.
- Requiring government approval of detailed design specifications before construction

Privatization-

Legislative Provisions that can affect Public-Private Partnerships

- **Provisions that encourage Public-Private Partnerships**
- Allowing a private entity to propose what it believes is a financially viable project
- Providing government assistance in planning, obtaining permits, acquiring land and resolving intergovernmental and interagency disputes.
- Having the government partially or fully fund environmental and land use studies

Privatization-

Legislative Provisions that can affect Public-Private Partnerships

- Providing loans to cover a portion of the projects capital costs
- Providing law enforcement services on a contractual basis
- Deferring local or state property taxes
- Exempting partnership projects from local sales taxes on construction supplies

Privatization-

Legislative Provisions that can affect Public-Private Partnerships

- Providing loans to cover a portion of the projects capital costs
- Providing law enforcement services on a contractual basis
- Deferring local or state property taxes
- Exempting partnership projects from local sales taxes on construction supplies

48

Privatization-

Legislative Provisions that can affect Public-Private Partnerships

- Placing reasonable limitations on tort liability
- Providing free (or subsidized) use (via lease or sale) of government owned land, or acquiring right-of-way through eminent domain.
- Allowing commercial development on the project site

49

Privatization-Goals of Armenia

- Hard currency infusion
- Infrastructure investment
- tax revenues
- stable market and supplies
- education and training of local workforce
- spin off services and industries
- stable regulatory environment

Privatization-Goals of Private Investor

- Private sector entities require a financial rate of return that is commensurate with what they could earn on alternative projects of comparable risk.
- Public-Private partnership structures must be designed so as to provide competitive rates of return.

Privatization-Goals of Private Investor

- Investors need to know what they are faced with:

Regulatory structure

- Investors will want the rules for investment, procurement, tariffs, collections, permits and dispute resolution clearly defined

Political stability

- Investors will want to be assured that the regulatory “playing field” won’t change with each change in government.

Privatization-Goals of Private Investor

- Political and regulatory stability provides:
- The ability to assess risk
- The ability to estimate revenues and costs
- The ability to compare investment opportunities