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Conference Proceedings

Power Sector Privatization in Central/ Eastern Europe and Eurasia: Results and Future Plans

United States Energy Association

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The Power Sector Privatization Conference aimed to:

- ◆ Review and assess the results of power sector privatization to date, and identify successful approaches for future privatization in the region.
- ◆ Expand communication among energy and privatization officials, utility investors involved in the region, investment bankers and international financial institutions (World Bank, EBRD, IFC) and disseminate the results of the conference.

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PART I – WELCOMING/KEYNOTE ADDRESSES AND CASE STUDIES

Laszlo Lovei, The World Bank <i>Energy Privatization in Central and Eastern Europe and the Former Soviet Union: Political, Social and Technical Challenges</i>	1
Miklos Andrasi, Hungarian Privatization and State Holding Company <i>Overview of Privatization in Hungary</i>	11
Allan Walmsley, Csepeli Eromu Rt., PowerGen International <i>Overview of the Csepeli Eromu Rt, PowerGen International</i>	16
Vitaly Lee, AES Silk Road <i>AES Overview</i>	24
Michael Ukleba, Ministry of State Property Management <i>Privatization of Large-Scale Strategic Enterprises</i>	31
Colin Denny, AES Telasi <i>Overview of AES Telasi, Tbilisi, Georgia</i>	35
Victor Bodiu, Department of Privatization, Moldova <i>Republic of Moldova: Privatization of the Electricity Sector</i>	46
Ignacio Ibarra, Union Fenosa <i>Overview of Union Fenosa</i>	55

PART II – UPDATED APPROACHES FOR COUNTRIES WITH DEVELOPED PRIVATIZATION PLANS

David Vardanyan, State Property Fund of Armenia <i>Power Sector Privatization in the Republic of Armenia</i>	67
Leonid Kalnichenko, State Property Fund of Ukraine <i>On the Progress of Power Companies Privatization in 2000 (Presentation Summary)</i>	75
Aleksandr Ryabchenko, Supreme Rada of Ukraine Committee on Privatization	78
Grzegorz Gostkowski, Ministry of Treasury, Poland <i>General Aims of Polish Energy Sector Privatization</i>	82
Nicolae Liciu, Ministry of Industry and Trade <i>Power Sector Privatization in Romania</i>	89
Razvan Purdila, CONEL-SA <i>Privatization in the Romanian Power Sector: A Corporate Point of View</i>	99

PART III – POLICY FRAMEWORK TO SUPPORT PRIVATIZATION IMPLEMENTATION PROCESS

Gabor Szorenyi, Hungarian Energy Office <i>Hungarian Electricity Industry Between Two Reforms (Two Restructurings) with Private Participants</i>	105
Oleksei Kucherenko, Committee on Fuel and Energy, Supreme Rada of Ukraine <i>The Special Features of Ukrainian Power Sector Privatization</i>	119
Fraser Morrison, Deloitte Touche Tomatsu <i>Power Privatization Policy Framework in Ukraine and Moldova</i>	122

PART IV – EARLY STAGES OF IMPLEMENTATION AND NEGOTIATING FINANCIAL CLOSING

Arpad Bajkay, (Retired) Hungarian Privatization and State Holding Company
Advisors and Ownership Structure of the Hungarian Electricity Sector Offered for Sale 134

Vladislav Vucetic, The World Bank
Privatization of Electricity Companies, The Implementation Phase 136

Arpad Bajkay, (Retired) Hungarian Privatization and State Holding Company
Tender Rules and Evaluation Process 143

Arpad Bajkay, (Retired) Hungarian Privatization and State Holding Company
Privatization – the Negotiation Process 145

APPENDIX

Executive Overview of Responses to Survey on Privatization

Power Sector Privatization Agenda

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The World Bank

**Energy Privatization in Central and Eastern Europe
and the Former Soviet Union
Political, Social and Technical Challenges**



**Laszlo Lovei, Lead Energy Specialist
Europe and Central Asia Region**

**Conference on Power Sector Privatization
June 6-8, 2000
Budapest, Hungary**



Outline

- **Worldwide Trends in the Energy Sector**
- **Recent Developments in CEE/FSU**
- **Benefits of Competition and Privatization**
- **What Kind of Competition?**
- **What Kind of Private Ownership?**
- **What Method of Privatization?**
- **Institutional Responsibilities**
- **Role of the Regulator**
- **Lessons Learned**



Worldwide Trends -- Overview

- **Vertically integrated state owned utilities are being broken up and privatized (North America, Latin America, Asia, Western Europe)**
 - *The old rule:* introduce private ownership into generation/production first, preferably through new capacity
 - *The new rule:* start privatization at the distribution level and then move to generation/production
- **More and more consumers can choose their electricity and gas suppliers (North America, Latin America, Australia/New Zealand and Western Europe)**



Worldwide Trends -- Overview (cont.)

- **Long-term contracts for producers with volume and price guaranteed by the government or the national utility are being re-negotiated/ abandoned (Asia)**
- **Power pools and gas flexibility mechanisms are transformed into spot/balancing markets with parallel bilateral contracts for physical delivery (North America and Western Europe)**
- **Forward electricity and gas markets are operated by standardized commodity exchanges (North America and Western Europe)**
- ⇒ **Gas and electricity markets converge towards a common model**



Recent Developments in CEE/FSU

A. In Central and Eastern Europe, requirements associated with EU Accession are pushing countries:

- To speed up the process of unbundling generation, transmission, dispatch, distribution, and supply
- To sell majority stakes to strong private investors in order to make electricity and gas companies ready for cross-border competition
- To allow large consumers to choose their own suppliers/producers
- To establish electricity exchanges
- To create small regional electricity markets to gain experience before the "big bang" (e.g., Baltic states)



Recent Developments in CEE/FSU (cont.)

B. In the FSU, the picture is mixed:

- Georgia, Moldova, Armenia have made good progress towards full electricity privatization
- Privatization has slowed down in Kazakhstan and Ukraine
- Russia, Kyrgyz Rep., Azerbaijan are considering privatization of electricity distribution in order to improve collection performance
- Overall, payment collections and prices have remained inadequate to ensure cost recovery



Benefits of Competition and Privatization

- Efficient use of resources
- Pressure to innovate/modernize
- Availability of capital and know-how
- Good customer service
- Strong payment discipline
- Revenues for budget



Competition and Ownership

- **Competition among entities with different owners results in improved utilization of equipment, materials, fuels and labor, leading to lower prices and/or better service for consumers**
 - **Competition among state owned entities results in half-hearted efforts since potential winners know that they will be asked to bail out the losers in the end**
- ⇒ **Competition without private ownership produces little efficiency gains**



Private Ownership without Competition

- Privately owned monopolies typically operate with higher efficiency than state owned ones
 - Award of non-natural monopolies leads to rent-seeking (costly lobbying efforts and corruption)
 - Markets and prices guaranteed by the government lead to a false sense of security, sub-optimal investment decisions, and costly bail-outs by the budget and/or consumers
- ⇒ Full benefits of private ownership will not materialize without competition



Regulation and Ownership

- Depoliticizing the regulation of electricity and gas prices is a long and difficult process
 - Initially the regulators are junior partners to the sector ministries who represent both the owner and the policy maker
 - The role, professionalism and autonomy of regulators grows as privatization moves ahead
- ⇒ The integrity of the regulatory process is difficult to preserve without private ownership



What Kind of Competition?

- **Levels of competition:**
 - competition only for the market (not in the market)
 - competition among producers who are obliged to sell to a single buyer (no retail competition)
 - partial retail competition (for sale to large consumers and distribution companies)
 - full retail competition (all consumers can choose their suppliers)
- **Moving to a higher level produces efficiency gains but requires more and more sophisticated technical and institutional mechanisms**
- ⇒ **Partial retail competition is the best choice at this stage in CEE/FSU**



What Kind of Private Ownership?

- **Privatization can help to ensure that the energy sector is**
 - not used as a substitute for a missing social safety net
 - not used as a tool to support loss making industrial and agricultural activities
 - not used as a funding source for the ruling political party
 - operated subject to strict financial discipline (no subsidies to energy companies, no directed credit, no tax forgiveness)
- **But not all ownership structures produce positive results**



What Kind of Private Ownership? (cont.)

- When corruption among government officials is widespread, ownership by managers/workers/ domestic investors maintains informal ties to government that are likely to be abused
- When legal protection of minority shareholders and input suppliers is weak, disperse ownership structures encourage wasteful activities and result in poor performance
- Ownership should be concentrated in the hands of foreign investors whose identities facilitate promise fulfillment (i.e., who have a reputation to protect)



What Method of Privatization?

- Sale to investors selected by management or government officials in a non-transparent manner leads to reduced legitimacy of ownership
- Sale through public offerings of shares leads to dispersed ownership structure
- Sale of large blocks of shares to investment funds fails to create the long term commitment and identity needed to improve corporate governance
- ⇒ Competitive sale of majority stakes to well-known, experienced foreign investors is the best method of privatization



Institutional Responsibilities

- **Parliament to approve general privatization framework (objectives, methods, constraints, responsibilities)**
- **Cabinet to set firm deadlines and hold government officials accountable to meet these deadlines**
- **Privatization Agency to hire experienced adviser, develop detailed schedule, and manage process**
- **Inter-ministerial committee to ensure coordination with Sector Ministry, Ministry of Finance, Regulator, etc.**

13



Role of the Regulator - Pre-privatization

- **Advise the government on industrial structure and market model**
- **Assist with preparation of tender documents:**
 - **Set constraints on horizontal cross-ownership (issue of market domination)**
 - **Set constraints on vertical cross-ownership (issue of equal network access)**
 - **Describe market/network access rules**
 - **Set minimum service quality requirements**
 - **Stipulate stable, predictable methodology of price regulation that will attract private investors**

14



Role of the Regulator - During Privatization

- Be available for consultation on market rules, pricing methodology and service quality requirements with potential bidders
- Do NOT take key role in selecting the winner
- Provide advice to the government negotiations team when establishing key parameters in the contract:
 - electricity pricing methodology
 - service/supply quality requirements
 - disconnection procedures
 - temporary exclusivity provisions
 - arbitration rules



Lessons Learned

- Regulatory autonomy, basic market model, and right to disconnect non-payers should be established in the law
- Assets and liabilities should be allocated very clearly during unbundling to prevent disputes later
- Service/supply standards are more important than investment requirements
- High minimum asset prices and investment requirements will result in high electricity prices
- Gas and district heat market model and regulation matters for private investors in electricity
- Factors subject to regulation should NOT be used to rank bids (but can be used to disqualify bids)



Lessons Learned (cont.)

- Pricing methodology may need to be changed during negotiations with the winning bidder - be flexible
 - Investors need time to improve service standards/collections - be realistic
 - Privatization agencies need education in the regulation of natural monopolies and the *importance of competition*
 - Privatization in the FSU may fail unless governments start taking their social protection responsibilities seriously
- ⇒ If you don't succeed the first time, draw lessons, make adjustments, and try again



Privatization process

Overview of Privatization in Hungary

Miklos Andrasi



Privatization process

- *First phase:* Spontaneous privatization prior to political changes
- *Second phase:* Finding the way and means in the early nineties (1991-1994)
- *Third phase:* 1995: privatization's peak year
- *Fourth phase:* Consolidation and the ongoing privatization process (1996-)



Situation in which government decided to privatize the energy industry:

High debt service of Hungary

- Process implementing market economy
- Old power plants, distribution network
 - Investment needed
- Need for new capacity

Objectives of the Government

- Implement market conditions in the energy industry
- Reduce responsibilities of Government
- Invite foreign capital to Hungary
- Income for the central budget
- Increase efficiency, environmental protection of the energy industry
- Follow international trend (privatization and more competition in the energy sector)

2



The main objectives for privatizing electric power assets based on government decrees of 1994-1995

• Guidelines for privatization of energy supply companies

- First stage: sale to strategic partners avg. 47%
- Second stage: option to get majority role for strategic partner followed by an IPO

• Guidelines for privatization of power plant companies

- First stage: sale to strategic partners (avg. 34-49%) imposing capital increase on them
- Second stage: option to get majority role for strategic partner

• Guidelines for privatization of MVM Rt.

- First stage: 24% sale to strategic partner with an option to get a further 25%+1 vote
- Second stage: another 15%-1 vote to be sold to strategic partners, the rest to be sold to retail investors and for compensation coupons

• Introduction of preference share to protect state interests

• Guidelines for open tender procedure

• Other Matters

3

AC

The results of privatization in 1995

Company	% Ownership sold	Revenue Billion Ft	Price % as of Investor Share Capital
Electricity Distribution Co.s:			
ELMU	46.15	49.4	178
DEMASZ	47.25	14.9	107
DEMASZ	47.98	21.6	122
EDASZ	47.55	27.5	154
EMASZ	48.81	18.4	109
TTVASZ	49.23	18.4	109
Power plant Co.s:			
Művelő Erőmű	38.09	13.8	79
Művelő Erőmű	48.76	19.5	120
Green:			
ELMU	46.15	49.4	178
RWE-EVS	49.4	178	178
Bayernwerk	14.9	107	107
EDFI	21.6	122	122
EDFI	27.5	154	154
RWE-EVS	18.4	109	109
RWE-EVS	18.4	109	109
Wärme- und Kälte	18.4	109	109
RWE-EVS	13.8	79	79
Power-In-Traebel	19.5	120	120

AC

The structure of electric power industry after restructuring in 1991-1992

MVM Rt.	state ownership to be held	50%-1
Nuclear Power Plant, PAKS	state ownerships to be held-preference share	
National Grid (OVI)	state ownerships to be held-preference share	
Power plant Co.s:	state ownership to be held-preference share	
Dunamenti		
Verecsi		
Budapesti		
Electricity Distribution Co.s:	state ownership to be held-preference share	
EDASZ		
DEPASZ		
EMASZ		
ELVIK		
Preference share-held by Ministry of Economics		



Privatization process of electric power sector between 1996-1999

- 1996
 - Sale of shares to employees
 - Sale of shares to municipalities
 - Sale of shares of electric distribution co's for compensation coupons (8% of registered capital each)
- 1997
 - Grants in 10% share ownership of registered capital of electricity distribution co's and minority share of three power plant co's to social security self government
 - Sale of shares in ELMU and EMASZ for compensation Coupons.
 - Sale of shares in Peci and Bakonyi power plants to strategic partners
- 1999
 - Secondary offering of remaining stake in electricity distribution co's at the capital market

6



Methods and techniques

Typical sale procedures

- Public and closed tendering,
 - Public auction,
 - Public bidding,
 - Public offering,
 - Private placement
 - Contract for sale via stock exchange,
 - In exceptional cases: without competitive bidding.
- Competitive bidding

7



The role of advisors in developing strategy and conducting the privatization

Two types of advisory role:

- Advisors sponsored by Western European, the U.S. Government, and the EU
 - Investment bankers and other privatization (e.g. Legal, accounting) advisors working in real market conditions, taking part in determining privatization strategies and possible schedules, preparing the evaluations of different companies
-



Social and labor issues related to privatization

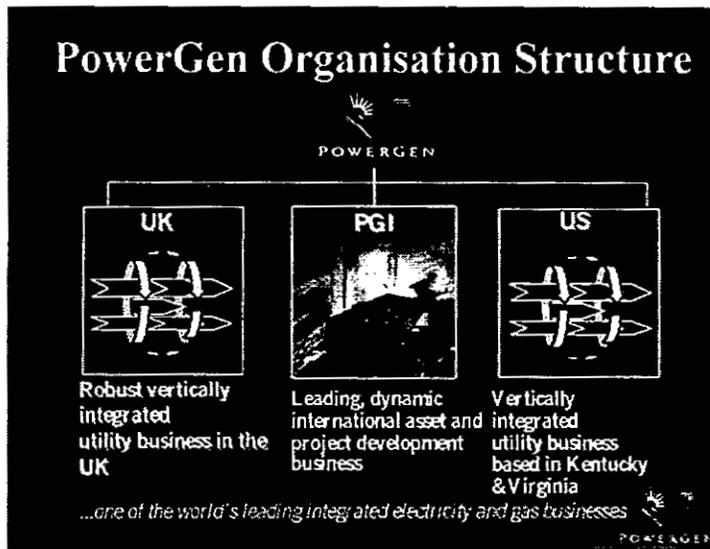
- Claims of municipalities in abolishing state ownership was based on:
 - Their rights as founders
 - Their stake in the land where the state companies were situated when transformed into incorporated companies
 - 25% of assets was due to them after the privatization of electric power sector companies
 - Compensation claims of earlier owners and those whose assets had been confiscated by the State in the past
 - Claims of workers in the electric power sector who were at a disadvantage due to privatization
-

**POWER SECTOR PRIVATISATION
CONFERENCE**

ALLAN WALMSLEY

GENERAL MANAGER
CSEPELI EROMU RT
POWERGEN INTERNATIONAL

6 JUNE 2000



POWERGEN IN 2000

- Generating output 47 TWh (16% of UK)
- Consolidated, integrated UK position
- 1999 Sales £3.746 bn (Euro 6.2 bn)
- 1999 PAT £0.720 bn (Euro 1.2 bn)
- Major US Acquisition agreed
- 6 GW international project portfolio
- 7,700 employees in UK and internationally



PowerGen International



Current investments over \$1bn
6 GW international project portfolio



Hungarian Market

- Market opportunity - a precondition
- Good track record over last decade
 - Country Credit rating improving,
 - EU accession planned,
 - Inward capital investment highest in region
 - Competing well for funds in the world
- A good position if maintained
- Conclusion - A long term high cost project in this market at this time must be backed by firm enforceable long term contracts to define cash flows.

POWERGEN

Hungary Acquisition

- Potential to buy Csepeli Eromu Rt - public utility serving a defined industrial estate, South Budapest
- Negotiations thru 1994
- Acquired mid-1995 for \$10m plus exclusive right to negotiate on a CCGT station on adjoining site
- Csepeli Eromu Rt since extensively restructured
- Csepel II CCGT 389Mwe and 140Mwt
 - PPA and financing concluded in mid-1998
 - construction almost completed
 - commercial operation due November 2000

POWERGEN

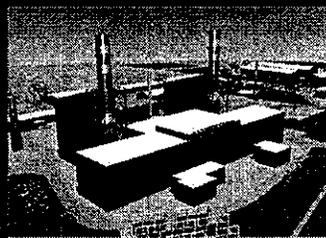
Learning Points

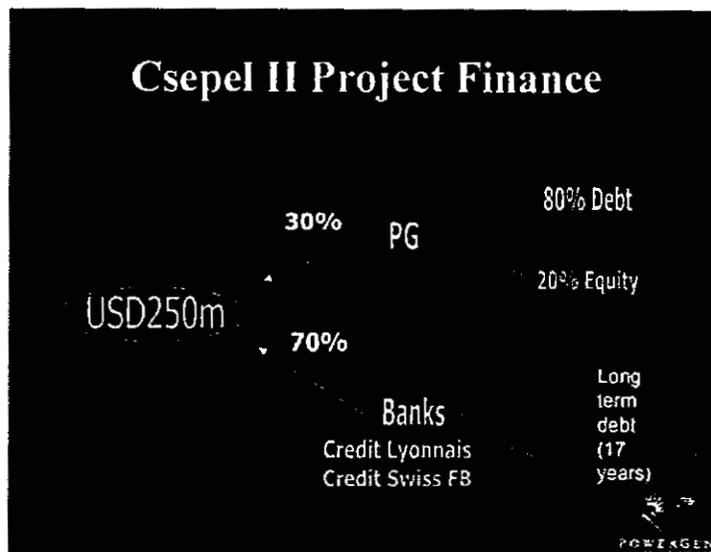
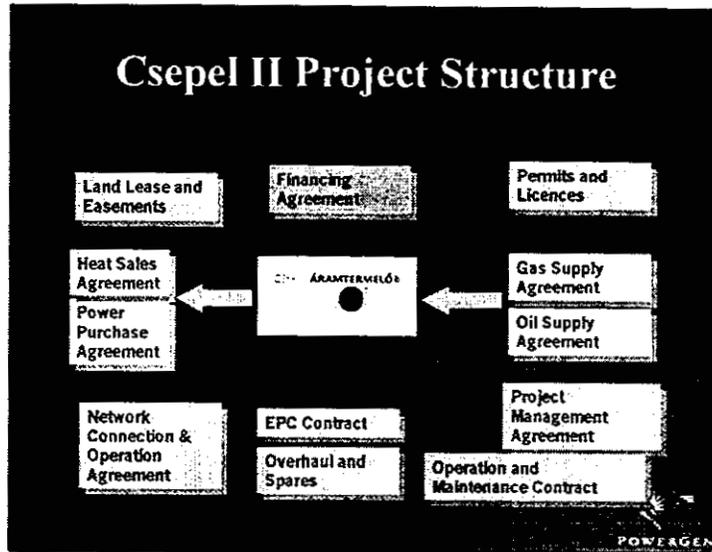
1. *FOCUS ON ONE OR TWO KEY ISSUES*
2. *PUT IN A STRONG TEAM AND DEVELOP A PLAN EARLY*
3. *DON'T UNDERESTIMATE THE DIFFICULTIES OF DOING BUSINESS IN A SECOND LANGUAGE*
4. *ALLOW TIME AND PATIENCE*



Csepel II CCGT

- Plant
 - 2 GE Frame 9E GT's
 - 1 GE Steam Turbine
 - 1 Aux. Steam boiler
 - 4 Hot Water boilers
- CCGT mode
 - 389MWe, 90MWth, 50% efficiency
- CHP mode
 - 365MWe, 139MWth, 65% efficiency

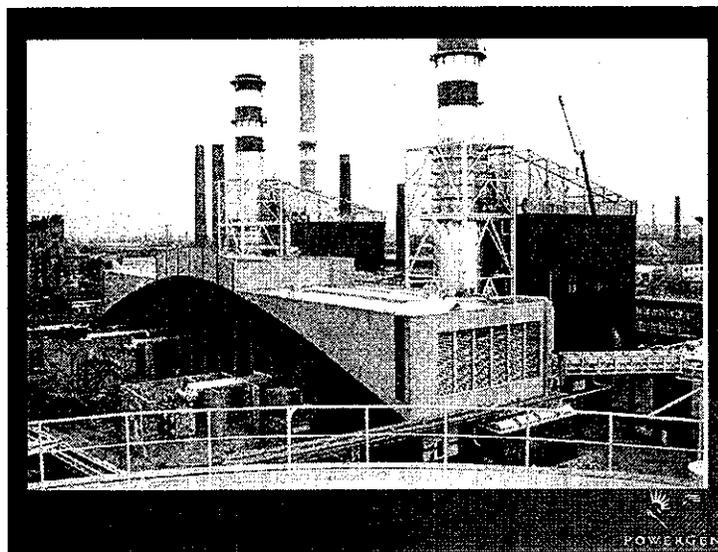




Csepel II Project Financing

The consequences of Project Finance are that project cash flows must

- repay capital.
- fund interest repayments.
- meet operating costs.
- provide return to Investors.



Csepeli Eromu Rt - The Basics

- Public utility company located on Csepel Island
- 5km south of Budapest, Hungary.
- 100% owned by PowerGen.
- 280 industrial and commercial customers with a turnover \$18m pa
- hot water supply to 11,000 domestic flats and houses
- 500+ staff



Csepeli Eromu Rt - The Assets

- 43 MWe and 280 MWth CHP high pressure "Sulzer" boilers, 2 PTVM boilers, 5 turbines and industrial water production plant.
- 600 knt electrical distribution network.
- 72 transformer houses.
- 15 km steam network.
- 20 km drinking water network.
- 20 km sewage network.
- 16 gas pressure stations
- 8 km gas network.
- 40 km road and street lighting network.



Csepeli Eromu Rt - Output

- Primary products are hot water, steam and electrical output throughout the local industrial park
- plus supply of 170 MW of hot water for a District Heating Scheme to 11,000 homes on Csepel Island.
- 120 GWh electricity supply and distribution
- Fuel Supply: LP Gas and Heavy fuel oil



POWERGEN



Silk Road

Vitaly A. Lee
Budapest, Hungary

AES is one of the largest power companies in the world:

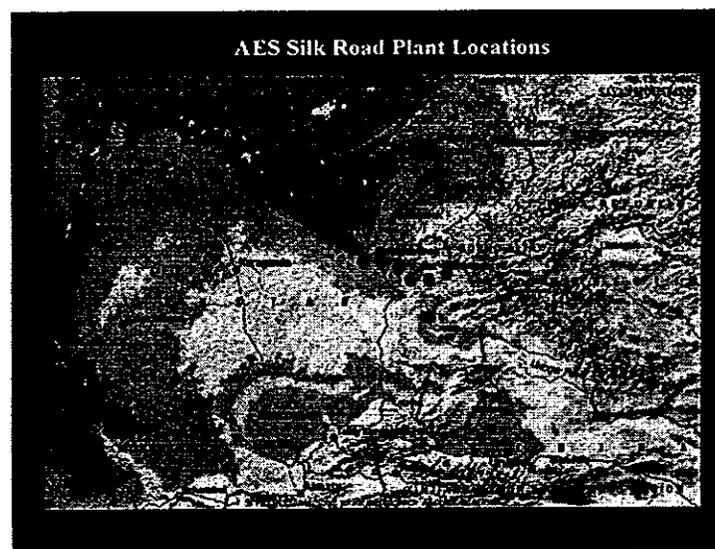
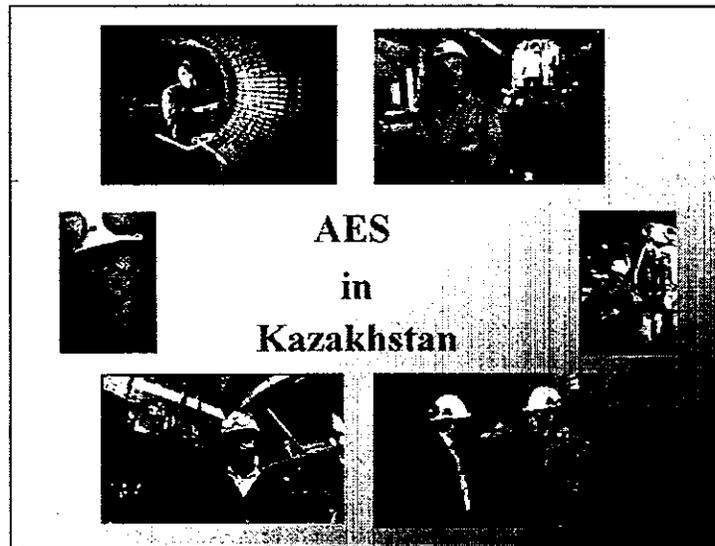
125 businesses in 16 countries
Generation: 44,000 MW
Distribution: 17 companies
54,000 AES business people
Market Cap: \$21 billion
Placed Financing: \$8 billion
1999 Net Income = \$377 million



AES people are committed to a set of shared principles/values:

Integrity
Fairness
Social Responsibility
And "Fun"





1996: 4,000 MW Ekibastuz GRES I

- 35 year PPA with NES-KE, investment obligations to upgrade to design capacity
- Lasted 2-3 months
- Now merchant plant
- 300 unreliable MW at takeover
- 1,200 reliable MW today

1997-1999: 1,300 MW Altai Power

- 20 year concession for 2 hydros
- 4 CHP
- Management contract for one heat and two electricity distribution companies

- Electricity reform and denationalization
- Strong power system
- Rich hydrocarbon basis and fossil fuel base
- Readiness to transit to market economy
- Strong local expertise and technical knowledge
- Challenge to make a difference
- Belief in the strong future of Kazakhstan

- **Technical and financial conditions of the assets required speedy privatization**
- **No vision or structured program leading to a discrepant process**
- **Full information available**
- **Improvement in the process each year**
- **Now Government has a detailed privatization plan for remaining distribution companies with the help of an international advisor**

- **Backwages and social payments**
- **Social and communal entities (schools, kindergartens, etc.) were imposed on new owners**
- **Post-Soviet legacy - overstaffed entities, necessitating a reduction of personnel through Voluntary Severance Selective (long, hard but beneficial in the long term)**
- **Trade unions and personnel development**

- Antimonopoly Agency (AMA) in lieu of truly Independent Regulator
- Fierce competition in generation drove wholesale electricity price down, GenCos are no longer regulated
- Transmission and Distribution are monopolies
- Inefficient & unstable tariff setting regime
- Tariff methodology which is not conducive to effective investment
- Recent movement toward more stability by AMA

- Government of Kazakhstan privatized 80% of generation, roughly 40% of distribution
- Major power sector reform has occurred
- Key to non-payment - REC privatization
- Key to effective REC privatization - shift to a stable tariff methodology which allows positive investment flow
- Independent Regulator
- Kazakhstan Electricity Association - voice of the industry



PRIVATIZATION FOR THE RESULT AND NOT JUST FOR THE PRIVATIZATION

MINISTRY OF STATE PROPERTY MANAGEMENT OF
GEORGIA

**PRIVATIZATION OF LARGE-SCALE
STRATEGIC ENTERPRISES**

1



Ministry of State Property Management of Georgia

MAIN OBJECTIVE:

- FOUNDATION OF TECHNOLOGICAL INNOVATION IN ENERGY, TRANSPORT, TELECOMMUNICATION, WATER SUPPLY AND SEWERAGE SECTORS AND LARGE-SCALE ENTERPRISES
- ATTRACTION OF STRATEGIC INVESTORS
- MODERN MANAGEMENT
- ATTRACTION OF INVESTMENT
- FOUNDATION OF TECHNOLOGICAL INNOVATION

2



Ministry of State Property Management of Georgia

ACTIONS TAKEN BY THE GOVERNMENT:

- POLITICAL DESIRE
- ADOPTION OF LAW ON THE SECTOR
- ELABORATION OF THE PRIVATIZATION STRATEGY ON THE SECTOR
- ESTABLISHMENT OF THE INDEPENDENT REGULATORY COMMISSION
- ESTABLISHMENT OF THE WHOLE SALE MARKET IN ENERGY SECTOR
- TRANSPARENCY
- SELECTION OF INVESTMENT BANK THROUGH THE TENDER
- PREPARATION OF INTERNATIONAL TENDER BY ASSISTANCE OF INVESTMENT BANK AND EXPERTS
- ASSISTANCE ACCEPTED FROM THE INTERNATIONAL INSTITUTIONS
- (WB, IMF, USAID, EC, EBRD, etc)
- HIGH SKILLED TENDER COMMISSION

3



Ministry of State Property Management of Georgia

PROBLEMS REGARDED PRIVATIZATION PROCESS:

- COMPETITION ON WORLD INVESTMENT MARKET
- TARIFF ISSUES
- PROTECTION OF SOCIALLY UNSECURED POPULATION
- DEBTS ISSUES, INCLUDING WHOLE ENERGY SECTOR
- SITUATION IN REGION
- ECONOMICAL SITUATION
- ACCELERATION OF PROCESS CAUSED BY BUDGETING PROBLEMS
- POPULISM AND DEMAGOGY

4



Ministry of State Property Management of Georgia

**PROBLEMS ARISEN IN ENERGY SECTOR BEFORE
PRIVATIZATION:**

- DEFICIT OF ELECTRICITY
- CORRUPTION
- PROBLEMS CONCERNING COLLECTIONS
- DEBTS
- LACK OF MANAGEMENT
- LACK OF INVESTMENTS
- LACK OF THE NEW TECNOLOGY
- PROBLEMS OF POPULATION (Expenses for wood, gas and for other heaters, also for feeders and cables)

4



Ministry of State Property Management of Georgia

PRIVATIZED ENERGY UTILITIES:

- "TELASI" ELECTRICITY DISTRIBUTION of TBILISI
(PRIVATIZATION, 370 000 CUSTOMERS)
- "GARDABANI" TPP UNITS 9 AND 10
(PRIVATIZATION, 600 MW)
- "KHRAMI 1" & "KHRAMI 2" HPP
(25 YEAR MANAGEMENT RIGHTS (112.8 AND 220 MW))

5



Ministry of State Property Management of Georgia

RESULTS AFTER PRIVATIZATION:

- END OF CORRUPTION
- DEBTS GROWTH WAS STOPPED AND PART OF THEM WHERE REPAID
- THE PROBLEM OF ENERGY DEFICIT WAS SOLVED
- IMPROVEMENT OF FEES COLLECTION BY INVESTOR
- ISSUES CONCERNING ECONOMY OF ELECTIRCITY
- EXPORT & RE-EXPORT OPPORTUNITIES ARE IMPROVED
- TAX PAYMENTS AND COUNTRY'S INCOME IS INCREASED
- ENERGY-CARRIERS ARE BEING PURCHASED BY INVESTORS
- SECTOR REHABILITATION PROCESS CARRIED OUT BY INVESTOR
- USAGE OF NEW CREDIT RESOURCES TO IMPROVE EXPORT POTENTIAL UTILIZATION

7



Ministry of State Property Management of Georgia

- LOANS ISSUED BY FOREIGN CREDIT INSTITUTIONS ARE ACTIVELY USED AND LIABILITIES OF THE GOVERNMENT ARE TRANSFERRED TO INVESTORS
- PAYMENTS FOR SUPPLIED POWER AND INVESTMENTS SAVED SAVED THE WHOLE ENERGY SECTOR
- THERE IS A WIDE RANGE OF INVESTORS IN THE SECTOR – TOGETHER WITH AMERICANS, FRENCH AND RUSSIAN INVESTORS BECAME VERY ACTIVE IN THE SECTOR, WHAT OF COURSE IS A PREREQUISITE OF HEALTHY COMPETITIVE ENVIRONMENT

8

A E S TELASI, TBILISI, GEORGIA.

Colin Denny

Regional Manager, AES Telasi

6th June 2000, Budapest

Georgian power sector sale

- Political desire and will to sell
- "Hands off" approach to electricity business by government
- Responsible regulatory authority
- Impartial information memorandum by advisors Merrill Lynch
- Prior KZ experience drove AES to bid for a distribution company

Georgian power sector sale

- Effective control and majority ownership
- Strong government support for sale
- Comprehensive Sale and Purchase agreement
- Information memorandum drawn up by impartial advisors Kantor /Merrill Lynch
- Prior experience drove AES to bid for a distribution company

3

Assets purchased

- All-wires and equipment within the business area, 110 kV and down
- Appropriate parts of 110 kV system
- Over 6/10 kV system satisfactory
- 6 kV and 0.4 kV in poor condition, overloaded and subject to faults
- 6 kV / 0.4 kV Transformers subject to frequent faults, fuses bridged causing failures of cables and transformers

4

Assets purchased

- Loss of heatnets created system overloads, creating demand that exceeds the design capacity
- Frequent power outages creates further stress on system and triggers faults
- Customer meters missing or broken in 60% of customer premises
- Existing meters 5/17 amp. Inadequate for customer demands

5

Assets purchased

- Buildings for staff and equipment included about 1,400 transformer structures
- Transfer of all Telasi property still in process
- Vehicles and equipment generally in need of replacement

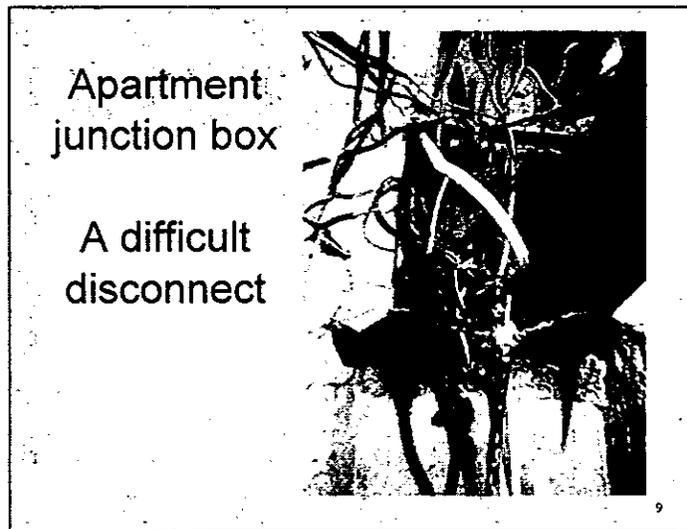
6

The privatization process

- Vendor clearly wanted to sell
- Information memorandum adequate
- The sale and purchase agreement is the foundation of the privatization process
- Good access to system and cooperation from Telasi and Gov't
- Long negotiations necessary to meet needs of buyer and seller

Commercial problems

- Collections low
- Metering inaccessible
- Meters missing or damaged
- Disconnections difficult
- Disconnections running at 2,000 per day, 5,000 customers targeted, 2,500 pay immediately
- Illegal connections frequent
- Fraudulent meter readings



- ### Social and labour issues
- Georgian law allows for redundancy under business reorganization
 - Redundancy payments are defined by Georgian law
 - Telasi had not paid wages regularly for some time before AES takeover
 - Back wages were paid under terms of AES acquisition
 - Wages were very low at AES takeover
- 10

Social and labour issues

- Telasi employees had lost morale
- Non payment of bills created impossible working conditions at Telasi
- Lack of funds led to Telasi people being unable to get materials for maintenance
- No computers but a TV in most offices

11

Social and labour issues

- Serious health & safety violations; several deaths each year; actual numbers not known
- Telasi staff numbered 2,200 at acquisition
- Serious over-manning and need for reorganization
- Improved payments raises need for employees initially

12

Banking and engineering relationships

- EBRD provided letters to AES for support at time of offer to vendor
- Continuous advice from our legal counsel during the negotiations
- Local Georgian banks very helpful, but have have limited lending resources
- Review of system condition by engineering consultants prior to offer

13

Telasi information availability

- Telasi management cooperated well
- Assessment of system condition could not identify full extent of problems
- System data not adequate in information memo
- Asset condition not detailed nor extent of neglect understood
- Extent of winter power availability worse than expected; 50% of demand only.

14

Telasi information availability

- Collection information not accurate
- Soviet cash accounting records, no accruals or IAS
- No central customer list - actual number of customers and total debts not known
- Collection and billing process subject to fraud
- Labour laws reasonably effective and clear

15

Telasi information availability

- Social and economic information from many agency reports
- Power shortages created frequent outages in Tbilisi distorting economic situation and growth expectations

16

Ownership

- 75% of company stock sold to AES
- 25% retained by gov't, of which 5% allocated to employees
- AES have overall operating responsibility
- The AES Telasi supervisory board includes one member from the government

17

Investment commitments

- Investment of agreed amounts of money into the system each year
- A commitment to the "Obligation to serve"
- Agreement to install new residential and bulk metering systems to improve payment discipline

18

Finance

- Major lender is EBRD / IFC who have agreed to provide \$60,000,000
- AES must meet stringent EBRD lending conditions

19

Operational needs

- Constructing billing process
- Rebuilding customer list
- Establishing bill delivery process
- Re-creating accounting process
- Building system operating management process
- Collection management process
- Introduction of environmental procedures

20

AES TELASI

End

21

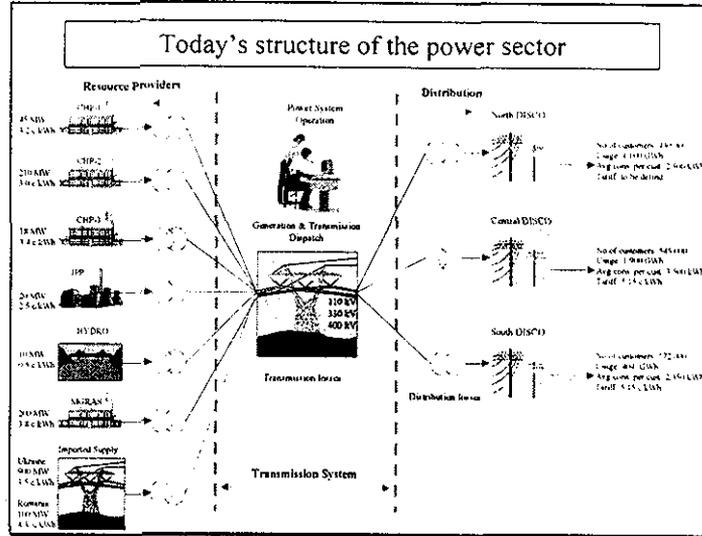
REPUBLIC OF MOLDOVA



PRIVATIZATION OF THE
ELECTRICITY SECTOR

Power market already re-structured along
internationally accepted guidelines

- Resource providers
 - 3 CHPs (privatisation launched in March 2000)
 - IPP (Sugar companies, already private)
 - Hydroplants (to remain state-owned)
 - Imported supply (Romania, Ukraine, Transnistria)
- Transmission
 - Moldtranselectro (to remain state-owned)
- Distribution
 - Three areas, North, Central and South (the latter 2 were privatised in February 2000, the northern area was launched in March 2000)
 - Independent suppliers (privately owned)



Main data on the distribution companies in 1998

	RED Chrinau	RED Centru	RED Nod	RED Nord-Vest	RED Sud
Total Population in Service Area ('000s)	800	990	720	540	510
Customers	217,029	310,000	265,519	165,219	162,550
Energy Distributed (GWh - metered consumption)	1,294	472	535	334	303
Sales ('000 USD)	58,174	22,095	25,689	15,135	13,362
% of sales to residential customers	32%	45%	36%	40%	38%
Gross Profit/loss	(1,506)	(11,028)	(6,349)	(6,796)	(8,958)
Technical Losses (%)	5.1	10.8	15.0	10.0	11.7
Commercial Losses (%)	10.8	26.8	19.4	24.2	28.9
Employees	925	1,327	1,010	509	890

A sound regulatory framework already in place

- The Law on Electricity (1998) defines the respective roles of
 - the Government (Dep. of Energy, Moldtranselectro)
 - the Regulator (the ANRE)
 - the electricity companies

- The Regulatory Agency - ANRE - was set up in August, 1997 (Gov. Decree)
 - Electricity Sector
 - Thermal Energy Sector
 - Natural Gas Sector

The Electricity Law ensures the independence of the Regulator

- The Regulator's - ANRE - budget is defined according to the Law and approved by the Government

- Directors of ANRE are appointed by the Government for 5 years

- A Director may be dismissed by the Government only in the limited cases specified in the Law

- ANRE presents annual report to the Parliament and the Government.

The Regulatory Agency has well defined tasks and duties

- Licensing
- Tariffs
- Promotion of Competition in the energy markets
- Protection of consumer rights and interests

... and rights:

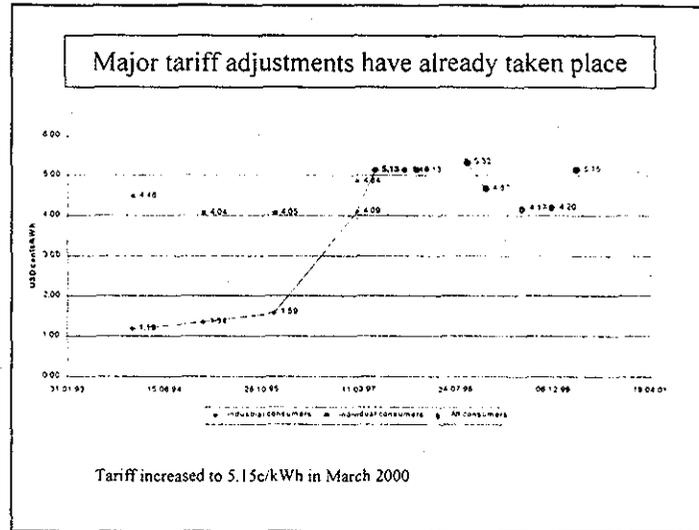
- Controls the observance of the conditions stipulated in the licenses.
- Suspends or terminates the licenses.
- Enforces the principle of minimum costs.
- Approves rules and regulations to insure the performance of licensees duties in the most efficient way.
- Exacts fines.
- Reviews licensees documents concerning regulated activities.

The Regulation on Licensing was passed in 1998, since then ANRE has issued licenses to power companies

- 13 Independent Electricity Supply Licenses;
- 5 Regulated Electricity Supply Licenses;
- 5 Regulated Licenses for Distribution of Electricity;
- 4 Licenses for Production of Electricity at Regulated Tariffs;
- 1 License for Dispatch Activity;
- 1 License for Transportation Activity

Tariff methodology for the sector defined by ANRE

- Based on pass through criteria for distribution and generation.
- Including calculation of expenditures plus a reasonable profit for the operators.
- Allocating expenditures and profits between electric and thermal energy production in combined heat & power plants.
- Aimed at promoting reliable supply of electricity at reasonable costs as well as efficient utilization of the production capacities.
The tariff methodology has been revised in negotiation with Union Fenosa for the distribution privatisation.
- The Tariff Policy is transparent and predictable for companies and investors



Moldova's power sector heavily relies on import

- The right bank has a power deficiency of approximately 700 MW out of 1,050 MW used.
- Resources structure:
 - 25% - local power plants;
 - 35% - imports from Ukraine;
 - 30% - purchase from Transnistria power plant;
 - 10% - imports from Romania.
- Competition takes place only among suppliers that bring energy from Ukraine, Romania and Transnistria.
- But, new projects are currently being contemplated.

Power market rules to encourage competition

- Power Market is composed of Bilateral Contracts Market and Balancing Power Market (spot market).
- Distribution companies conclude Bilateral Contracts with resource providers (since January 1, 1999).
- Dispatch Center is responsible for the Balancing Power Market operations.
- Market Rules are currently elaborated and will be approved after public hearing.
- Customers are not permitted to sign direct contracts for the delivery of power.

Privatisation

Well under way and heavily supported by IFIs

- 3 of the 5 Discos privatised in February 2000 to Union Fenosa of Spain
 - Purchase price : USD 25mn
 - Committed investments: USD 60mn over 5 years
 - New tariff methodology negotiated
- Tender for the northern distribution package re-launched on March 7, 2000
- Gencos to follow until September 2000
 - Announcement of Gencos privatisation on March 7, 2000
- EBRD to co-invest in Discos
- World Bank Group to provide finance and guarantees.

Privatisation to Union Fenosa
A well balanced rehabilitation programme

- Proposed investment plan: \$100mn over 5 years
- Committed investments: \$60mn
- Main focus of investments: new metering to reduce commercial losses. Major replacement programme in first 2 years
- Technical investments (new cables, etc.): more limited in scope and mostly over years 3-5

Reasonable tariff and state-of-the-art tariff methodology

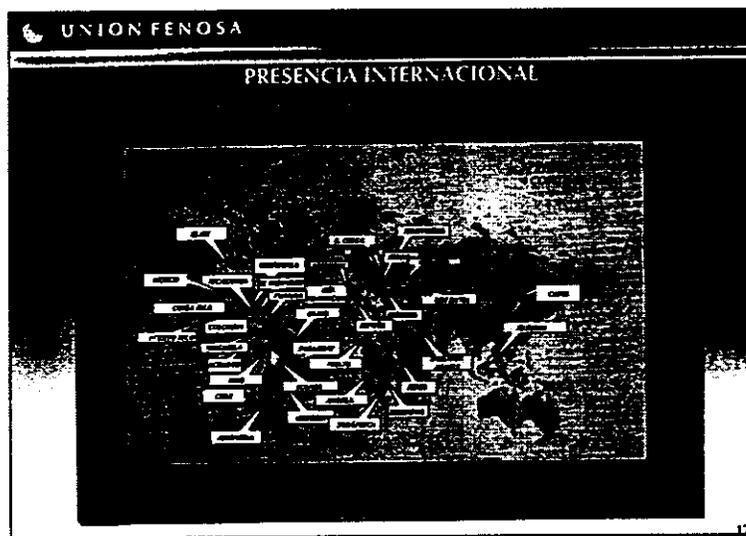
- New tariff methodology negotiated with ANRE
- Allowed return based on return on investment
- Tariff period 7 years
- Year 1 is a transition period with review at year end leading to a new tariff based on actually achieved costs
- Starting tariff 5.15c/kWh, revision after 3 months to enable pass through of actual power purchase price and loss levels
- Any shortfall due to inadequate provision for operating costs in first year tariff to be recovered through the tariff over the rest of the tariff period

Privatisation to Union Fenosa: Tariffs

- Tariff will be adjusted during the tariff period to reflect
 - fluctuations in power purchase price
 - inflation rate
 - fluctuations in the exchange rate
 - decrease in technical and commercial losses allowed to be passed through in tariff
 - annual cost indexation linked to inflation and other factors and subject to deduction of a cost efficiency factor

Next steps

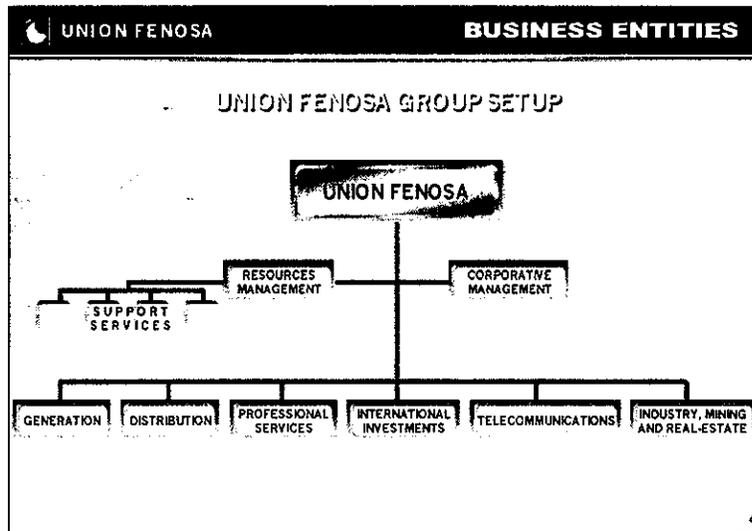
- Privatisation of the remaining 2 distribution companies
 - June targeted for transaction closing
- Privatisation of the Combined Heat and Power Plants
 - Experienced management company required for Thermocom and Thermocomenergo, the heat distribution companies
 - 70% of the shares (blocking minority at 33%) for sale
 - Transaction closing targeted for July

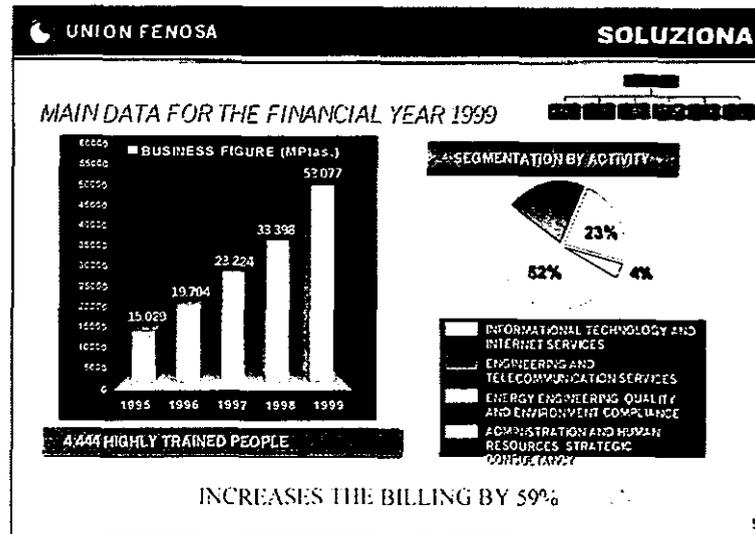


UNION FENOSA **GENERAL CHARACTERISTICS**

UNION FENOSA	1999
A CONTINUOUSLY GROWING GROUP	CAPITAL 918 M \$
A WIDE INTERNATIONAL PRESENCE	MARKET VALUE 5112 5.308 M \$
WELL POSITIONED IN HIGH GROWTH SECTORS (TELECOMMUNICATIONS, IT)	BUSINESS FIGURE (P ₇) 2.096 M \$
STRENGTHENED BY IMPORTANT STRATEGIC ALLIANCES	ASSETS 9.199 M \$
FINANCIALLY REINFORCED	

3





UNION FENOSA **INTERNATIONAL INVESTMENTS**

1999 INVESTMENTS

	COUNTRY	PART. %	ACTIV.	POWER/CUSTOMERS	RELEVANT INFORMATION	INV. 1999	PEND. OR FORESEEN
ASIA							
MERALCO	PHILIPPINES	9,1%	Distrib.	3,475,000 Cust.	20,430 GWh bill/year	120	-
SOUTH AMERICA							
HERMOSILLO	MEXICO	100%	Gener.	250 MW	CCGT	13	22
DEOCSA / DEORSA	GUATEMALA	80%	Distrib.	670,000 Cust.	1,025 GWh bill/year	112	-
EDE SOUTH/NORTH	DOM. REP.	50%	Distrib.	550,000 Cust.	3,000 GWh bill/year	215	-
AIRPORTS MEX.	MEXICO	4,6%	Manag.	15 MIL. Passen.	12 Airports	102	-
TDE BOLIVIA	BOLIVIA	38%	Transp.	1,550 km net	Int. AT and MT. 21 seb.	14	-
EUROPE							
CAMBRIDGE WATER	UK	100%	Distrib.	136,000 Cust.	Water, Gas & Electricity	45,2	42,4
OTHER COUNTRIES							
OTHERS						18,8	
TOTAL				4,831,000 Customers		640	644

Millions \$

6

UNION FENOSA **ACTIVITIES ENVISAGED FOR THE YEAR 2000**

INTERNATIONAL INVESTMENTS

DEVELOPING PROJECTS:

AFRICA	MSE GHANA (80 MW)
SOUTH AMERICA	CONECTA (GAS URUG.), STO. DOMINGO (180 MW)
EUROPE	MOLDAVIA (753.000 CUSTOMERS)

PREPARED PROJECTS:

GENERATION

ASIA	SAUDY ARABY
AFRICA	MOROCCO, KENIA
SOUTH AMERICA	MEXICO, ECUADOR, COSTA RICA, URUGUAY

DISTRIBUTION

ASIA	VECO PHILIPPINES
AFRICA	TANGER, TETUAN
SOUTH AMERICA	EMELEC-GUAYAQUIL, NICARAGUA

7

UNION FENOSA **THE BASIS OF THE GROWTH**

✓ **FINANCIAL STRENGTH**

✓ **STRATEGIC POSITIONING IN NEW BUSINESS**

✓ **TECHNOLOGICAL COMPONENT (IT & TELECOMMUNICATIONS)**

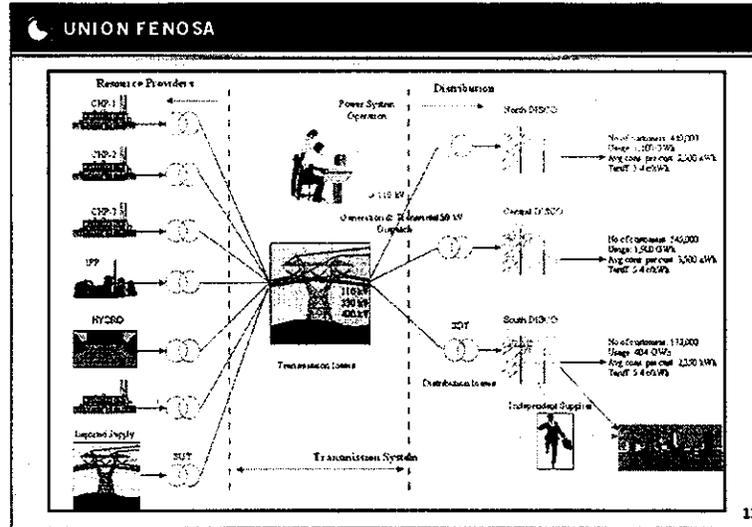
✓ **INTERNATIONAL NETWORK**

✓ **INTERNACIONAL ALLIANCES**

✓ **MANAGEMENT CAPACITY**

VALUE CREATION BY MEANS OF ENLARGEMENT

8



11

MAIN DATA ON THE DISTRIBUTION COMPANIES

	RED Chisinau	RED Centru	RED Nord	RED Nord-Vest	RED Sud
Total Population in Service Area ('000s)	800	990	720	540	510
Customers	217,029	310,000	265,519	165,219	162,550
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Gross Profit/Loss	(1,506)	(11,028)	(6,349)	(6,796)	(8,958)
Technical Losses (%)	5.1	10.8	15.0	10.0	11.7
Commercial Losses (%)	10.8	26.8	19.4	24.2	28.9
Employees	725	1,327	1,010	809	390

12

UNION FENOSA

PRIVATISATION: well under way and heavily supported by IFIs

On 7th of February, 2000 3 of the 5 Distribution Companies were privatized to Union Fenosa

Purchase date:	22nd of February 2000
Purchase price :	USD 25mn
Committed investments:	USD 60mn over 5 years

- ✓ New tariff methodology negotiated with ANRE, approved on 21 of March 2000 and published in "Monitorul Oficial".
The CCF acted as a Government consulting bank in the process of privatization,
- ✓ It was a legal and honest process, efficiently managed by the Department of Privatization of Moldova Republic.
- ✓ This process was deeply guided and overseen by EBRD and the World Bank.

13

UNION FENOSA

INVESTMENT PLAN

- Proposed investment plan: \$100mn over 5 years
- Committed investments: \$60mn
- Main focus of investments:
 - new metering to reduce commercial losses
 - major replacement programme in first 2 years
- Technical investments (new cables, etc.):
 - more limited in scope and mostly over year 3-5

14

 UNION FENOSA

ACTIVITIES DEVELOPMENT AFTER THE ACQUISITION

By the time when the three enterprises RE Chisinau, RED Centru, RED Sud have been purchased they were in a very bad financial situation:

- big amounts of accumulated debts to the suppliers*
- significant problems with the electrical supply*

many hours of power switching-off every day, except the capital of the country, the mostly problematic areas being the South and the Center for more than 7 years

15

 UNION FENOSA

- Look for new power suppliers*
- Recommence the relations with the suppliers broken along of accumulated debts*
- To contribute to the capital of the three networks up to the amount of 11.5 millions USD*
- To initiate the active efforts in order to completely eliminate the power switching-off*
- Measure devices installation, substations and network maintenance plan*
- Start up the Management Improvement Plan: implementation the systems OPEN SGC, SGA, SIE, SGD*

16

UNION FENOSA

Management Improvement Project Strategy

OBJECTIVES

- ✓ To be the **Control Center of the Managerial Transformation**, managing the changes that assume the transition from actual situation of the enterprise to the needed situation supervising the development of the Project without being responsible for the daily operation.
- ✓ Develop the Management Improvement short-term objectives
- ✓ Execute the task needed for the complete development of the MIP on medium-long term

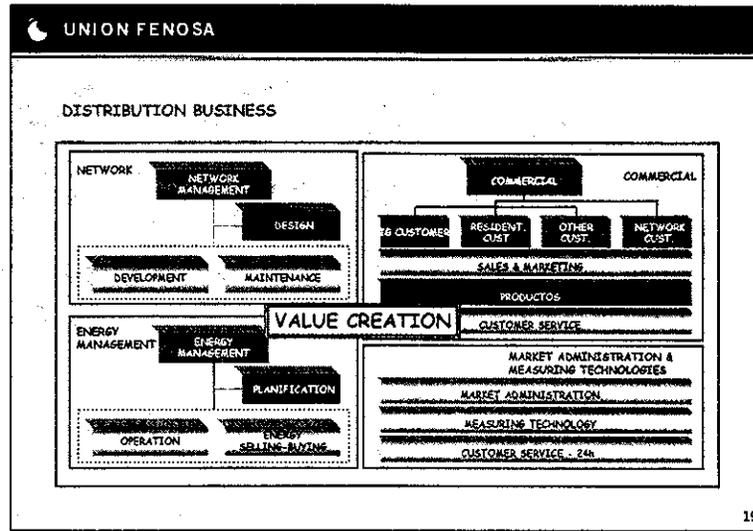
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UNION FENOSA

SCOPE

SCOPE	Management of Networks	Management of Energy	Commercial	Market Analysis and Marketing Technology	Generation
Organization and HR					
Financial Economics					
Social Communication					
Telecommunications and System					
Auditing & Management Control					
Regulation and energy purchase					

18

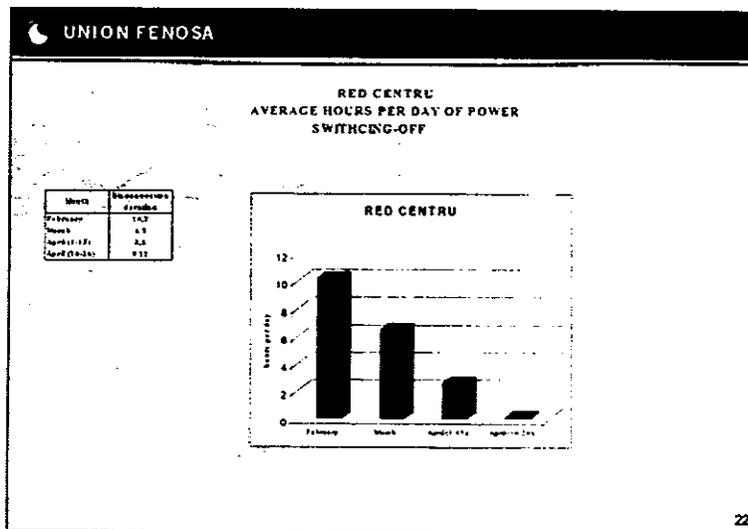
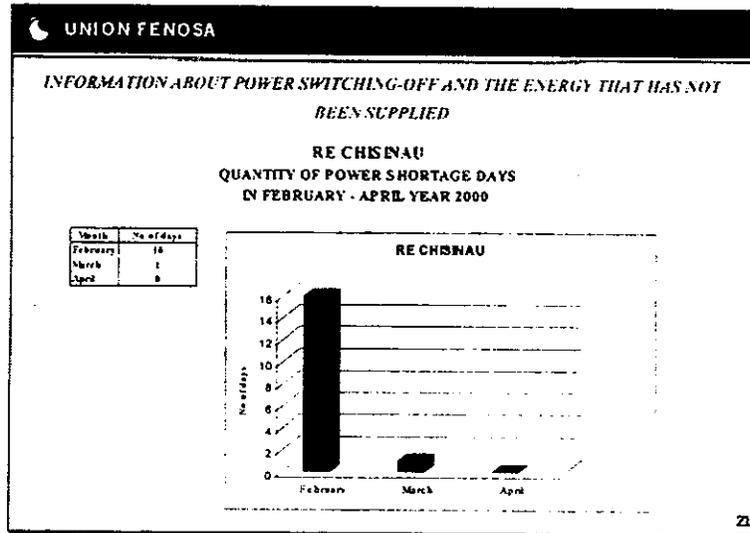


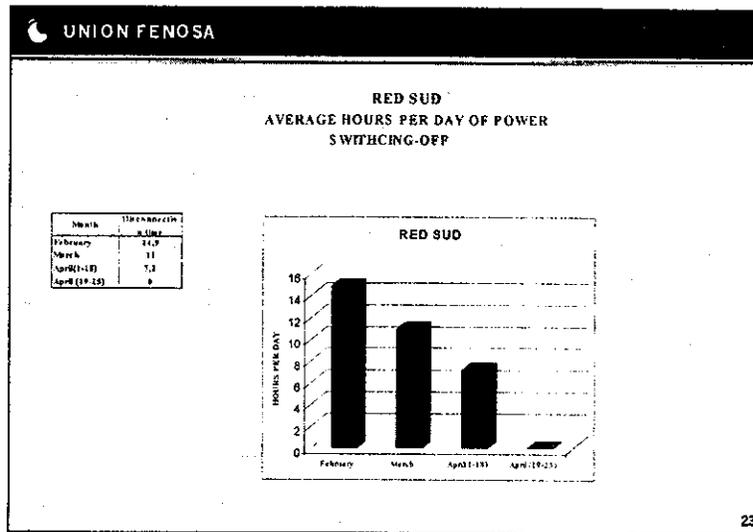
UNION FENOSA

As a consequence of all previous actions it was achieved to completely stop the power switching-off on all of the areas subordinated to RE Chisinau, RED Centru, RED Sud within 2 months after taking the control.

Presently the power supply is being carried 24 hours a day and throughout the three networks there are no disconnections any longer.

20





Power Sector Privatization in the Republic of Armenia

*By David Vardanyan
Minister of State Property Management of the
Republic of Armenia*

Dear Ladies and Gentlemen – Conference participants,

Before commencing the discussion of privatization issues, is it worthwhile to present you with a short overview of the Armenian power system.

Overview of the Power System of the Republic of Armenia

Currently, the power system of Armenia has an installed capacity of nearly 3,200 MW (not taking into account Unit No. 1 of the Metsamorsk Nuclear Power Plant.) The projected peak load is expected to reach the level of 2,100 MW by 2010.

The electric power is generated in the Republic on the basis of heat and power plants, hydroelectric plants, and the Metsamorsk NPP. The heat and power plants are located in Erevan, Razdan, and Vanadzor. The district heating installations (with capacity of up to 100 MW) provide for the combined generation of heat and electric power. Armenia does not possess natural fuel reserves, with the exception of certain coal reserves, and the entire volume of fuel requirements for HPPs is provided through imports.

Following the December 1988 earthquake, the Metsamorsk NPP (whose capacity is 880 MW – 2 units, 440 MW each) was shut down for the purposes of safety assurance, even though the plant had suffered no damage. Following a complete overhaul and implementation of additional earthquake resistance measures, the operation of Unit No.2 of the Metsamorsk NPP was resumed in 1995, in order to provide for the national power supply independence.

The only local power generation resource in the Republic of Armenia is hydropower. The overall installed capacity of hydroelectric power plants is approximately 1,000 MW, including 530 MW on the basis of seven plants of the Sevan-Razdansk cascade, 400 MW on the basis of three plants of the Vorotansk cascade, and 60 MW based on small hydroelectric power plants.

The high-voltage power grid in Armenia was designed as a component of the Transcaucasian power system. The overall length of the high-voltage transmission lines equals approximately 4,500 km, these lines being connected with the neighboring countries of Georgia, Iran, Azerbaijan and Turkey. The throughput capacity of the high-voltage transmission system, which permeates the entire country, is more than enough to support the projected loads.

Currently Armenia is an exporter of electric power, with the 1999 export volumes to Georgia equalling approximately 240 million kWh of electricity.

The national power grid is managed by the dispatch center located in Yerevan within Armenergo. The communications with all the power plants and nodal substations are through

telecommunications channels; however, the existing system is somewhat outdated and requires upgrading.

The Privatization Program, its Goals, and the Purposes Behind Power Facilities Privatization

The privatization of state enterprises in the Republic is carried out in accordance with the Law, "On the Privatization Program." Currently, the 1998-2000 Privatization Program is being implemented in the Republic, which is aimed at the second, "monetary" phase of state assets privatization. The priorities under this program include: development and extensive application of the privatization methods (primarily constituted by competitive bidding) which promote the inflow of investments and the sale of enterprises to strategic investors; increase of the state budget income from privatization proceeds; etc. It should be noted that just like in the case of several Central and Eastern European countries, the first phase of privatization involved the issuance and use of privatization certificates/vouchers. The privatization vouchers were used as means of payment only with regard to acquisitions of small-scale privatization enterprises and facilities, and they expired on 1/1/99.

The existing privatization program includes large and medium-size enterprises and facilities of the power industry, mining industry, chemical industry, radio-electronics manufacturing, construction materials industry, transportation, agriculture and other sectors of the national economy.

The current privatization program also encompasses the main facilities in the sphere of electric power generation and distribution, such as the Razdansk heat and power plant (HPP), Yerevan HPP, hydroelectric power plant of the Sevan-Razdansk cascade, hydroelectric power plant of the Vorotansk cascade, and others. The privatization of the distribution system shall be carried out in accordance with a separate law regulating the main principles, terms and conditions of the sale of these facilities. These and a number of other enterprises are slated for privatization within the framework of the 1998-2000 Privatization Program, and in the event of an extension of the privatization timeframe, they will be included in the subsequent Program, or else the term of the existing program will be extended.

As of now, 13 small hydroelectric power plants have been privatized in the Republic; however, they only solve local power supply problems in certain regions of Armenia and have no overall influence on electric power generation within the scope of the Republic. The competitive bidding for the privatization of small hydroelectric power plants also involved the participation of foreign investors, for example, two plants, Vokhchi-2 and Vokhchi-3, were acquired and are currently operated by a French firm, "Kapan Energie".

As for the purpose behind the privatization of power facilities in the Republic of Armenia, the following goals should be noted:

- to attract foreign investments into the power sector in support of improvements and modernization of assets whose costs can not be covered out of the state budget or out of the profits of the sector itself;
- to improve the collection of payments from power consumers (both residential and industrial) and the financial vitality of the power sector, as well as the financial terms of suppliers (in particular, those providing fuel for power plant operation);

- to prevent further accumulation of debts and to promote the solution of problems related to debts accumulated to date;
- to assist in the modernization/upgrading of the power sector through the provision of additional management and new technologies expertise;
- to promote the inflow of domestic investments into the power sector of the Republic; and
- to provide for long-term investment resources for social security purposes.

The Preparation of Entities for Privatization (Privatization Process Schedule)

The role of government in the privatization process consists of the determination and implementation of the privatization policy, which includes the formulation of privatization goals, the identification of enterprises subject to privatization, the creation of the legal and regulatory framework in support of the process, the determination of privatization methods and implementation timeframe (for each individual facility), the formulation of winning bids selection criteria (in case of privatization based on competitive bidding procedure), the provision for the transparency and clarity of the process for all parties involved, and so on.

The preparation of an entity for privatization involves the implementation of a complex of measures preceding the actual privatization, and encompasses the following steps:

- restructuring of state enterprises into joint-stock companies (corporatization);
- unbundling, separation of joint-stock companies, as well as their unification and mergers with other companies;
- audit of the financial and economic activities of an entity subject to privatization;
- restructuring of the debt of the joint-stock company in question;
- development of the program of activities (business plan);
- revaluation of assets and liabilities of the company;
- preparation of new stock issues, as well as valuation of shares;
- revision of licenses, if the privatized enterprise engages in licensed economic activities and the license needs to be revised;
- implementation of measures for entities who have expressed their desire to participate in the privatization process, in order to familiarize these entities with the financial and economic activities of the company; and
- publication of information on the activities of the privatized joint-stock company.

The content and time schedule of preparatory activities and the agencies responsible for their implementation are established by the Resolution by the Government of the Republic of Armenia.

It should be noted that the entire range of preparatory work is required for those privatized facilities which play a strategic role in the national economy of the Republic. Strategic facilities include enterprises which meet the following criteria:

- enterprises which provide the majority of products/services for the corresponding national economy sector and which therefore influence the overall development of the corresponding sector;

- enterprises which are called upon to provide for the requirements of the general population in a certain sphere;
- enterprises which enjoy a monopoly in the market for certain types of products/services, including natural monopolies.

The power sector facilities are included among these enterprises, and it is not by chance that their preparation for privatization is afforded so much time, effort, material and labor resources.

The privatization transaction will be considered completed and closed only upon signing of the agreement for the purchase and sale of shares and upon the issuance of the corresponding licenses, property rights documents and other documents required under applicable laws of the Republic of Armenia. It is too early at this point to talk about the completion schedule with regard to the distribution system facilities privatization, since the Parliament of the Republic is now in the process of passing a separate law regulating the terms, conditions and procedure of privatization of these facilities.

The Role of Advisors in the Privatization of Power Industry Facilities

As for the distribution system facilities, the Government of the Republic of Armenia has already taken concrete steps in preparation for their privatization. For instance, a contract has been signed between the Government of the Republic of Armenia represented by the Ministry of Economy and Finance, Ministry of Energy and Ministry of State Property Management of the Republic of Armenia on the one hand, and the consortium of companies including Raiffeisen Investment AG, and Austrian Investment Bank and Ben Shahar Associates (BSA), concerning the provision of agency (consulting) services in support of the privatization of the distribution system facilities.

Pursuant to the contract, the role of the privatization consultant consists of the following:

- development of recommendations on the preparation for privatization (based on detailed study of the structure, operations, and financial and economic status of privatized companies);
- holding competitive tenders for the pre-qualification of potential investors (including publicizing/promotion and management of the pre-qualification process, provision of documentation and comprehensive information to the participants concerning the distribution system facilities, etc.);
- development and provision of bidding documents on the distribution system facilities to potential investors who have been pre-qualified and admitted to further participation in the privatization process;
- consultations pertaining to the negotiation of the contract for the purchase of shares; and
- provision of other services necessitated by the client.

The compensation of the advisor for its services also takes the form of performance payments, or "payment for success", calculated as a percentage of the privatization transaction value.

The pre-qualification criteria for potential investors had been established by the Resolution of the Government of the Republic of Armenia and were as follows:

1. The annual income of bidders must be at least US\$ 150 million;
2. The bidder must be an operator in the power industry, with the annual income derived from these activities equaling or exceeding US\$100 million.

The pre-qualification of bidders was performed with a slight deviation from the established schedule (it was delayed due to domestic problems) and resulted in the selection of the following bidders who were admitted to further participation in the privatization process:

1. AES Silk Road (USA)
2. ABB Energy Ventures (Switzerland/Russia)
3. Electricite de France (France)
4. Union Fenosa Acex (Spain)

The pre-qualified potential investors were granted open access to all the required information on the privatized facilities – financial, technical, social, and labor related. The required information was provided by the privatization advisor (consortium) both in the form of prepared specialized materials and at the request of the clients.

Furthermore, in February 2000, an international conference was held in Yerevan with participation of potential investors and other interested parties, the purpose of which was to discuss the issues pertaining to the upcoming privatization, as well as the privatization approaches. During the conference, the participants had an opportunity to meet and discuss the issues of interest with governmental officials (i.e., representatives of the Ministry of Energy, Ministry of State Property Management, Ministry of Economy and Finance, Energy Commission, etc.), and to visit the facilities in order to learn first-hand their technical condition, examine the financial and economic records, learn about the labor resources and the overall economic situation in the Republic.

The Government of the Republic of Armenia has also engaged a legal government consultant, who can help draft legislation which will enable the government to proceed with the privatization, including the revision of current laws and regulations which set forth ownership relationships, property rights and corporate management arrangements.

The legal consultant develops the following recommendations, among other things:

1. *The restructuring of distribution system facilities, including:*
 - the recommendations concerning the elimination of gaps/omissions in the legislation which could potentially become a barrier to privatization;
 - the development of founding documents for the privatized enterprises;
 - the recommendations concerning the allocation of property rights;
 - the study of the liabilities of the privatized joint-stock companies (including environmental liabilities) which could negatively affect the parties in the future, as well as the development of measures aimed at their settlement.
2. *Social security measures, including:*
 - the development of labor agreements – taking into account their potential effect on the operations of the distribution facilities;

- the clarification of the potential obligations of the privatized joint-stock companies under labor agreements, which could emerge in the process of privatization, including social assistance payments to employees;
 - the clarification of the relations between the employees and the labor unions;
 - the development of the draft collective agreement (between the executive body of the enterprise and its employees), including the rights, responsibilities, and obligations of the parties to the agreement;
 - the inclusion in the purchase and sale agreement of standards taking into account the rights of consumers, as well as the requirements for the provision of the operations of life-line social sphere facilities.
3. *The functions of the legal consultant also encompass the following:*
- consultations on credit agreements in effect for the privatized enterprises and identification of obligations to be taken into account during company restructuring;
 - study of the distribution company license issuance procedure, as well as the license compliance oversight procedures, and, if necessary, the development of recommendations on these issues.
4. *The legal consultant is also involved in the preparation and implementation of privatization, and, in particular, it:*
- provides for the development of all the privatization documentation (and, if necessary, participates in the development of this documentation). These documents could include, among others, licenses, agreements for the purchase and sale of shares in the privatized companies, draft agreements between power suppliers and distributors, etc.
 - provides legal assistance to the Government of the Republic of Armenia during privatization transaction negotiations;
 - resolves issues pertaining to the assurance of energy security of the Republic and the inclusion of these requirements in the corresponding agreements and other documentation; and
 - performs a number of other specific tasks.

As can be seen from the above description, the organizational issues pertaining to the privatization of distribution system facilities are resolved with the help of both an agent and a legal consultant. In this, the functions and responsibilities of each party are clearly outlined, with the legal consultant being charged with the task of providing a legal framework for certain social and labor related issues.

Social Aspects: On account of the upcoming privatization of the distribution companies, there is a feeling of mistrust toward the future transaction on the part of the citizens of the Republic. Given the conditions of low income levels and high unemployment rates, the public is concerned with electricity rate increases.

For instance, the results of the sociological study performed by the Armenian Sociology Society jointly with SIBLEY International and with USAID assistance in March of this year, demonstrate that 66 percent of survey participants are convinced that the rates charged for electricity will go up as a result of privatization. Fifty percent of survey participants believe that current rates for electricity are too high, and that the main cause of non-payments is the insolvency of the population.

Rates and Tariffs: The role of the regulator who establishes the rates for electricity and grants licenses for engaging in operations in the power industry in the Republic is performed by the Energy Commission of the Republic of Armenia. Irrespective of whether a given entity is state-owned or private, it must adhere to these rates and operate within the framework of the licenses issued by the Commission.

In the process of distribution companies privatization, the difference between the power sale and power purchase prices (i.e. margin) shall be fixed; it shall be guaranteed to the investor by the Government of the Republic of Armenia and must be adhered to by all investors; the length of time during which this condition will be in effect shall also be fixed. Of course, these points shall be covered in the bidding documentation.

Privatization Approaches: In the process of preparation for privatization, 11 regional distribution systems were reorganized by way of mergers into 4 expanded joint-stock companies, which currently provide for the distribution of electricity throughout the Republic. The merging of enterprises into larger entities allowed to increase their manageability and to consolidate assets and liabilities of individual subdivisions.

In accordance with the preliminary measures taken to prepare the distribution systems for privatization and to identify potential participants in the privatization process, the Government of the Republic of Armenia envisions the following privatization pattern:

- 51% of shares in each distribution system are planned for privatization through competitive bidding, via sale to pre-qualified strategic investors. This share package will grant the right to make decisions on all the key issues of joint-stock company operations, including the issues of profits distribution. Pursuant to the shares purchase and sale agreement, the investors shall have established capital stock investment obligations, which have been estimated at US\$160 million for the four companies;
- the European Bank for the Reconstruction and Development has expressed interest in acquiring up to 20% of shares in each of the distribution systems;
- 5% of shares in each distribution system will be offered for sale at the stock exchange;
- 4% of shares in each distribution system is planned for distribution among the employees of the joint-stock companies – through direct sales, which can become an incentive to improve the performance and can offer a solution to some of the labor problems;
- 20% of shares in each distribution system shall be retained by the government. The possibility of the Government of the Republic of Armenia obtaining a “golden share,” which grants veto rights on certain issues, may also be considered.

The Problem of Debts of Privatized Companies: The problem of debts of privatized companies remains one of the real priority tasks requiring speedy resolution. It should be noted that there is no defined single approach to the solution of this problem for all the enterprises, and there is a reason why. The problem of the indebtedness of each privatized enterprise is discussed during the preparation of the enterprise for privatization. The solutions will depend on the size of debt, its structure, repayment ability, “bad debt” status, and other factors. The debts carried by the privatized enterprises generally pass over to the new owners; however, in certain cases it is

possible that they will be repaid, the payment schedule extended, debt restructured, or another solution found, and with regard to a number of enterprises, the Government of the Republic of Armenia has taken such steps.

As regards the debts of power sector enterprises, it should be noted that significant problems have piled up in this area, keeping in mind the fact that the number of electricity users is so high, while their financial positions are so different, and certain cases require thorough consideration. The accumulated debts (both payables and receivables) will be reviewed in detail – by individual power enterprises and debtors during the period of preparation for privatization.

I would like to note that the approaches to solving the problem of company indebtedness will also be considered within the legislative framework, i.e. through amendments to the laws of the Republic of Armenia, and on an individual basis, i.e. through negotiations with interested parties.

*Leoniya Kalnichenko
Deputy Head
State Property Fund of Ukraine*

**On the Progress of Power Companies Privatization in 2000
(Presentation Summary)**

The reform of the Ukrainian power sector along the lines determined by the principles of establishing a market environment, which began in 1994. The issues surrounding power companies privatization have played an important role in the overall reform program. Prior to actual privatization, eight interregional power associations consisting of power plants, power transmission trunk lines and distribution lines, broad auxiliary facilities infrastructure, substantial social sphere facilities, etc., had undergone restructuring. As a result of this effort, the following entities were created:

- 7 power generation companies: Energoatom, on the basis of five nuclear power plants, four companies with large organic fuel power plants (Dniproenergo, Donbasenergo, Zakhidenergo, and Centrenergo), as well as two companies with cascading hydroelectric power plants on the Dnieper and Dniester Rivers (Dniprohidroenergo and Dnistrohidroenergo);
- 27 power distribution companies, to match the number of political subdivisions: in the Autonomous Republic of Crimea, in 24 *oblasts* and in the cities of Kiev and Sevastopol;
- Ukrenergo State Company, which included 220 kV and above power distribution trunk lines, as well as dispatch, operational and process control centers of the Single Power Grid of Ukraine;
- a company established as a separate subdivision of Ukrenergo, having an independent balance sheet, for the purposes of providing services to the wholesale power market, which at the present time has been reorganized into a fully independent company on the basis of the Resolution by the Cabinet of Ministers of Ukraine;
- the National Energy Regulatory Commission (NERC) was established, charged with the task of overseeing the activities of power market participants in order to balance different rate policy approaches and to settle other issues involving Ukrenergo, generating companies, power distribution companies and numerous end-users.

The first stage of power companies privatization (preferential sale of shares to employees and sale of various share packages through competitive bidding and stock exchange auctions) was completed in 1998, resulting in the transfer to the new owners of controlling interest (over 50% of the authorized share capital) in seven out of twenty seven power distribution companies. The number of shares sold in the remaining companies amounted to 25%-25% of the authorized share capital of these companies, except for two companies, in which 49% of shares were sold.

Based on the analysis of the results of the first phase of privatization, the main rules governing the procedure of bidding and share package sale were substantially adjusted on the basis of the Decree by the President of Ukraine No. 944 dated 08/02/99, "On Certain Aspects of the Privatization of Power Industry Complex Entities." The new competitive bidding procedures make substantial use of the international experience pertaining to power sector privatization, as

well as advice and suggestions offered by international organizations, investment banks and potential strategic investors. The key differences of the new regulation, which has been approved by the joint Order of the State Property Fund, Minenergo, Antimonopoly Committee, and the State Securities and Stock Exchange Committee and filed with the Ministry of Justice, are as follows:

- the share packages offered for sale represent a higher-than-controlling interest;
- the share packages are sold pursuant to the instructions of the privatization advisors selected through a competitive bidding process out of prestigious foreign investment banks possessing considerable positive experience in the area of power companies privatization; the first round of competitive advisor selection for the group of seven power distribution companies has already taken place – out of six candidates, Credit Suisse First Boston Bank emerged as the winner. The next round of bidding for the selection of the privatization advisor will be announced in the near future, following the adjustments to the existing procedure with the aim of bringing the rules governing the competitive bidding process as close as possible to the general European standards;
- participation in the competitive bidding for share packages shall be open to pre-qualified strategic investors with power company management experience;
- in the process of bids preparation, the participants shall be allotted an adequate period of time to conduct due diligence with regard to power companies offered for sale;
- the competitive bidding preparation and implementation process shall be open and shall be widely publicized in mass media, including international mass media, and through the Internet;
- the terms and conditions of holding competitive bidding, as well as bidding results shall be coordinated with the **Cabinet of Ministers of Ukraine**, since we anticipate that parallel to the privatization process, different governmental agencies will work on resolving various aspects of power companies operations related to production, financial and economic activities.

It is anticipated that subsequent bidding will involve two groups of power distribution companies, with a single advisor competitively selected for both groups of companies. Privatization of power generation companies will begin upon the completion of *oblenergo* privatization.

The main goal of power companies privatization is to provide income for the state budget and to obtain resources from strategic investors in support of the Ukrainian power sector modernization and upgrading, with the introduction of state-of-the-art technologies and advanced management techniques, which will in turn provide a real opportunity for the integration of the Ukrainian power industry into the pan-European power system. As of today, the international 750 kV power transmission trunk lines connecting Ukraine to its Western neighbors remain virtually unloaded.

Based on these goals, and proceeding from the analysis of the most recent strategic investor experience in other countries (such as Hungary, Kazakhstan, Georgia, Moldova, etc.), we expect revisions to be made in May, 2000 to the aforementioned Presidential Decree, “On Certain Aspects of the Privatization of Power Industry Complex Entities,” which will involve a

significant increase in the size of share packages in power companies to be offered for sale through the competitive bidding procedure. The purchase of such share packages will grant the strategic investors full ownership rights with regard to the corresponding company.

We would like to express our particular gratitude to consultants from donor countries and international financial organizations, for their help in the process of preparing for and implementing the privatization of the Ukrainian power sector. This assistance has been highly qualified in nature and quite adequate in its scope, even though now and then we still encounter unsolved issues and misunderstandings primarily due to the differences in legislation between countries. In such cases, it is always possible to reach a reasonable compromise, which will result, as we hope, in the successful completion of the Ukrainian power companies privatization process.

O.V. Ryabchenko
Head, Special Supervisory Commission
on Privatization
Supreme Council of Ukraine

Privatization of the Ukrainian Power Sector

In the economy of any country, power industry serves as one of the key sectors whose efficient performance assures stable functioning of the entire economic system. Of particular urgency in this context are the issues of denationalization of the Ukrainian power sector.

The Ukrainian power sector is currently going through hard times. Such phenomena as power outages, financial constraints of power companies, lack of working capital, misappropriation and corruption have become a part of everyday life. The power sector finds itself in a serious crisis of non-payments. The debt for electric power consumption keeps on growing: as of May 19, 2000, it has reached the level of 9.6 billion grivnas (including 2,894.376 million gr. due to privatized *Oblenergos*; 640.659 million gr. due to *Oblenergos* under the control of the local administration; and 6,080.253 million gr. due to state-owned *Oblenergos*.) The situation is exacerbated by the low level of cash payments for the consumed power resources. Thus, in April of 2000, the average collection of cash payments amounted to merely 20.8% of consumed power. In addition, the technical condition of key generation facilities dramatically declined in the previous year.

The government lacks adequate financial resources needed to take the sector out of the crisis. Therefore, far-reaching denationalization and privatization of power utilities, along with further development of market mechanisms and modern management approaches, are seen as the primary path towards the rehabilitation of the Ukrainian power complex.

The starting point in the Ukrainian power sector privatization was defined by the Presidential Decree, "On Ukrainian Power Complex Restructuring", dated April 4, 1995, on the basis of which 33 public utilities were established (27 power supply companies and 6 generating companies), and by the November 15, 1995 Resolution by the Cabinet of Ministers of Ukraine No. 911, "On Priority Measures in the Implementation of the Program of Action by the Cabinet of Ministers of Ukraine for 1995 – 1996," which provided for the beginning of partial privatization of power companies in 1996 (with the government retaining the controlling interest in the privatized companies).

The process of power sector companies privatization can be conditionally broken down into three phases. The first and most active phase lasted through April 1998 and was characterized by a relatively high interest toward the stock offered for sale. During this period, the State Property Fund sold a total of 22 share packages to portfolio and strategic investors at stock exchanges and *PFTS*, which amounted to 99.1 million gr. The mean factor by which the selling price exceeded the offering price was 1.54.

In the course of the privileged privatization which took place during the first phase, the employees of power utilities acquired from 10 to 34% of their shares in exchange for privatization certificates and for cash. These privileged sales yielded 88.8 million gr.

In 1997, 18 commercial tenders for power utilities share packages were announced. Only 9 tenders were actually held, resulting in the execution of share purchase and sale agreements worth 191,941 thousand gr. In addition, the new owners took upon themselves an obligation to invest by 2003 a total amount of 324.8 million gr. and 13.3 million dollars. The selling price exceeded the offering price by a factor of 1.63.

The total amount of cash proceeds from the privatization of power companies into the off-budget privatization fund was 379.8 million gr., or 36.9% of the overall inflow of privatization revenues into the off-budget State Privatization Fund in the 1992 – 1999 period.

By combining the shares purchased through tenders and in the secondary market, private owners have obtained a controlling interest in seven power distribution companies and a blocking interest in two additional distribution companies.

In their preparations for the sale of the corresponding share packages in *Oblenergos*, governmental authorities were counting, first and foremost, on the participation in the process of established industrial investors, with power industry operations background and adequate financial resources for resolving the existing problems.

The actual experience has shown, however, that within a short period of time, the share packages which had been sold turned up in the hands of a number of affiliated offshore companies, so that instead of interacting with industrial investors, the government had to develop the tactics of dealing with financial investors.

Correspondingly, the approaches to interacting with investors had to be somewhat modified. The majority of issues to be addressed were related to the mechanisms of payments on the Power Market, to payment procedures, and to rate development, whereas the issues of technological upgrading, rehabilitation of power facilities, increased power supply self-sufficiency of Ukraine and reduced dependence on imports of inputs and processed materials were forced in the background.

The main cause for this state of affairs was the unwillingness on the part of the government to sell its controlling interest in *Oblenergos* through tenders. The new owners of the stock purchased through tenders were not responsible for the performance of the enterprises, even in situations when they managed to secure the controlling interest via the secondary market. In this setting, the government did not perceive the privatization process to be either transparent or sufficiently effective.

The second phase of power companies privatization was commenced in June of 1998. The guidelines related to the privatization of power facilities in 1998 were established by the April 18, 1998 Resolution by the Cabinet of Ministers of Ukraine No. 508, "On the Approval of the Plan of Financial Revitalization of the Ukrainian Power Sector," which specifically provided for the completion in 1998 of the privileged sales process and for the execution by January 1, 1999 of tender sales of shares in 15 *Oblenergos*.

As a result, the State Property Fund made plans for the sale of 16 share packages in power distribution companies, with the overall par value of 39.9 million gr. However, the Cabinet of Ministers of Ukraine (CMU), in view of the financial crisis and the corresponding decline in the market value of the shares offered for sale, suspended the sale (Par. 7 of the "Additional Instructions" of the Extract from the Minutes No. 23, June 18, 1998 Session of the Cabinet of Ministers of Ukraine). The state-owned share in the authorized capital of power distribution companies was raised from 25% to 50% + 1 share.

The practice of transferring state-owned shares to local administrative bodies was widespread at the time. Unfortunately, off-tender transfers to commercial entities, as well as the dispersion of management rights between regional and sectoral authorities, did not facilitate the attraction of strategic investors to the power sector, nor did it help in securing revenues for the public budget.

The second phase was characterized by a discrepancy in the positions of the Power Industry Ministry and of the State Property Fund as to the direction of the revival of the power companies privatization process, and also by the uncertainty on the part of the Power Industry Ministry concerning the mechanism of sector denationalization.

The commencement of the third phase of the Ukrainian power sector privatization was associated with the passing of the Presidential Decree, "On Certain Issues Related to the Privatization of Power Complex Facilities" No. 944 dated August 2, 1999, which stated, among other things, that tenders primarily involving the sale of controlling interest in power companies will require the participation of hired advisers, and that share packages could be sold only to entities which possess prior experience of managing power complex facilities and of operating in the power market.

In the execution of this Presidential Decree, the State Property Fund, jointly with the Antimonopoly Committee, State Securities and Exchange Commission, and Power Industry Ministry, prepared Bidding Guidelines for the Acquisition of Shares in Power Companies.

In December 1999, the State Property Fund announced the bidding process for the selection of an adviser to provide services in the preparation for and holding of a tender for the sale of shares in seven utilities: *Kievoblenergo* (50% + 1), *Rivneoblenergo* (50% + 1), *Zhitomiroblenergo* (50% + 1), *Sevastopolmiskenergo* (45%), *Mikolaivoblenergo* (45%), *Khersonoblenergo* (40%), and *Kirovogradoblenergo* (26%). CS First Boston Bank emerged as the winning bidder, with whom the State Property Fund of Ukraine signed on May 23, 2000 a Consulting Services Agreement. The sale of shares in the aforementioned group of *Oblenergos* is planned for December 2000, and it is expected that at least 600 million gr. will be received, to be cashed in 2001.

On the basis of its Order dated February 21, 2000, the State Property Fund has resumed the sale of power companies shares at stock exchanges and through *PFTS* tenders.

It is expected that a Presidential Decree will be passed soon, eliminating the constraints associated with the state-held shares in *Oblenergos*.

The passing of the Law of Ukraine, "On the National Privatization Program," was a step forward in the progress of privatization. The most important feature of this Law is that unlike the Programs of the previous years, the new Law extends the term of the current Program to three years (2000 – 2002). The Law includes the provisions for the privatization of public property exclusively for cash. This privatization program designates a change in the priorities, which involves a move from massive privatization to more individualized approaches, fully taking into account in the denationalization of enterprises their unique characteristics, the market conditions, the demand for specific facilities, and so on. Furthermore, a new approach to the grouping of the privatized facilities has been introduced, along with a more efficient and transparent procedure of securing public ownership of *VAT* shares, a new approach toward the sale of controlling interest to industrial investors without mandatory investment commitments, the elimination of privileges related to free transfer of shares to company employees, a refined procedure of preparation of enterprises for privatization, the engagement of domestic and foreign advisers, independent consultants and experts for the assistance in the process of preparing companies for privatization.

The Law sets forth the goal of the total privatization in 2000 of 1,094 medium and large enterprises, with approximately 600 additional facilities privatized in 2001 – 2002. The plans include the generation of privatization revenues for the Ukrainian national budget in the total amount of 2.5 billion gr. in 2000, and an equivalent of US \$1.5 billion and US \$1.0 billion in 2001-2002, respectively.

The plans also include the provision of additional funds for the Ukrainian budget during the same period from the privatization of power sector companies through the involvement in the sector of industrial investors. It is further hoped that the industrial investors would revitalize the economic situation in the sector.

At this stage, potential foreign investors view participation in the Ukrainian power sector privatization processes with a certain degree of wariness. This attitude on the part of the investors is influenced by a number of factors, such as instability and imperfection of the current legislation, government interference in the financial and economic affairs of private entities, incomplete sector restructuring, and so on.

Thus, the need for changes and improvements in the sector is still great. Nevertheless, denationalization of the power sector of Ukraine continues. Today, all the prerequisites exist to support further progress in this area, provided appropriate changes are implemented.

The reform of the Ukrainian power sector is only one of the elements of the country's overall economic transformation. Privatization processes are a decisive force in the effort to build an effective market system in Ukraine. There is no alternative to well-managed large-scale privatization of medium and large enterprises in Ukraine.



Power Sector Privatisation in Central / Eastern Europe and Eurasia: Results and Future Plans

DIRECTIONS OF POLISH ENERGY SECTOR PRIVATISATION

Budapest, Hungary, June 6 - 8, 2000



GENERAL AIMS OF POLISH ENERGY SECTOR PRIVATISATION

Privatisation processes, which have been implemented throughout the entire transformation period in Poland, aim at:

- improvement of management in privatised entities
- increase of competitiveness of companies on domestic and foreign markets with the view to the unification with the European structures and globalisation
- development and strengthening of the domestic capital market

Currently the Polish energy sector consists of three subsectors:

- generation: 17 power plants, 33 GW of installed power capacity, 101 TWh of yearly production
- transmission: 1 company, PSE S.A.: 750kV - 114km, 400kV - 4552km, 220kV - 7884km, 110kV - 27km
- distribution: 33 companies; <110kV - 506 096km

Stron 2



STRATEGIC OBJECTIVES OF POLISH ENERGY SECTOR PRIVATISATION

There are following primary strategic objectives of the Polish energy sector privatisation strategy:

- Consumer protection by creating a free energy market
- Maintenance of energy security of the State
- Creation of an appropriate capital base for a rational level of investment within the realms of integration with the European Union
- Optimisation of social security of employees of the sub-sector
- Optimisation of income from privatisation

Slide 3



POLISH PRIVATISATION EXAMPLES (heat generation plants)
ELEKTROCIĘPŁOWNIA KRAKÓW S.A. - FIRST POLISH COMPANY FROM ENERGY SECTOR WHICH WAS PRIVATISED

ELEKTROCIĘPŁOWNIA „KRAKÓW” S.A.

Schedule

1. The Ministry of State Treasury received seven offers for acquiring EC Kraków in 1996
2. Three potential investors were chosen in 1996:
 - EDF
 - Coastal Power
 - Rumel
3. Rumel was excluded from group of potential investors at the beginning of 1997
4. EDF obtained exclusivity for negotiations
5. Ministry of State Treasury signed with EDF privatisation agreement in October 1997
6. Transaction was completed in May 1998. EDF acquired 55% stake in EC Kraków

Transaction

1. Transaction value	USD 78.8 million	3. Price per 1 kW (cWw + kWb)	USD 75.7
2. Price per share	USD 24.6	4. Price per 1 kW (cWw)	USD 315.4

Investor Obligation

1. EDF is obliged to spend USD 5 million on modernization of the company
2. EDF was obliged to increase equity by USD 10 million (done)

Slide 4

POLISH PRIVATISATION EXAMPLES (power producers)
ZESPÓŁ ELEKTROWNI PAŃNÓW ADAMÓW KONIN S.A. - FIRST PRIVATISED POLISH POWER STATION

ZESPÓŁ ELEKTROWNI PAŃNÓW-ADAMÓW-KONIN S.A.

Schedule

- 12.09.1997 - public invitation to negotiations
- 24.10.1997 - National Power, Konsorcjum Elektrum, Cal Energy Inc. and AES Electric Ltd. lodged their preliminary offers
- 7.03.1998 - National Power and Konsorcjum Elektrum (which consists of among others, Cal Energy Inc. as Ministry of State Treasury agreed) made binding offers. AES withdrew from the process
- 30.09.1998 - National Power obtained the exclusivity for negotiations and then withdrew from transaction, just before signing an agreement
- 07.01.1999 - Konsorcjum Elektrum obtained exclusivity for negotiations
- 30.03.1999 - Signing privatisation agreement
- 30.08.1999 - Transaction was completed. Elektrum took over 20% stake in ZE PAK S.A.

Transaction

1. Transaction value	USD 87.9 million	3. Price per 1 KW (MW+MW)	USD 132.36
2. Price per share	USD 65.9	4. Price per 1 KW (MW)	USD 160.54

Investor Obligation

- Elektrum is obliged to make investments worth USD 1 billion within next 10 years
- Elektrum is required to increase equity by USD 100 million
- Elektrum is obliged to reinvest capital gained from selling company assets

Slide 7

POLISH PRIVATISATION EXAMPLES (power producers)
ELEKTROWNIA IM. TADEUSZA KOŚCIUSZKI S.A. - POLISH FOURTH BIGGEST POWER STATION IN TERMS OF INSTALLED CAPACITY

Elektrownia im. Tadeusza Kościuszki w Potańcu S.A.

Schedule

- Ministry of State Treasury invited potential investors to negotiations in August 1999
- Deadline for making binding offers was set for 4.10.1999
- Short list, that was created in October 1999, consisted of such potential investors as: Tractebel, AES, Exxam Power and Energy
- Exclusivity for further negotiations was granted to Tractebel
- Privatisation agreement was signed on 6.04.2000
- According to signed agreement, Tractebel took over 25 % stake plus one share in Elektrownia Polaniec

Transaction

1. Transaction value	Euro 67.6 million (USD 63.9 million)	3. Price per 1 MW	USD 106.36
2. Price per share	Euro 50 (USD 48)		

Investor Obligation

- By the end of 2005 investments will amount to at least Euro 45 million and by the end of 2010 - Euro 330 million
- Investor will increase equity by Euro 61.6 million within 2 - 2.5 years
- Employees have guarantee of employment for the next 10 years. They will also get privatisation premium

Slide 8



THE IMPORTANT ELEMENT OF THE POLISH ENERGY MARKET WILL BE POLISH POWER EXCHANGE, WHICH IS OWNED PARTIALLY BY THE STATE TREASURY AND PRIVATE COMPANIES

Polish power exchange ownership structure:

The State Treasury (30%)	GZE S.A. (energy distribution company, 6%)
Endessa (10%)	Energa S.A. (energy distribution company, 5%)
Elektrim S.A. (10%)	STOEN S.A. (energy distribution company, 2%)
Polish Power Grid S.A. (10%)	Elektrim Volt (four energy distributors, 1%)
Warsaw Stock Exchange (10%)	Bergen Energii (1%)
El. Opole (power plant, 7%)	Polish Railways (1%)
ZE PAK (power plant, 6%)	DM Penetrator S.A. (stockbroker, 1%)

The company was registered in December 1999 after the 4 months tender procedure organised by the Ministry of State Treasury. On May 24th, 1999 the Supervisory Board of Power Exchange S.A. accepted the first version of the Trade Regulations. The first transactions are planned for the end of June 2000

Slide 9



HEAT GENERATION PLANTS PRIVATISATION

Zespół Elektrociepłowni Wytorska S.A. w Odleszku
The Ministry of State Treasury assumes that the privatisation agreement should be signed in June 2000. Currently the final contract between the State Treasury and investor (consortium EDF-GdF) is in the last stages of the legal approval. The detailed negotiation of the social package with the workers' representatives has been finalised. The details of the contract are under verification and approval process by both parties.

Elektrociepłownia Zielona Góra S.A.
The Ministry of State Treasury assumes that the privatisation agreement should be signed by the end of 2000 beginning 2001. The privatisation strategy has not been decided yet.

Elektrociepłownia Białystok S.A.
The Ministry of State Treasury assumes that the privatisation agreement should be signed in the second half of this year. The evaluation of the potential investors offers who have answered to the invitation published in April, will be finished in June.

Elektrociepłownia Tychy S.A.
Pre-privatisation advisor was selected by way of a public tender. The Ministry of State Treasury has accepted all privatisation reports. The privatisation strategy will be decided in June.

The Ministry of State Treasury assumes that in the next few years 3 to 5 companies (from this subsector) will be privatised annually, so that the heat generation plant privatisation process could be finished in 2002

Slide 10



POWER PLANTS PRIVATISATION

Lignite Mine Belchatów, Powerplant Belchatów

In April 2000 The Ministry of State Treasury finished the privatisation advisor selection process for Kopalnia Węgla Brunatnego Belchatów S.A. lignite mine and Elektroenergia Belchatów S.A. (the largest lignite-operated power plant in Poland, 4,320 MW), which should make their privatisation possible in 2001 (introduction of the same strategic investor or listing on the Warsaw Stock Exchange). The advisor for the privatisation of both companies has just been selected

South Energy Company

The procedure for the consolidation and future privatisation of "South Energy Company S.A." has been accepted by the Ministry of State Treasury. This company will consist of Jaworzno III, Łaziska, Halemba, Łagisza and Siersza brown coal power producers. The consolidation will start in June and the privatisation advisor for this group should be selected in this year. The market potential of this group is significant and it will have the big impact on Polish energy market in this region. New company will operate about 4,500 MW

Side 11



ENERGY DISTRIBUTORS PRIVATISATION

Górnśląskie Zakłady Energetyczne S.A.

Process of the selection and negotiations with the potential investors for GZE S.A. in Gliwice should be finalised in the 3Q of 2000. The contract for the sale of 25% shares is planned for 4Q of 2000. GZE S.A. is the biggest single power distributor with app. 8 % of Polish market

The group of 8 distributors (EDCs) from North-West Poland

The privatisation advisor started its work in May 2000. The draft reports are planned for the end of August 2000. The approval of the reports is planned for the 3Q of 2000. The exact privatisation strategy and the announcement of the negotiation process for the potential investors is planned in the beginning of 4Q of 2000. The whole group of these companies (Kozalin, Slupsk, Energa, Olsztyn, Elblag, Toruń, Kalisz and Plock) will eventually be sold as a one package. The sale of minority package of shares is planned for 1Q of 2001

STOEN S.A.

The process for the selection of the advisor for STOEN S.A. in Warsaw has just started. The sale of the first package of shares will take place not earlier than in 2Q of 2001

The group of 4 distributors from South-East Poland

The process for the selection of the advisor for a group of 4 energy distributors in South-East Poland will start soon. Their privatisation is planned for the second half of 2001

Privatisation of Polskie Sieci Elektroenergetyczne S.A. (Polish Power Grid) will begin in 2002

Side 12



CONCLUSIONS

- Privatisation procedure is aimed to be as clear as possible and it should ensure an opportunity to anyone to participate in this process if the requirements of the Ministry of State Treasury are met
- Privatisation through Invitation to negotiations should give an investor a sufficient level of confidence that privatisation process will be run transparently, so that investor is able to invest safely new capital
- Energy Law, which is compatible with EU directives and the Independent regulator (URE) created fair conditions for investors on the Polish energy market
- Poland being one of the most attractive markets in Central and Eastern Europe creates promising prospectives for energy sector companies

Slide 13

POWER SECTOR PRIVATIZATION IN ROMANIA

Dr. Eng. Nicolae Liciu
Ministry of Industry and Trade

I. General Framework

Electricity and heat sector is a key element of the Romania economy.

Privatization philosophy and objectives for Romanian power sector are, generally speaking, the same as for other different branches of our national economy, naturally with specific features of the sector.

Recently, Romanian Government with other numerous specialists has elaborated a Romania's Medium Term Economic Strategy, which was sent to the European Commission in Brussels.

The crux of this project is the creation of a smooth functioning market economy, consistent with EU principles, norms, mechanisms, institutions and policies.

In this framework, a special Commission has elaborated a document named "Energy and Energy Policy", and an "Action Plan for Governmental Programs for the year 2000 and 2001-2004 period."

These documents show that financial needs, the achievement of competition capability on the market at the EU level, inter alia, make a necessity to privatize some activities from the energy sector. We consider that, at the level of 2005 year, an important share of energy activities, excepting those realized via public property, must be made in the private sector.

The pace and privatization methods must take into consideration the need for obtaining a high price for the selected energy assets proposed to the sale, simultaneously with the energy reliability and fulfillment of post-privatization objectives (infrastructure modernization, increasing of financial viability and of competition capability for economic companies on the market.)

We think that it is important to attract for privatization process representative and strong companies, acting on the EU market, preferably from holding type big companies, which are born today, through mergers, and which probably will dominate EU power market.

Also, we consider essential that obtained funds from privatization to be in majority reimbursed as investments in energy sector.

Privatization process must not neglect the possible contribution of Romanian capital, including interests of local communities, and of employees.

Privatization process through capital investments could find a solution for financing investments, development of corporative governance, and of a modern management, penetration on third markets.

Recovery of the private invested capital could have as a consequence, however, in the first stage, an increase of tariffs, and needs state guarantees (at least, in the case of an insufficient country rating).

If the economic feasibility is demonstrated, must be stimulated capital investments in joint-ventures for ending investments project started before, and stopped or with a little progress of works.

As we have shown before, the pace and privatization methods must be tailor-made for each part of the power sector.

One way will be private investments for realizing for the beginning about 200 MW as independent power producers (IPP).

Also, some cogeneration plants or thermal plants could be sold, as well as other installations from thermal energy field.

We take into consideration to offer as concessions many hydro-power plants started before 1989, but unfinished due to our lack of funding.

In this stage, we think to maintain the transmission network in the state property.

For the distribution network, the optional ways for attracting private capital will be adopted after a specific PHARE study, in progress now, will be finalized this fall.

All this evolution is based on Governmental Decision no. 138/2000 regarding the further development of restructuring process in CONEL (National Power Company), in Romania, and on progress made in elaborating new legislation, especially secondary one, in which an important role had and has the two years ago founded National Authority for Regulation in the Energy Field (ANRE), making many of necessary power market regulations.

For instance, this year we have introduced eligible customers and we have open power market, for the beginning with a little percent, but so we could examine the consequences and to promote the best ways for further liberalization of power market.

Before starting to present specific features of our thinking in attracting private capital in different parts of power sector, let us introduce some data about our national electricity system (Figure 1-3).

As it is known, the National Power Company emerged based on the Governmental Decision no. 365/1998, stating the reshape of the former RENEL (National Electricity Authority) by spinning off the nuclear sector and design and research activities and by splitting off its own subsidiaries as joint stock commercial companies, having the status of legal persons: S.C. termoelectrica-S.A., S.C. Hidroelectrica-S.A. and S.C. Electrica-S. A.

II. Further Restructuring and Privatization in S.C. Termoelectrica – S.A.

Termoelectrica is yet one of CONEL'S subsidiaries, a joint stock commercial company, an independent legal person whose sole holder is, for the time being, CONEL.

The main activities developed by Termoelectrica are generation and selling of power and heat produced in fossil fuel-fired power plants. This company is also involved in heat transport and distribution to the district heating systems which it manages.

Termoelectrica owns 20 power branches including 40 thermal power plants, 11 thermal plants and 6 small hydro-power plants, spread over the whole country.

At the 31st of December 1998, Termoelectrica had an overall installed capacity of 13.9 GW, of which 61% coal firing (lignite and hard coal) and 39% hydrocarbons-firing.

Of the installed electric power, ca. 48% is represented by the cogeneration units and 52% by the condensing units.

Termoelectrica owns also installed capacities for heat generation amounting to more than 11,500 t/h for steam and 18,200 Gcal/h for hot water.

The age of these units is as follows:

- 0 – 5 years	6%
- 6 – 10 years	10%
- 11 – 20 years	37%
- over 20 years	47%

One of the main problems is that Termoelectrica faces is the high installed capacity excess as against the power and heat demand which has been seriously decreased after 1989.

We had therefore to take out of operation a great number of power units which are now under conservation and, function of the demand evolution, the ones being under the poorest condition and having the lowest performances will be decommissioned.

Additionally, there are also capacities amounting to ca. 1 GW which had to be decommissioned at their standard life time elapse, but due to lack of funds, this activity could not be carried out, so far.

The general framework in which the company is developing its activities is characterized by the following political and social factors:

- government legislation policy;
- electricity and heat tariffs policy promoted by the newly set up National Authority for Regulation in the Energy Field, as regards, the relationship between the entities within CONEL, Nuclearelectrica and other independent producers and the end-users as well;
- government support for the restructuring process;
- trade unions actions.

At present, Termoelectrica is competing on our power market with Hydroelectrica, Nuclearelectrica, and with some small independent producers (the most important being the former thermal power plants of CONEL: Govora and Tr. Severin).

In a close future, new independent power producers will be set up and, according to the information received from some industrial consumers, they are willing to invest in small and medium – size power generating units which should provide the energy necessary for developing their own activities.

Regarding heat market, at present Termoelectrica heat weight is ca. 40% of the whole heat delivery and ca. 60% of the heat amount delivered to the residential consumers.

Two components occur on this market:

- steam supply, where there has already occurred the trend of some consumers to invest in their own capacities in parallel, generally with a serious consumption diminishing;
- hot water for heating and domestic hot water preparation, where there are also some cases of urban consumers who want to create or even have already created some individual heat sources.

In order to develop its activity on a highly reliable commercial ground, based on the forecast studies concerning the Romanian power and heat demand and on the optimal load distribution so far developed, Termoelectrica has already proceeded to some optional restructuring-oriented solutions.

Based on the technical, economical, and financial analysis on the present situation, in order to set the specific measures urged for the company economical reinvigoration, a strategy has been drawn up concerning the future of the thermo-power plants included in the present patrimony of Termoelectrica and which have been grouped by categories as follows:

1. Thermal power plants or parts of them that are of utmost importance for the National Power System (NPS) operation, which are remaining in a power and heat generation company being under the direct state control.

As regards this power plant category, the option to attract private investors is Termoelectrica capitalization by issuing stocks to be sold, but maintaining the state control as a majority shareholder, in a first stage (less than 2 years).

Mention should be made that concerning the lignite-fired power plants and the hard-coal-fired ones, we foresee the opportunity of setting up some holdings with the mines supplying coal to these power plants.

2. Thermal power plants or parts of them which due to their attractiveness, efficiency, and a relative constant heat market as well as due to the requirement of some important investment achievement, are proposed to be the Termoelectrica's participation quota in the new joint ventures-independent power producers.
3. Thermal power plants or thermal plants which due to their local importance are proposed to become independent commercial companies or to be transferred, based on governmental

decisions, to other economic agents being under the municipalities subordination. These thermal power plants future operation is not needed to cover the NPS load curve, they are only necessary for ensuring the heating of some towns.

4. Thermal power plants or thermal plants which due to their poor financial condition or their physical and moral extended wear, are proposed to be sold (entirely or by parts.)

III. Further Restructuring Process and Attracting Private Investors in Hydro-Power Subsector

The restructuring process for Hydroelectrica will be followed and the company will be consolidated.

As we have mentioned, there are started before 1989 about 900 MW, with about 1.3 TWh/year electricity output.

It is presented in the table "investment project proposed for financing to foreign potential investors," in which there are mentioned project cost updated in 2000, and we can discuss about main features of each project.

In the care of hydro-power plants we take into account the concession procedure. Also, we try to introduce in our legislation a procedure BOT with "sunk costs."

Also, a hydro-power plants (ca. 1000 MW), with pumping – storage capacity in Tarnite is envisaged (eventually for only 500 MW).

We have started the rehabilitation process for our biggest hydro-power plants (Iron Gates I), with a consortium led by Sulzer SA.

IV. Electricity Distribution Network Restructuring and Privatization

Now, Electrica – SA has 42 subsidiaries. With a PHARE project, we try to find the best solution for restructuring these in 8-14 legal independent companies, to consolidate these new ones, and after a time to privatize two of them for the beginning.

It is important to mention that in the strategy for the period 2001-2004, it was precised as an important objective to privatize each year a minimum of two generation companies, and two distribution companies.

* * * *

In conclusion, the restructuring and privatization process of power sector in Romania is in progress, and we could give many other details in the discussions.

MAIN PRODUCTION OF PRIMARY ENERGY

				Year 1998 in % regarding Year 1997		
	Total	Production	Import	Total	Production	Import
- physical units -						
Coal (thou tonnes)	29990.4	26124.3	3866.1	76.8	77.3	73.7
Crude Oil (thou tonnes)	12126.4	6286.8	5839.6	95.0	96.5	93.5
Natural gas (Mil. mc 15° C)	18664.1	14008.9	4655.2	93.3	92.2	96.8
Hydroelectric energy. Nuclear-electric energy and imported electric energy (Mil. KWh)	25365.3	24184.1	1181.1	105.9	105.6	113.8
Imported petroleum products (thou tonnes)	2715.1	-	2715.1	69.4	-	69.4
- thou tonnes conventional fuel (equivalent coal 7000 kcal/kg) -						
Resources total out of which	55100.7	35108.8	19991.9	88.7	90.4	85.8
- Coal	9530.0	7229.8	2300.2	75.9	76.7	73.7
- Crude oil	17064.5	8719.8	8344.7	95.0	96.5	93.5
- Natural gas	21538.0	16184.5	5353.5	93.3	92.2	96.8
- Hydroelectric energy. Nuclear-electric energy and imported electric energy	3120.0	2974.7	145.3	105.9	92.2	113.8
- Imported petroleum products	3752.6	-	3752.6	69.4	105.6	69.4

ENERGY ELECTRIC BALANCE

	Mil. kWh	
	Year 1998	Year 1998 in % regarding year 1997
Resources – total	53666.5	92.2
Production	52485.3	91.8
Import	1181.2	113.8
Destinations – total	53666.5	92.2
Out of which		
- Final consumption	46213.7	90.8
• economy	37657.8	89.0
• public lighting	397.7	113.0
• population	7858.2	99.8
- Own technology consumption in networks and substations	6737.4	104.0
- Export	715.4	87.5

**INVESTMENT PROJECTS PROPOSED FOR FINANCING
TO POTENTIAL FOREIGN INVESTORS**

Cod project	Domain company	Name of the projects	Remaining investment Project costs updated by MIT. Order No. 16/2000 (in Dec. 98 rates) – M USD	
			Total	Of which external sources
1.23	CONEL SA Cucuresti Production, transport and distribution of electricity system production and production and transport of the thermal energy	High voltage conversion AC/DC/AC "BACK TO BACK" type in the 750/400 KV Isaccea substation	92	92
1.24		CERNA RIVER – Stage II VAJA DAM and CLOCOTIS hydro power station Completion of construction	75.4	75.4
1.28		SURDUC – H.P.S. NEHOIASU hydro power station Completion of construction	425.6	425.6
1.29		STREI – SUBCETATE hydro power station Completion of construction	207.5	207.5
1.30		RUNCU – FIRIZA hydro power station Completion of construction	58.7	58.7
1.31		RAUL ALB hydro power station Completion of construction	200	200
1.32		BORCA POIANA TEIULUI Completion of construction	126.7	126.7
1.33		COSMESTI MOVILENI Completion of construction	242.8	242.8
1.34		CORNETU – AVRIG Completion of construction	285.8	285.8

INSTALLED POWER IN ROMANIA AT

01.01.1999

- according to the UCTE methodology -

	MW
Total	17570.9
from which:	
I. TPP	10,900.2
From which:	
• In condensing power plants	6190.0
• Combined electro and district heating power-plants	4710.2
II. H.P.P.	5964.2
III. N.P.P.	706.5
From the total:	17570.9
a) National Company for Electricity (CONEL)	15879.0
from which:	
• In condensing power plants	6190.0
• Combined electro and district heating power - plants	3755.0
• H.P.P.	5934.0
From total termo CONEL:	9945.0
• Coal - fuel	5934.0
• Hydrocarbonate - fuel	4011.0
b) Self-producers:	585.4
from which:	
• Hydrocarbonate - fuel	555.2
c) I.P.P.:	1106.5
from which:	
• N.P.P.	706.5
• Combined electro and district-heating power plants	400.0

TRANSPORT AND DISTRIBUTION LINES

- 1999 -

Tension - kV	Length - km
750	154
400	4392
220	3641
110	17996
1 - 60	119884
under 1	168342
Total:	314409

STATION AND SUBSTATION

- 1999 -

Tension - kV	No.	Capacity - MVA
750	1	2500
400	21	14563
220	46	16453
110	867	37720
1 - 60	64671	23968
under 1		
Total:	65606	95204

**Ministry of Industry & Trade
Department of Energy
Electricity Regulatory Authority**

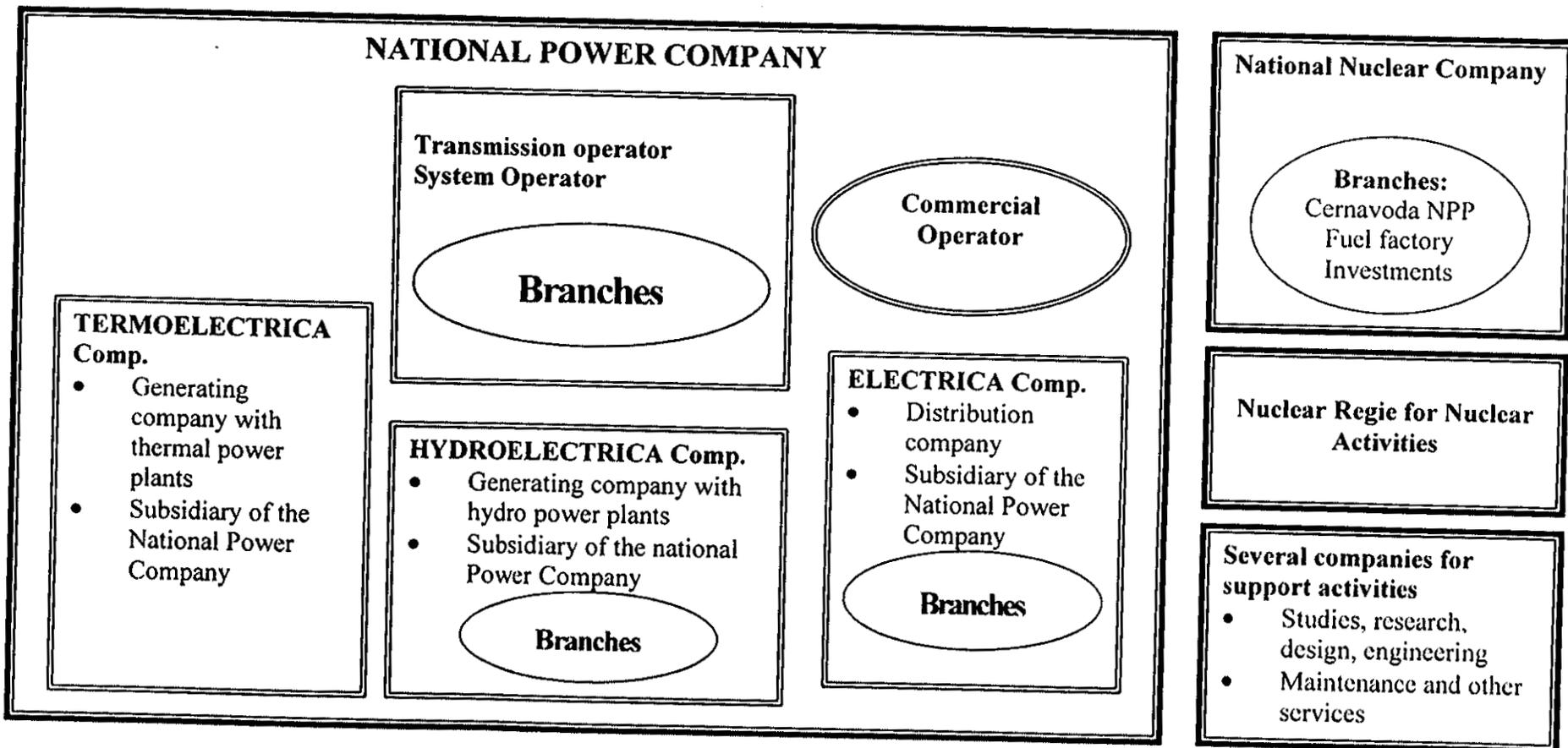


Figure 3: Electricity sector structure after the first restructuring stage

*“One never notices what has been done,
one can only see what remains to be done.”*

Marie Curie

POWER SECTOR PRIVATIZATION
IN CENTRAL/EASTERN EUROPE AND EURASIA RESULTS AND FUTURE PLANS
Budapest, June 6-8, 2000

**PRIVATIZATION IN THE
ROMANIAN
POWER SECTOR:
A CORPORATE POINT OF VIEW**

Razvan Purdila
Director of Strategy
CONEL - SA

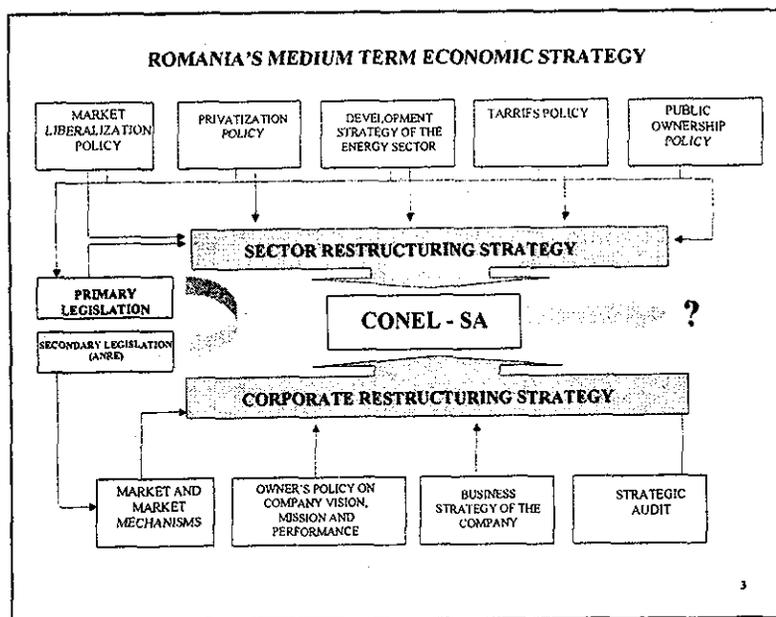
**A new strategic vision proposed for the power
sector in Romania**

- In 2010 Romania will be a full member in EU, having internalized "l'aquis communautaire" and having successfully completed the main structural adjustments;
- The electricity market will be part of the EU internal energy market, a market dominated by competition and eligible customers;
- The majority of the generation, distribution and supply activities will have to be carried-on by private businesses, not by state-owned companies;
- Significant activities in the power sector will belong to the private international group of companies (mainly from EU), now in a frantic process of repositioning, M&A;
- Trading and risk management will represent key knowledge assets for successful companies in the power sector

Main strategic objectives for privatization and capital investments

- Till 2005 an important part of the power activities must be carried on in privately owned companies;
- To attract in the privatization process major utilities acting on the EU energy market;
- To sell at the highest level possible and to use the obtained financial amounts for needed projects in the power sector;
- To facilitate the contribution of the local capital and to take care of the interests of local communities and the employees;
- IPP's and joint ventures in selected investment projects with proven economic feasibility, projects which today today are other suspended or continuing with a minimum of financing

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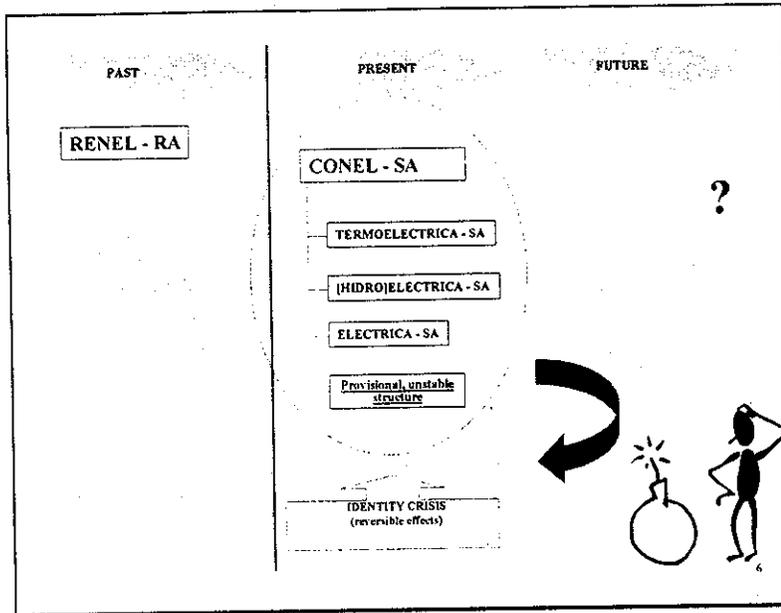
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UPS AND DOWNS IN THE REFORM PROCESS

- In the last years energy policies have been marked by oscillations, fragmentation and disputes; the reform has alternated in periods of stagnation and periods of slow progress; several political syndromes:
- In consequence the legal and institutional environment, despite many progresses, is still incomplete and unstable:
 - Example: the first draft of the electricity law has been elaborated in 1993; we might end probably the year 2000 without a proper law, discussed and approved in Parliament, from the Emergency Ordinance no. 63/98;
- For a long time privatization has not been contemplated as a true priority;
- Corporate strategies have been "captive" to political decisions;
- Electricity a slow paradigm shift: from "a sacred mission" to "trading a commodity".

A corporate reality

- In a complex and shifting environment, it has been very difficult for RENEL/CONEL to develop and properly execute corporate strategies and business plans;
 - Many projects have not been kept in budget, time and performance indicators;
- In fact corporatization is a welcomed but late discovery;
- In the last two years, CONEL has faced several problems, difficulties and even crisis, both internal and external:
 - An identity crisis;
 - A management crisis;
 - A market and cash-flow crisis;
 - A communication crisis, both with authorities, clients and mass-media;



MANY STAKEHOLDERS

- Political parties and trade unions;
- State authorities: GOR, MIT, MOF, SOF, local authorities;
- Regulator: ANRE
- Customers: captive and eligible, industrial and residential.
- Employers associations, NGOs,
- Foreign and local suppliers for the industry;
- Potential investors, foreign and local;
- **Executive management;**
- Employees and their trade unions;

• Different values and perceptions;

• Different understandings and interests;

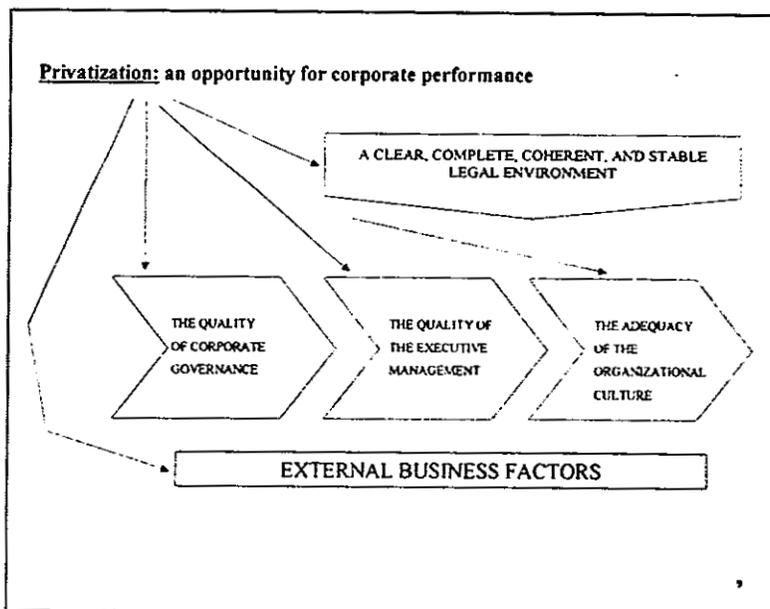
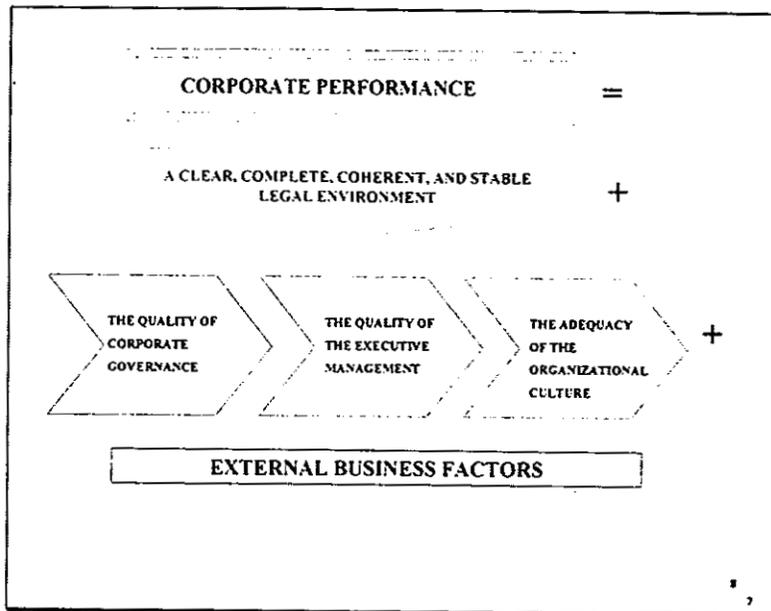
• Different policies and positions;

• Level of concentration: low;

• Probability of conflict: high;

• Level of lobbying: high;

**PRIVATIZATION
IN THE ROMANIAN
POWER SECTOR**



**Privatization: an opportunity is not a certitude;
dilemmas still exist;
a certain number of conditions must be met**

- Market liberalization and privatization: rebalancing the two processes;
- Privatization: a last resort to crisis or institutional construction; the big difference: credibility impacting on price and market structure;
- Restructuring by atomization of the power sector: how stable and adequate such a solution could be in terms of real constraints and challenges?
 - Small companies would be “sitting ducks” for foreign competition on the internal market;
 - Justified costs and transactions costs;
- How much restructuring before privatization?
- How to gain the confidence of clients, employees and trade unions?
- Significant improvements in commercial regulation;
- Privatization: when and how?

10

CONCLUSION



- Privatization could be the single, most important feature of the reform process in the Romanian power sector;
- It must be accepted; not as a “lip service”!
- It must be prepared; in proper balance with market liberalization;
- It must be executed “on the crest of the wave” with speed and resolution

11

ISEA / USAID
Regional Forum

June 6 - 8, 2000
Budapest, Hungary

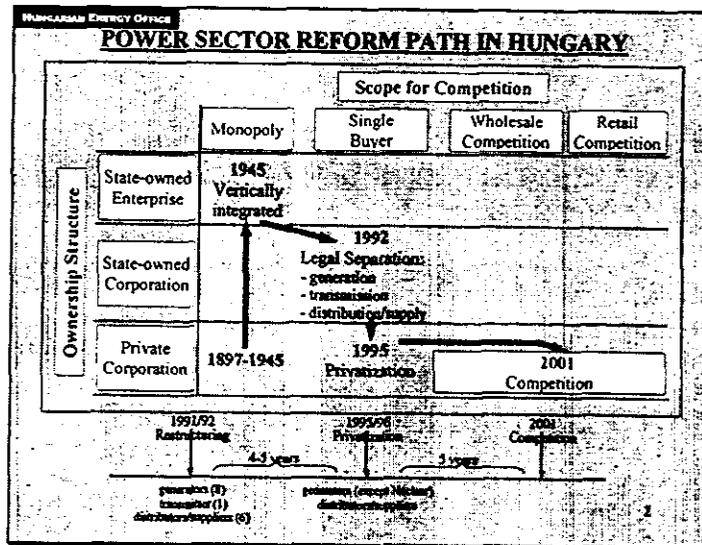
**REGIONAL FORUM
ON THE
POWER SECTOR PRIVATISATION in CENTRAL and EASTERN
EUROPE & EURASIA**

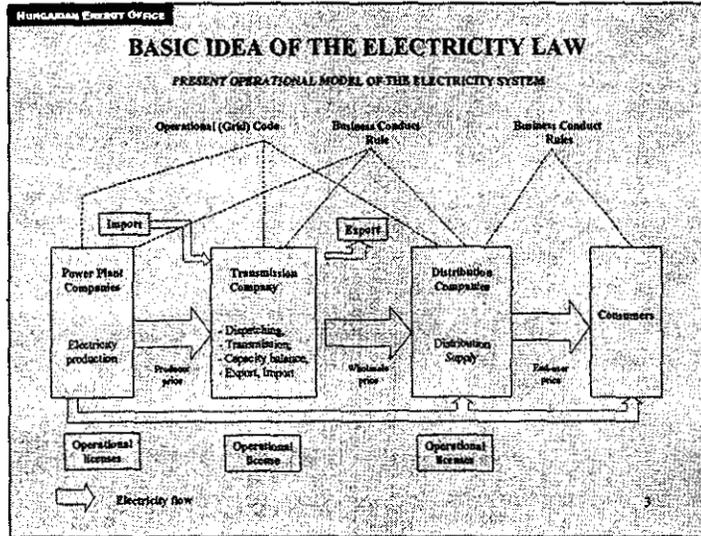
Panel: Development of the policy framework and strategy

**HUNGARIAN ELECTRICITY INDUSTRY BETWEEN
TWO REFORMS (TWO RESTRUCTURINGS) WITH
PRIVATE PARTICIPANTS**

**DR. GÁBOR SZÖRÉNYI, DEPUTY DIRECTOR
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Hungary





- HUNGARIAN ENERGY OFFICE**
- SPECIAL FEATURES OF THE PRESENT HUNGARIAN MODEL**
- TRANSMISSION COMPANY IS THE SINGLE BUYER WITHOUT OWN POWER PLANT (EXCEPT STATE OWNED (not privatized) ONES)
 - ALL OF THE GENERATORS ARE IPPs (separate legal entities)
 - REGIONAL DISTRIBUTION/SUPPLY COMPANIES WITHOUT GENERATION
 - TRANSMISSION COMPANY HAS NO COMMERCIAL CONTACT WITH THE END-USERS
 - PRICE SETTING: FOR EACH GENERATORS + WHOLESALE PRICE + END-USERS
 - BENEFITS OF THIS MODEL:
 - UNDER STATE CONTROL (restructuring, privatization):
 - SEPARATION OF ACTIVITIES, ASSETS
 - PRACTICE IN COMMERCIAL BUSINESS BETWEEN COMPANIES
 - PREPARATION OF REGULATION DETAILS
 - UNDER PRIVATE OWNERSHIP (preparing for competition):
 - COST CUTTING → READY FOR COMPETITION

HUNGARIAN ENERGY OFFICE

**LESSONS LEARNT FROM RESTRUCTURING,
PRIVATISATION AND SUGGESTIONS**

- CLEAR MODEL (responsibilities, rights, duties)
- TAKING INTO CONSIDERATION DOMESTIC CONSTRAINTS (legal, economical, technical, political, etc.)
- PREPARING FEASIBILITY STUDIES (Impact; on prices, on new investment)
- CLEAR FUTURE ROLE OF THE GOVERNMENT
- PRIVATIZATION INCOME VERSUS FUTURE PRICES
- MARKET DOMINANCE
- REGULATORY POWER (Customer + Investor Confidence, Stability, Continuity, Predictability in Decisions, Fairness)
- NO HURRY BUT CLEAR SIGNALS, RIGHT DECISIONS
- SOMEONE (Who is willing to and who can restructure / privatize) TAKE THE LEAD

HUNGARIAN ENERGY OFFICE

**BENEFITS AND DISADVANTAGES OF THE PRESENT
HUNGARIAN MODEL AND THE SEQUENCES OF THE
ACTIONS FROM LIBERALIZATION POINT OF VIEW**

- RESTRUCTURING, PREPARATION OF PRIVATIZATION:
 - SEPARATION OF ACTIVITIES, ASSETS (+)
 - PRACTICE IN COMMERCIAL BUSINESS BETWEEN COMPANIES (+)
 - PREPARATION OF REGULATION DETAILS (+)
 - PRIVATIZATION STRATEGY
- PRIVATIZATION:
 - LONG TERM PPA (-)
 - PRIVATIZATION INCOME (+)
 - KNOW HOW, MANAGEMENT PRACTICE, INVESTMENT (-)
- PREPARATION OF DEREGULATION (RE-REGULATION), COMPETITION:
 - PREPARATION OF MODEL DETAILS
 - PREPARATION OF NEW LAW, SECONDARY LEGISLATION, RE-REGULATION (-)
 - FURTHER SEPARATION OF ACTIVITIES (ISO) (-)
 - COST CUTTING → READY FOR COMPETITION (+)

INTERNATIONAL ENERGY GROUP

THREE BASIC APPROACHES OF REGULATORY PROCESSES (1)

IN EACH REGULATORY APPROACH THERE SHOULD BE A BALANCE IN:

- COMMITMENTS OF "FAIR" REGULATORY PROCESS (SAFETY OF PRIVATE INVESTORS)
- CONSTITUTIONAL PROTECTION AGAINST ADMINISTRATIVE EXPROPRIATION

REGULATORY APPROACHES:

- US - STYLE: PUBLIC UTILITY COMMISSION (NOT TOO DETAILED LEGISLATION; STRONG AND AUTONOMOUS PUCs, WHICH REALLY REGULATE ⇔ TRANSPARENT DECISION-MAKING PROCESS)

9

INTERNATIONAL ENERGY GROUP

THREE BASIC APPROACHES OF REGULATORY PROCESSES (2)

REGULATORY APPROACHES:

- (EXTREMELY) DETAILED LEGISLATION (PRESIDENTIAL SYSTEM: STABLE LEGAL FRAMEWORK, THE REGULATORY PROCESSES ARE SET IN LEGISLATION, REGULATOR IS TO ACT WITH VERY LITTLE DISCRETION ⇔ SAFE, STABLE SYSTEM FOR INVESTORS, LACK OF REGULATORY FLEXIBILITY)
- CONTRACT LAW (LICENSE-BASED REGULATION) (PARLIAMENTARY DEMOCRACY; CASE LAW: NO DETAILED LEGISLATION; REGULATION THROUGH LICENSES ⇔ LICENSES COULD BE CHALLENGED)

10

U.S. ENERGY OFFICE

POLITICAL, ECONOMIC, CULTURAL AND SOCIAL ENVIRONMENT IN CENTRAL/EASTERN EUROPE IN WHICH GOVERNMENTS ESTABLISHED NEW REGULATORY FRAMEWORK (1)

- SHORTLY AFTER POLITICAL CHANGES ⇒ NO DETAILED PRACTICE IN DEMOCRATIC PROCEDURES
- AFTER 40-50 YEARS OF CENTRALIZED PLANNING ⇒ GOVERNMENTS TRY TO KEEP POWER OF DECISION-MAKING (LACK OF REGULATORY AUTONOMY)
- NO DEVELOPED CONFLICT RESOLUTION METHODS ⇒ LACK OF PRACTICE IN PUBLIC HEARINGS
- CONTINENTAL LAW ⇒ DETAILED LEGISLATION PRACTICE
- BEFORE DRAMATICAL PRICE INCREASES ⇒ POLITICAL CONTROL OF PRICE SETTING

11

U.S. ENERGY OFFICE

POLITICAL, ECONOMIC, CULTURAL AND SOCIAL ENVIRONMENT IN CENTRAL/EASTERN EUROPE IN WHICH GOVERNMENTS ESTABLISHED NEW REGULATORY FRAMEWORK (2)

- NO INSTITUTIONAL FRAMEWORK PROTECTING THE INTEREST OF SMALL CUSTOMERS
- BEFORE PRIVATIZATION ⇒ GOVERNMENTS WANT TO DEMONSTRATE SAFETY FOR INVESTORS
- NO GOVERNMENTAL PRACTICE IN "NEGOTIATION-PROCESS" WITH FOREIGN PRIVATE INVESTORS
- FOREIGN ADVISORS FROM ANGLO-SAXON COUNTRIES ⇒ MIX OR REGULATORY ELEMENTS WHICH DO NOT PROPERLY FIT IN WITH LOCAL LEGAL FRAMEWORK (LICENSES, PUBLIC HEARINGS, COMMISSIONS)

12

HUNGARIAN ENERGY OUTLOOK

HUNGARIAN APPROACH OF REGULATORY PROCESS

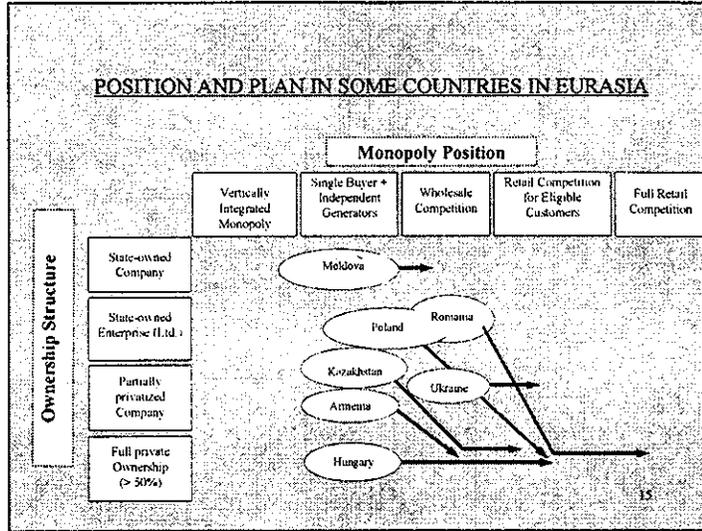
- MIXTURE OF DIFFERENT BASIC REGULATORY APPROACHES
- CONTINENTAL LAW - DETAILED LEGISLATION BUT ON THE OTHER HAND VERY DETAILED LICENSES ISSUED BY HEO
- LACK OF REGULATORY AUTONOMY, FREEDOM, SET BY LAW (NO PRICE SETTING) ⇒ HEO CANNOT SET RULES
- HIGH INFORMAL REGULATORY POWER
- LICENSES WITHOUT PRICING RULES
- RESOLUTIONS OF HEO (LIKE LICENSES) COULD BE CHALLENGED
- REGULATORY PRACTICES PICKED UP FROM OTHER COUNTRIES WITH DIFFERENT REGULATORY APPROACHES (PUBLIC HEARING, PRICE CAP, QUARANTEED SERVICE, CUSTOMER SATISFACTION MEASUREMENT, ...)
- MULTI-PURPOSE "REGULATOR" FOR GAS, ELECTRICITY, DISTRICT HEATING; ONE PERSON

13

COMPARISON OF ENERGY REGULATORS IN HUNGARY AND THE REGION IN RESPECT OF AUTONOMY AND ORGANISATION

	HUNGARY	REGION
AUTONOMY	no freedom from direct governmental control	more freedom from direct governmental control
REPORTING	ministerial supervision	rates
COMPETENCE	licensing tariff preparation	licensing tariff setting
BUDGET	fees	mostly from State Budget
ORGANIZATION		
HEAD	appointed by Minister of Economy	appointed by PM or President
TYPE	one-person regulator	commission

14



IMPLEMENTING REGULATORY METHODS, PRACTICE APPLIED BY OTHER REGULATORS

- OFFER (British Know How Fund);
 - GUARANTEED SERVICES
 - MEASURE OF SERVICE LEVEL
 - ANALYSIS OF OUTAGES
- CEC, CPUC (USAID);
 - MEASURE OF CUSTOMER SATISFACTION
 - DATA AND INFORMATION BASE, LAN
 - LICENSE CONDITIONS - COMPLIANCE MONITORING SYSTEM
- VICTORIA /AUSTRALIA/;
 - BENCHMARKING PERFORMANCES OF LICENSEES
- PUC OF MAINE (USAID);
 - STABILITY, CONTINUITY AND PREDICTABILITY IN DECISIONS
 - GUIDELINES
 - PUBLIC HEARINGS
- CNSE /SPAIN/ (EU-Phare)
 - CLEAR COMPETITION-MODEL, RESPONSIBILITIES

**DIFFICULTIES IMPLEMENTING REGULATORY PRACTICE OF
THOSE COUNTRIES WHICH HAVE MORE EXPERIENCE IN
MARKET ECONOMY, DEMOCRACY, PRIVATE INVESTMENT
AND UTILITY REGULATION**

- COST REVIEW ⇒ HIGH INFLATION BUT LACK OF ASSET REEVALUATION (ACCORDING TO THE ACCOUNTING RULES)
- USING PRICE CAP PRICING METHOD + NEW FOREIGN, PRIVATE OWNERS ⇒ DRAMATIC COST CUTTING ⇒ SUPPLY QUALITY ↓, OUTAGES ↓
- GUARANTEED SERVICE ⇒ CUSTOMERS DO NOT BELIEVE THEY HAVE RIGHTS (DO NOT ASK FOR COMPENSATION)
- OVERALL STANDARDS ⇒ DISTRIBUTORS/SUPPLIERS REQUIRE SOME YEARS FOR DEVELOPING DATA MANAGEMENT SYSTEM

17

HUNGARIAN ENERGY OFFICE

COOPERATION BETWEEN REGULATORS

(Sponsored: USAID, Know How Fund, EU-Phare, Tacis)

- **BILATERAL COOPERATION (workshops, visits)**
- **REGULATORY MEETINGS (EU: OTEF, CNSE; CEE-NIS, CENTREL)**
- **CONFERENCE (CEE + NIS)**
(1997 Budapest, 1998 Warsaw, 1999 Budapest - 20 countries - 100 participants)

(Sponsor: USAID) (Organizer: USEA, NARUC)

- **INFORMATION EXCHANGE (E-MAIL, FAX, WEB SITE)**
- **DICTIONARY (regulatory terms)**
- **GUIDE BOOKS, GUIDELINES, HAND-BOOKS**
- **ISSUE PAPERS**
- **QUARTERLY REPORTS**
- **COMMON TRAININGS**
- **MEETINGS, CONFERENCES, STUDY TOURS**

18

HUNGARIAN ENERGY OFFICE

ANALYSIS PAPERS (short handbooks) AS ELEMENTS OF A SERIES PREPARED BY LICENSING COMMITTEE (1)
(Sponsored: USAID) (Organized: USEA, NARUC) (Facilitated, Drafted: Bechtel, Hagler Bailly)
(Participated by the Regulators of: Armenia, Georgia, Hungary, Kyrgyzstan, Moldova, Poland, Russia, Ukraine)

1. WHAT ARE THE MOST IMPORTANT STATUTORY ELEMENTS RELATED ISSUING LICENSES AND MONITORING (CONTROLLING) LICENSE HOLDERS?
2. AMENDMENT OF THE LICENSES (INITIATED BY REGULATOR) - UNDER WHAT CIRCUMSTANCES, IF ANY?
3. FINANCIAL FEASIBILITY OF LICENSED OPERATION AND NEW CONSTRUCTION + GUARANTEES (WHAT SHOULD THE REGULATOR REQUIRE?)
4. OWNERSHIP LIMITATION - HOW TO AVOID MONOPOLY SITUATION?
5. CAPACITY LIMITS ON LICENSES (MINIMUM LICENCED CAPACITY) + DURATION OF LICENSE - WHAT SHOULD THEY BE?

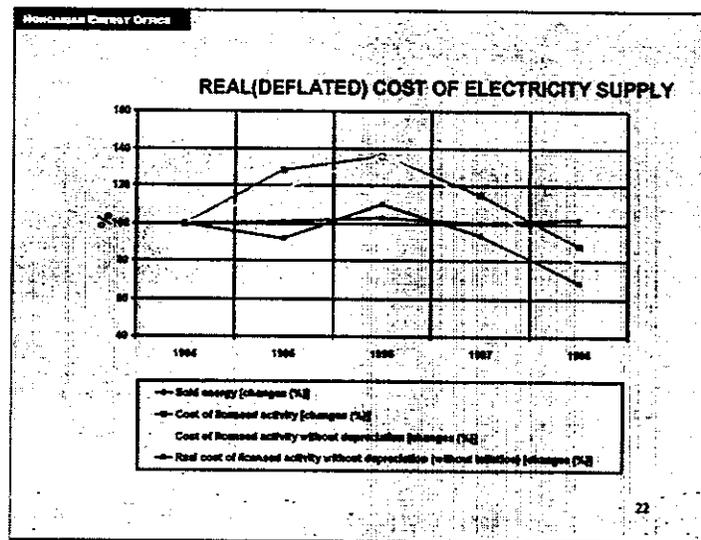
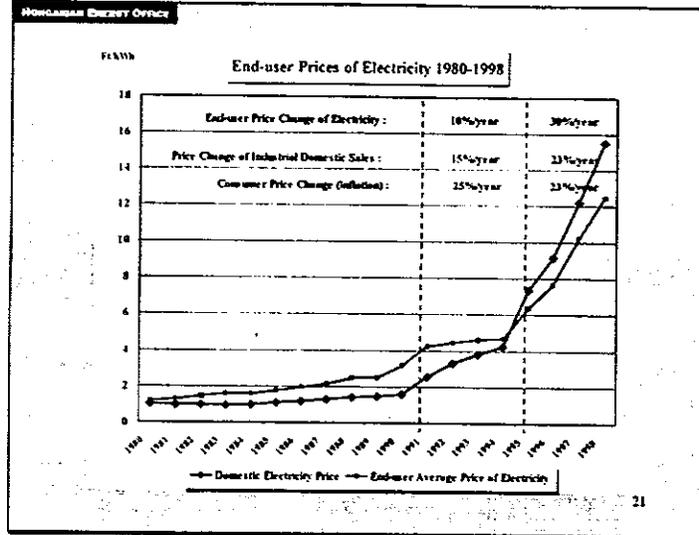
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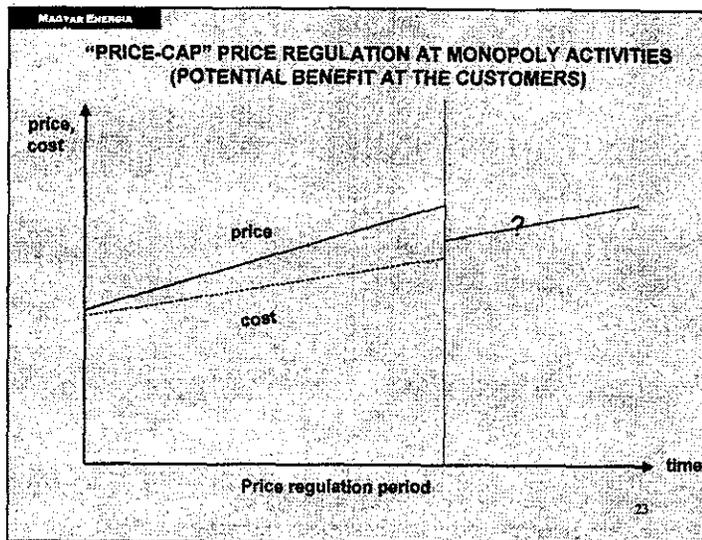
HUNGARIAN ENERGY OFFICE

ANALYSIS PAPERS (short handbooks) AS ELEMENTS OF A SERIES PREPARED BY LICENSING COMMITTEE (2)

6. HOW TO DEAL WITH TECHNICAL, SAFETY, ENVIRONMENTAL PROTECTION, SYSTEM SECURITY QUESTIONS? (IN THE LICENSE, IN GRID CODE, IN OTHER REGULATION, IN COMMERCIAL CONTRACTS,...?)
7. WHAT TO DO IN THE CASE OF VIOLATION OF LICENSE, LAW (FINE, WITHDRAW OF LICENSE) FROM BOTH A LEGAL AND PRACTICAL POINT OF VIEW?
8. HOW TO MEASURE THE LEVEL (QUALITY) OF SUPPLY?
9. METHODS OF COMPLIANCE MONITORING (REQUIRED DATA, INFORMATION + ANALYSIS)
10. TRANSMISSION, TRANZIT, EXPORT, IMPORT (LICENSING, PRICING)
11. GENERAL LICENSING QUESTIONS, LICENSE AS A REGULATORY TOOL

20





HUNGARIAN ENERGY OFFICE

**NEW CHALLENGE: PREPARATION FOR MORE
COMPETITION + JOINING THE COMMON EUROPEAN
ELECTRICITY MARKET**

*Directive 96/92/EC of the European Parliament and of the Council of
19 December 1996 concerning common rules for the internal market
in electricity*

ARTICLE 20., SECTION 3: "Member States shall designate a competent
authority, which must be independent of the parties... settle disputes..."

ARTICLE 22.: "Member States shall create appropriate and efficient mechanisms
for regulation, control and transparency..."

- ANALYSIS OF THE DIRECTIVE
- ANALYSIS OF DIFFERENT MODELS IMPLEMENTED
COMPETITION
- IMPLEMENTING REGULATORY METHODS: PRACTICE APPLIED
BY OTHER REGULATORS
- PAY ATTENTION TO THE PREPARATION, PRACTICE OF OTHER
STATES
- STRATEGY OF HEO BASED ON THE EXISTING LEGAL
FRAMEWORK

24

HUNGARIAN ENERGY OFFICE

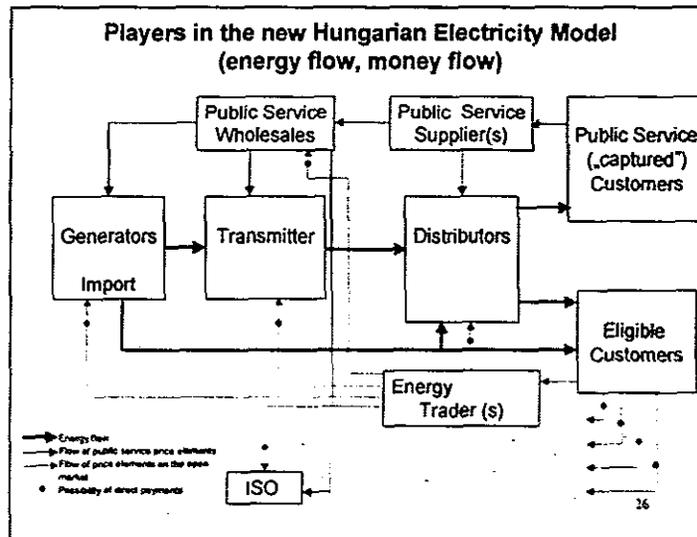
TIMING OF NEW REGULATION FOR MORE COMPETITION

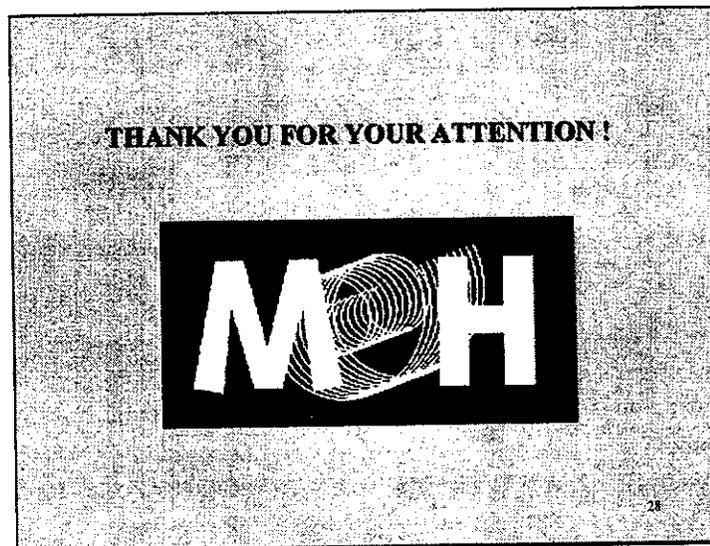
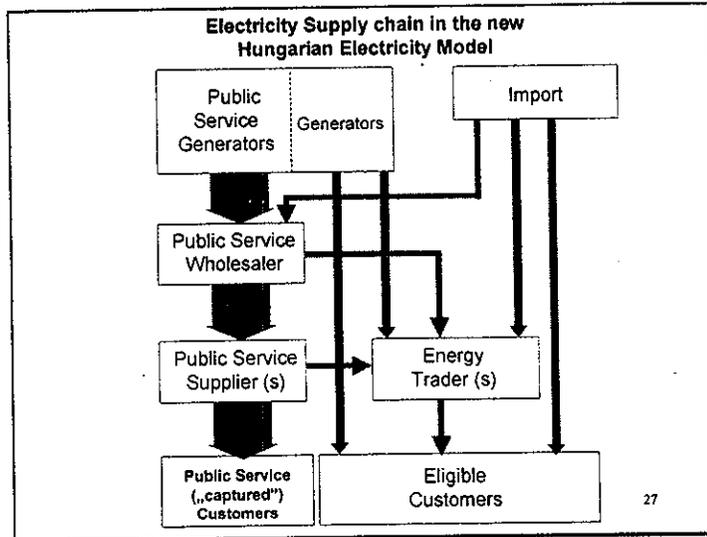
HOW TO OPEN THE MARKET?

- AS FROM FEBRUARY 1999 ALL MEMBER STATES MUST OPEN AT LEAST 25,37% OF THE MARKET TO FREE COMPETITION
- IN 2000 THE MARKET SHARE WILL BE CALCULATED ON THE BASIS OF 20 GWh, RESULTING IN APPROX. 28% (and 33% in 2003).
- IN HUNGARY:

Over 100 GWh/year:	15 end-users,	13,5%
Over 40 GWh/year:	43 end-users,	19%
Over 20 GWh/year:	95 end-users,	24%
Over 9 GWh/year:	212 end-users,	29%
Over 4,6 GWh/year:	400 end-users,	33%
- TARGET START FOR MARKET OPENING: 1 JANUARY 2001
(WE DID NOT ASK FOR DEROGATION)

25





A. Kucherenko, First Deputy Chairman of the Committee for Fuel and Energy Complex, Nuclear Policy and Nuclear Security of the Supreme Rada of Ukraine

The Special Features of Ukrainian Power Sector Privatization

Privatization is one of the most important factors assisting in the implementation of reforms in the Ukrainian economy, and it is in fact the only chance we have today for the restructuring and technological retooling of the domestic industry. The level of efficiency and adequacy of its implementation by the current government will to a large degree serve as an indicator of the attainment of market reforms in Ukraine for western entities. The results of privatization will to a significant degree determine the level of assistance offered by international organizations and foreign governments in support of the transformations carried out in our country, as well as the depth of cooperation in the economic arena. Which, in turn, is extremely important from the point of view of creating a politically and economically stable and globally respected Ukrainian nation.

As for the power sector of our country, today it is in urgent need of new technologies, modern management techniques and, most importantly, significant resources for the modernization and restructuring of the industry. For that we need a serious strategic investor, and it is for this very purpose of attracting such investors that we are so painstakingly perfecting the mechanisms and main principles of privatization implementation in Ukraine. International organizations are active participants in this process, and we welcome their participation.

Over the past six months, quite a bit of work has been accomplished toward carrying out the process of power companies privatization. The State Privatization Program for 2000-2003 has been approved, the Resolution, "On the Privatization of Power Enterprises" has been adopted, and the first bidding for the selection of the advisor for the privatization of the first group of power distribution companies has taken place. Following a pause in the privatization process which lasted over a year, as well as the avalanche of criticism regarding the outcome of the first unsuccessful attempt at power distribution entities privatization, one can say that we have managed to channel the process in the direction of the positive. **It is true that the mechanisms utilized today need further improvement, but in general, by their fundamental characteristics, they are in line with internationally accepted standards.**

Therefore, what I would like to discuss today is a different issue, which is not actively debated in the context of power companies privatization. It is the issue of the **macro-conditions, the existence of which determines the success of the privatization efforts and in absence of which the privatization will not yield the results expected by us and our foreign partners - potential investors, even if the most ideal mechanisms are used.**

I would like to emphasize that the **outcome of privatization depends not only on the principles and mechanisms of its implementation but also on the macroeconomic factors and conditions in which it progresses.** The role of macroeconomic effects is particularly great during privatization within the power industry. **Lack of realization of this role can erase any and all expected positive changes, no matter how effective the mechanisms and approaches that we utilize.** Without the assurance of a stable national economic policy, creation of the environment conducive to the development of private enterprise, improvement in

the tax laws and the budget system, and streamlining of the system of market relations, it would be naïve to count on privatization being an effective instrument in the transition to a market economy. **If the situation in the country were to change in the nearest future, the new power company owners, no matter how hard they try, will not be able to fully realize their potential, and the expectations placed by Ukraine on privatization will not be justified.**

When I talk about rapid changes in the economic environment in the country, I don't mean the change of living standards, or improvement in the technical, financial or economic performance characteristics – these cannot be achieved overnight. Economic systems are cumbersome and tend to be plagued by inertia. **By changes on the macro-level which would enable the creation of adequate conditions for the effective implementation of privatization I mean, first and foremost, the following:**

- The establishment of the national strategy of power industry reform and phases of its implementation;
- The existence of a realistic plan of measures aimed at revitalizing the power sector and the economic situation in the country as a whole;
- The establishment of an environment in support of streamlining business practices and of assuring transparent and clear requirements to entrepreneurs on the part of the government;
- The determination of principles for the improvement of tax laws;
- The establishment of a system of privileges and benefits and the determination of the sources of their financing; and
- The streamlining of power market relations.

Unfortunately, **all the enumerated conditions are absent as of today.** The governmental “Concept” for the reform of the electricity and gas markets is still being finalized and discussed; significant complications emerged in the process of discussing the Law, “On the Main Principles of Wholesale Power Market Organization,” adopted in the first reading; the tax code is in the process of preliminary discussion, and so on. All of these factors significantly complicate the circumstances surrounding power industry privatization.

An uncoordinated, fragmented approach to the laws and regulations pertaining to the power industry and lack of a single, generally accepted understanding of how and based on what principles power and gas markets should function, lead to a situation in which potential investors find themselves incapable of evaluating and estimating their prospects of entering Ukraine as owners of power distribution companies, which consequently causes them to approach the privatization of Ukrainian power enterprises with extreme caution. In such an environment the value of shares in power companies drops significantly and, as a consequence, both the state and the power companies do not obtain a fair share of funds which they otherwise could derive in the conditions of stability and certainty.

Therefore, the goal of developing a comprehensive and consistent legal framework in the power sector deserves the closest attention today.

The “piecemealing” and our uncoordinated attempts to solve individual tasks within the power industry have lasted way too long. **It is time for us to switch to systematized, coordinated and sound approaches.**

It is the realization of the latter that prompted our Committee (Committee on Fuel and Power Complex, Nuclear Policy and Nuclear Security of the Supreme Rada of Ukraine) to establish an **Interagency Working Group on the Development of the Concept of the Ukrainian Energy Laws**. The Group consists of ten People's Deputies – Committee Members, representatives from the Office of the President, Cabinet of Ministers of Ukraine, National Energy Regulatory Commission, Ministry of Fuel and Energy, Antimonopoly Committee, Committee on Energy Conservation, Ukrainian Union of Manufacturers and Entrepreneurs, as well as other executive branch officials, representatives of non-governmental organizations and analytical centers. We are convinced that **the development and endorsement of the Law, "On the Fundamentals of the Ukrainian Energy Policy" (which is the first step on the agenda of the Working Group), as well as the establishment on its basis of the Ukrainian Energy Laws Concept will play a key role in the improvement of the investment climate and will significantly raise both the attractiveness of power companies slated for privatization and the potential capabilities of their future owners with regard to the technological and managerial development of the acquired companies.** All of the above measures, implemented as a set, will create the basis for the stabilization and development of the national power sector and the overall national industry.

I would also like to inform you of another initiative put forth by our Committee, which emerged out of our desire **to make public the process of Ukrainian power industry privatization, to increase the level of confidence in our country on the part of investors, and to follow the implementation of the power industry privatization process with the goal of timely correction of any mistakes.** These issues are dealt with by the **Interagency Working Group on Monitoring the Privatization in the Fuel and Energy Complex**, created by the Committee. In addition to the earlier enumerated governmental organizations and institutions and the Ukrainian State Property Fund, the Working Group also includes representatives from international organizations such as USAID, EBRD, World Bank, etc. as well as potential strategic investors in our power industry (AEC, British Energy, EDF). We believe that **the representative composition of this body along with its regular painstaking efforts to implement the tasks with which it is charged will enable us to carry out the privatization at a high level and to attract serious professional investors to the energy complex of Ukraine.**

Power Privatization Policy Framework in Ukraine & Moldova

Presented to USAID Forum:
Power Sector Privatization in Central/Eastern Europe &
Eurasia: Results and Future Plans

Presented by:
Fraser Morrison
Deloitte Emerging Markets Group

Budapest, Hungary
June 8 - 9, 2000



Outline

- Privatization Objectives
- Power Sector Frameworks
- Tender Management
 - Investment bank tender
 - Distribution company tender
- Barrier Management
- Government Decision Makers
- International Privatization Participants
- Results of Privatization Programs
- Conclusions



2

Privatization Objectives

The objectives of the Ukraine/Moldova power privatization are to expand the application of democratic free market principles in the EE/NIS; These objectives are driven by the donors and key Ukrainian and Moldovan government leader. Key objectives are:

- To promote transparency and international standards in the bidding, regulatory, and market operation process to increase competition and maximize the market's value;
- To support legal, regulatory, and market reforms in the power sector that will increase cash collections, commercial viability, and the value of these assets.

The plan has been to support the privatization of first power distribution followed by generation over a two year period in a way that attracts long-range strategic private investors which will catalyze the formation of competitive power markets.

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3

Power Market Frameworks

Moldova

- Population: 4.5 million
- Capacity: 318 MW*
- Power imports: ~ 70%
- Power sector originally vertically integrated; now unbundled into 3 Gencos, Moldtranselectro, and 5 Discos;
- Independent regulator: ANRE.

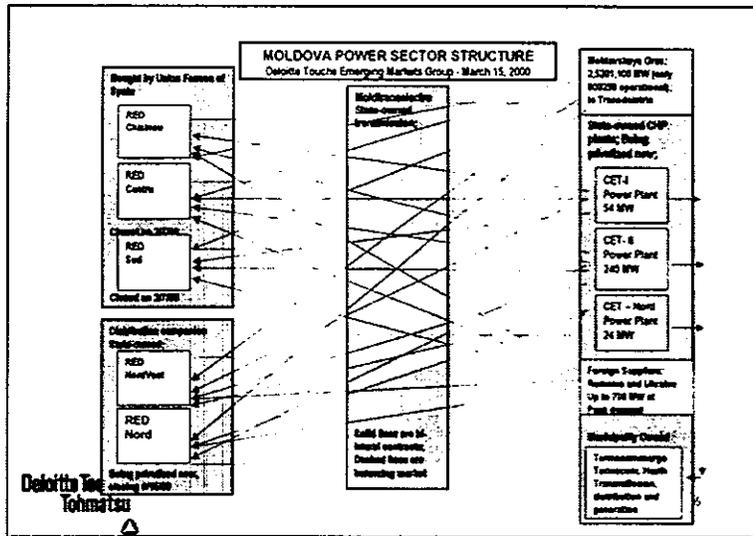
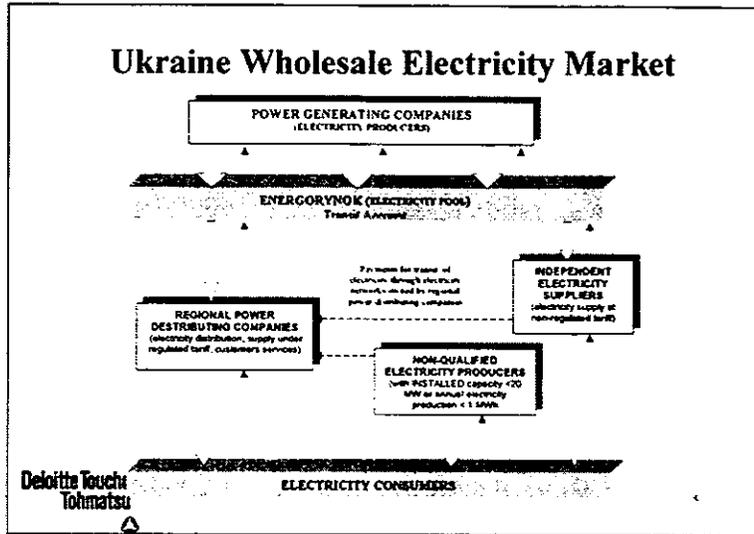
* Transnistria capacity not include such that power from Transnistria is regarded as imported

Ukraine

- Population: 50.5 million
- Capacity: 54,000 MW
- Power imports: > 3%
- Power sector originally vertically integrated; now unbundled into separate 5 Energos, Energorynok, and 27 Obienergoss;
- Independent regulator: NERC

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4



Power Market Sales Frameworks

Moldova

- 5 Discos & 3 Gencos are for sale;
- Discos 100% state-owned prior to privatization;
- 100% Discos for sale to strategic investors.

Ukraine

- 20 Discos and later 5 Gencos are up for sale; 7 discos already privatized;
- Discos partially-privatized with 7 majority private;
- 25 - 70% of Discos for sale to strategic investors.

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7

Privatization Framework Issues

- Resolution of differences between domestic and international best practice tender processes;
- Prioritization strategy: tariff minimization versus investment/debt coverage maximization;
- Company sales packaging plan;
- Prioritization of companies or packages for sale;
- Percent of companies for sale;
- Anti-monopoly issues;
- Donor and local government coordination.

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8

Tender Management: Investment Bank

- Investor expression of interest (EOI) invitation *
- Shortlist finalization *
- Evaluation process definition
- Preparation of RFP
- Issuing of RFP
- Bidders' meeting *
- Bid Acceptance & Evaluation
- Winning bidder negotiation
- I Bank contract signing

* shortlisting process has been not part of Ukrainian regulations has present a
or difference to reconcile with international tender procedures

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9

Tender Management: Discos

- Technical due diligence
 - engineering
 - environmental
 - social
- Financial due diligence
 - legal ownership
 - financial statements
- Information memorandum preparation
- Bid evaluation criteria & process definition
- Shortlisting process implementation (not in Ukraine regulations)
- RFP preparation and issuing
- Data room preparation
- Bidders' conference and road show organization
- Bid acceptance and evaluation
- Winning bidder negotiation
- Contract signing

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10

Barrier Management

- Identification of key barriers to sale of Discos/Oblenergos;
- Strategy formulation for addressing barriers;
- Identification of responsibilities with donor/advisory community for overcoming obstacles;
- Implementation of priority actions to achieve sale;
- Monitoring of progress through periodic donor/GoU or GoM roundtable meetings.

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11

Privatization Barriers

- **Power market and privatization legal/regulatory framework**
 - *legal*: new draft wholesale electricity market law; privatization and tender process legal framework
 - *regulatory*: NERC/ANRE market rules, licensing, and tariff policy; tender process regulations
 - *financial*: transit account policy
- **Financial/Economic management**
 - restatements of Disco financial statements
 - debt restructuring and assumption
 - bankruptcy law consideration
 - transparency and efficiency of Ukrainian Stock Market
 - Disco share trading and liquidity
 - privileged consumer subsidy management
 - non-payments problem resolution

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12

Privatization Barriers (continued)

- **Contractual legal framework**
 - investment bank & investor contract negotiations
 - conflict resolution & international arbitration
- **Property ownership**
 - transfer of state shares from GoU or GoM to private ownership
 - right of way access for power line maintenance & metering/billing
- **Public education & training**
 - energy sector workers
 - power ratepayer
 - Discog management
 - policymakers

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13

Ukrainian Government Decision Makers

- President
- Cabinet of Ministers
- Verkovna Rada Committee for Fuel & Energy Complex
- State Property Fund (SPF)
- National Electricity Regulatory Commission (NERC)
- Ministry of Fuel & Energy (MinTopEnergo)
- Anti-Monopoly Committee
- State Commission on Securities and Stock Market

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14



Moldova Government Decision Makers

- Prime Minister & President
- Presidential Advisors on Privatization
- Tender Commission
- Parliament Committee on Privatization
- Ministry of Industry & Energy
 - Department of Energy
- Ministry of Economy and Reforms
 - Department of Privatization
- ANRE, regulatory agency

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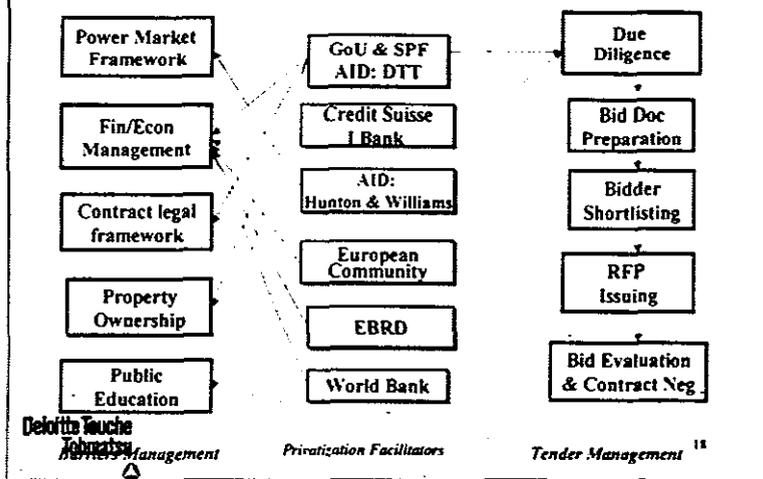
International Privatization Facilitators

- Power Sector Task Force (Ukraine)
- Power Sector Working Group (Moldova)
- European Bank for Reconstruction & Development (EBRD)
- World Bank
- U.S. Agency for International Development (USAID)
- European Community (EC)
- USAID legal, regulatory, market, and privatization advisors
 - Deloitte & Touche, privatization advisor
 - Hunton & Williams (Ukraine), Hagler Bailly (Moldova)
- EC TACIS advisors
 - Commerz Bank, Flemings, BNP, Banexi (Ukraine)
- Investment Bank: Credit Suisse (Ukraine), CCF (Moldova)



17

Donor Role in Ukraine Oblenergo Privatization



18

Moldova Results Achieved

- 3 Discos were sold to Union Fenosa for \$25 million in February 2000 with promised investments of at least \$70 million over 5 years.
- Union Fenosa from February to April has improved reliability from about 12 - 15 hrs of outages per day to less than 2 hours, collections are improving.
- Tender for the sale of 3 Gencos and remaining 2 Discos is out with bids due June 19th and 12th respectively.
- 8 international investors shortlisted for Gencos, 3 for Discos.

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19

Moldova Privatization Of Discos (Phase 1)

Schedule of Event

- | | |
|--|----------------------------|
| >Contract signed with the Investment Bank
Credit Commercial de France | May 31 1999 |
| >Tender Announcement | August 2 1999 |
| >Press Conference in London
for attracting expression of interests & bids - | August 10 1999 |
| >8 pre-qualified bidders | September 10 1999 |
| >3 bids submitted finally | November 21 1999 |
| >Union Fenosa announced as winning bidder | December 7 1999 |
| >Negotiation with Union Fenosa | December 7-February 7 2000 |
| >Contract signed with Union Fenosa
for purchase of 3 discos | February 7 2000 |

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20

Ukraine Results Achieved

- Seven Oblenergos privatized in 1998 via over the counter stock sale rather than to strategic investors: this approach is generally viewed by donors as not being the way to continue;
- GoU commitment to a schedule for privatization to strategic investors established in law and within the RADA, Council of Ministers, and the State Property Fund (SPF);
- Investment Bank. Credit Suisse, contract with SPF signed and starting to implement the sale of the first 7 Oblenergos with bids due by November, 2000; Second Investment Bank tender for remaining 13 Oblenergos to be announced in June;
- Donor community and the GoU working closely to address range of issues from short-term cash collections to overall market reforms necessary for privatization.

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21

Ukraine Oblenergos to be Privatized

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22

Conclusions: Critical Requirements

- **Confidence in the power market** has had to be established through a sufficiently clear legal/regulatory framework, regulator authority, market rules, and investment framework; Investors are able to work within various power sector models; what is important is that they have some certainty of the model structure and accepted laws & regulations in Moldova and Ukraine;
- **Shortlisting criteria** critical to preventing investors participating that could undermine the market by not bringing world class expertise, capital, and management;
- **Marketing to investors** through a well-prepared information memo, press coverage, and road show has been needed to develop investor interest in a region with high risks and deteriorating economic conditions.

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23

Conclusions: Critical Requirements

- **Due diligence:** Key areas of due diligence were financial restatements, land surveys, asset boundary clarification;
- **Privatization Advisory Support,** the ability of the GoM DoP and the GoU SPF to implement without a privatization advisor and investment bank was limited; targeted support for due diligence, info memo preparation, marketing, barrier management, and limited public information was clearly needed;
- **Donor Coordination** between IMF, World Bank, EBRD, USAID, and EC has been critical to communicating a clear message to the GoU and GoM regarding power sector and privatization priorities.

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24

ARPAD BAJKAY
ADVISORS AND OWNERSHIP
STRUCTURE OF THE HUNGARIAN
ELECTRICITY SECTOR

1

ADVISORS

FINANCIAL	-	SCHRODERS
LEGAL	-	STIKEMAN, ELLIOTT
ACCOUNTANT	-	DELOITTE & TOUCHE
TECHNICAL	-	ESBI

DID THEIR BEST

- «TRANSLATION» OF POLITICAL INTENTION IN FINANCIAL AND LEGAL TERMS
- STRUCTURING INFORMATION MEMORANDA
- NEGOTIATIONS WITH INVESTORS FROM MANY COUNTRIES
- SYNTHESIS OF NEGOTIATIONS
- OPERATIONAL EXECUTION

1

OWNERSHIP STRUCTURE OF THE HUNGARIAN ELECTRICITY SECTOR OFFERED FOR SALE				
COMPANIES	SHARES OWNED BY			
	MVM Rt	COAL	MUNICIP	APV Rt
Bakonyi ERt.	34.69	30.62	0.69	34.00
Budapesti ERt.	50		8.41	41.59
Dunamenti ERt.	50		1.24	48.76
Matrai ERt.	38.24	23.52	0.15	38.09
Pecsi ERt.	43.82	12.36	3.23	40.59
Tiszai ERt.	50		0.29	49.71
Vertesi ERt.	39.50	20.99	0.79	38.71
EDASZ Rt.	50		2.45	47.55
DEDASZ Rt.	50		2.76	47.24
DEMASZ Rt.	50		2.02	47.98
EMASZ Rt.	50		1.19	48.81
TITASZ Rt.	50		0.77	49.23
ELMU Rt.	50		3.85	46.15
MVM Rt.			0.18	99.82

POWER PLANTS	~ 73 bill HUF
SUPPLY COMPANIES	~ 114 bill HUF
MVM Rt.	- 249 bill HUF

2

**Privatization of Electricity
Companies**

The Implementation Phase

Selected Issues

Vladislav Vucetic
World Bank

Objective

- To do it right, and do it right the first time
 - Mistakes could be costly
- To have successful transactions, if possible
- To learn and adjust the approach, if necessary

Pre-privatization Activities

- Legal and Regulatory framework developed
- Industry structure: unbundled, corporatized, assets defined
- Competition policies stated: retail? Full/partial? When (at the earliest/latest)?
- Market structure and rules: at least basic principles set – trading rules, responsibilities for balancing market, system services –although could be evolving
- Privatization strategy adopted and endorsed by parliament and government
- Management of the privatization process organized, responsibilities and procedures defined
- Investment advisors in place (marketing, legal, accounting, engineering)

2

Marketing

- To investors:
 - Demonstrated and sustained political will and commitment – the best marketing tool
 - Working in problem-solving rather than problem-creating or excuse-looking mode
 - Advertisements, direct contacts, presentations, etc. important, of course
- To the public:
 - Set the right expectations – in many of the countries, electricity business is not profitable
 - The largest benefits are avoided costs of progressive sector decline, worsening electricity shortages, constraints on economic development and impact on well-being of people.

3

Pre-qualifications

- Credible, proven strategic investors
- Long-term commitment to the industry – experience, assets, performance
- Demonstrated financial, technical, and managerial capability
- Successful operational experience and performance track record in managing comparable assets
- Financial statements audited by reputable independent auditor

4

Bid Solicitation

- One-stage or two-stage bidding (“technical” proposals, financial proposals)
- Evaluation criteria should be clear, both to establish the “technical” responsiveness and for ranking bids
- Two stage bidding
 - The first-stage (“technical”) proposals should not contain ranking elements
 - More complex to manage: confidentiality and fairness more difficult to preserve

5

Elements of the "Technical" Proposals

- Tariff proposals (if tariffs regulated)
- Performance commitments (loss reduction, collections, reliability of supply/availability of production assets)
- Business plan
 - investment plans
 - environmental performance
 - labor plans, including training

6

Investment vs. Performance Requirements

- Investment requirements should not be set directly (investment costs are passed through tariffs)
- Performance requirements:
 - should drive the investment plans
 - should be realistic
- Investment needs could be indicated (not required) in physical terms as part of IM
- Investors will invest, if environment is right

7

Bid Ranking Criteria

- Cash price should be dominating, if not sole ranking criterion
- Other: incentives to bid for less attractive packages
- Do not include in the ranking criteria the elements which are regulated: they can and should be used to accept or reject bids
- Do not use debt or other liabilities for bid ranking

Schedule and Sequencing

- Long enough to allow orderly process
- Short enough to limit the period of uncertainty and use of resources and time of people involved
- Prequalifications – bidding: 3-4 months
- Bid Evaluation: 1 month, but could be shorter or longer, depending on the number of bids
- Negotiations: 2-3 months
- Start with distribution, but then could be mixed

Some Pitfalls and Open Issues

- Responsibilities and rights of parliament, government, privatization agency, tender committee, regulator
- Division of assets (35-/110-kV network, land and structures)
- Assignment of liabilities, role and rights of creditors, broader sector liabilities (apart from debts of entities being privatized)
- Too few bidders
- Rejecting bids because of low price
- Too prescriptive and inflexible privatization law – lost market opportunities
- Conditional bids (accepting bid requirements subject to conditions)

10

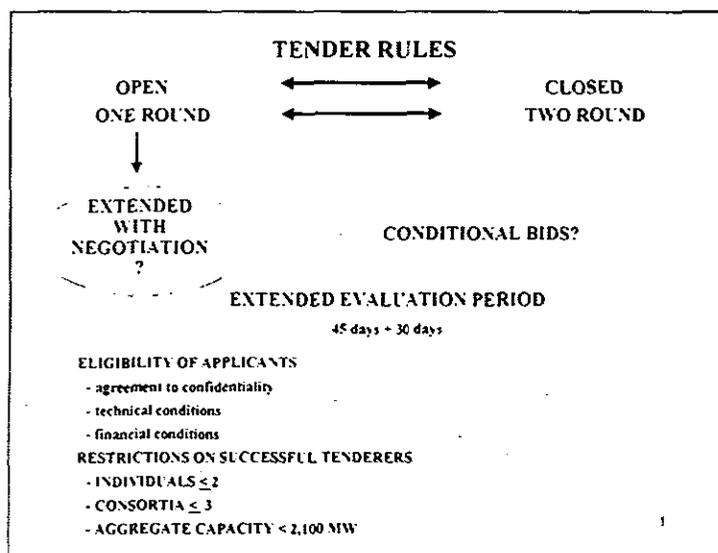
Main Message

- Privatization can be done right first time, assuming:
- Political consensus and commitment, proper planning, preparation, and execution

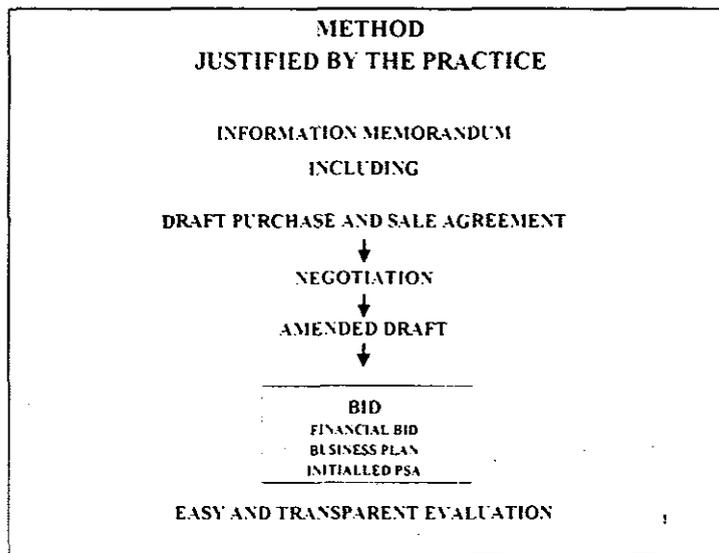
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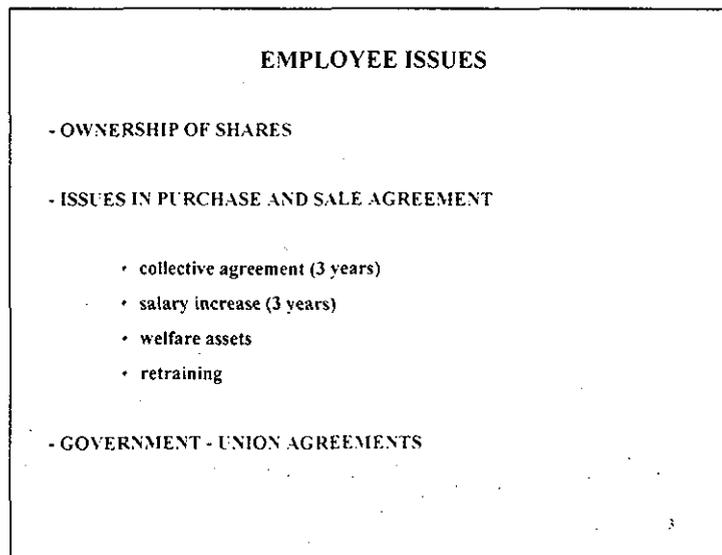
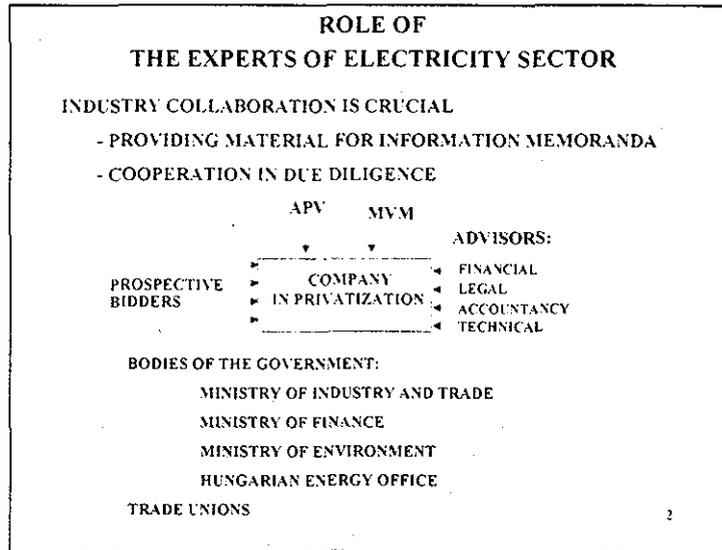
- Privatization of existing companies/assets to strategic investors
- Open, transparent, competitive tendering, which protects confidentiality of bids, and:
 - should lead to successful and defensible outcomes
 - is the least prone to abuse and corruption (real or suspected)
 - is publicly most acceptable

ARPAD BAJKAY
TENDER RULES AND
EVALUATION PROCESS



ARPAD BAJKAY
***PRIVATIZATION – THE
NEGOTIATION PROCESS***





**TIMING
OF ELECTRICITY PRIVATIZATION**

December 7,	1994	Gov. Resolution
July 2,	1995	Advisory Agreement
July 31,	1995	Notice
October 9,	1995	Info Memo
November 30,	1995	Bids
December 8,	1995	Signing
December 21,	1995	Closing
July 4,	1996	Remaining
September 12,	1996	Generation
December 23,	1997	Companies

4

EXECUTIVE OVERVIEW OF RESPONSES TO SURVEY ON PRIVATIZATION

Questions	Armenia	Georgia	Hungary	Kazakhstan	Moldova	Poland	Romania	Ukraine
<p><u>Level of Privatization</u></p> <p>What number of generation, distribution and transmission companies have become privatized? What number remain state-owned?</p>	<p><u>Privatized</u> 13 generation companies</p> <p><u>State-owned</u> 6 power plants, 1 transmission company, 1 dispatch company with the Single Buyer functions and 4 distribution companies.</p>	<p><u>Privatized</u> 4 generation plants (2 thermal and 2 hydro) 10 distribution companies</p> <p><u>State-owned</u> 5 generation plants (all hydro) 51 regional distribution companies</p>	<p><u>Privatized</u> 6 generation plants 6 distribution companies</p> <p><u>State-owned</u> transmission company (MVM) 2 generation plants</p>	<p><u>Privatized</u> 37 generation plants 3 distribution companies</p> <p><u>State-owned</u> 17 generation plants 15 distribution companies transmission company</p>	<p><u>Privatized</u> 3 distribution companies</p> <p><u>State-owned</u> 2 distribution companies and 3 CHP scheduled for privatization in 2000. Transmission company is not scheduled to be privatized.</p>	<p>Poland's plan is to privatize all 17 power plants, 19 combined heat and power plants, and 33 distribution companies by 2002 and to begin the privatization of the Polish Power Grid Company (the transmission company) in 2002.</p>	<p><u>Privatized</u></p> <p><u>State-owned</u> Currently all. Privatization will commence October 1, 2000.</p>	<p><u>Privatized (partial)</u> 4 generation companies partly privatized (76-85 % belongs to the state) 7 distribution companies mostly privatized (25-33 % belongs to the state) 2 companies partly privatized (51-60 % belongs to the state) 17 minor companies privatized (65-75 % belongs to the state) 1 company managed by the municipal board (Kievenergo)</p> <p><u>State-owned</u> 3 companies (hydro and nuclear) 100 % belongs to the state</p>
<p><u>Objectives</u></p> <p>What was/is the objective of the power sector privatization and how did it inform the privatization policy that was developed? For example, did the government seek to maximize revenue, obtain managerial skills in the sector, or encourage popular ownership of energy sector assets?</p>	<ul style="list-style-type: none"> • attract investments • improve management and upgrade the network • improve sector performance • increase operating efficiency • increase collection for the electricity supplied • provide revenue from the assets sale • improve power plant performance due to regular payments for the power supplied by them 	<ul style="list-style-type: none"> • enforce rational state policy upon restructuring of the sector • separate regulatory and operational functions within the sector • ensure reliable power supply to customers and improve financial discipline in the sector • establish competitive environment • create electricity market and formation of related enterprises 	<ul style="list-style-type: none"> • attract experienced foreign investors who could make the Hungarian firms efficient and profitable • obtain highest purchase price 	<ul style="list-style-type: none"> • income to budget • select strategic investor to get improved managerial skills in the sector • Government considered ownership of energy assets or ownership of stocks particularly in each case 	<ul style="list-style-type: none"> • introduce financial discipline and modern management methods • generate revenue from sales. • ensure the energy security of the country • increase the reliability and quality of energy production and services • attract foreign and local investments for rehabilitation and expansion of the enterprises 	<ul style="list-style-type: none"> • consumer protection • energy security • creating a capital foundation for investment in the sector • introduce improved management skills 	<ul style="list-style-type: none"> • attract financial resources to sustain the development of the power sector • improve technology and management skills • increase cost-efficiency and achieve customer benefits 	<p>At the first stage of the privatization (1997-1998), the main objective was obtaining funds to the budget, together with attraction of investments into electricity distribution. Commercial tenders were conducted, and bidders were required to pay cash for the packages on sale to the budget and also pledge to invest certain amounts of money within some fixed periods of time.</p>

* The information in this matrix goes only to past privatization efforts in Ukraine. Going forward, Ukraine is concentrating on sales of majority ownership in privatized assets, to strategic investors.

Questions	Armenia	Georgia	Hungary	Kazakhstan	Moldova	Poland	Romania	Ukraine
	them	<ul style="list-style-type: none"> enterprises • promote development of domestic market • establish economic system for efficient 			<ul style="list-style-type: none"> • increase the efficiency of the energy sector <p>Agreements between GOM and IMF & WB for general</p>			
		<p>functioning on external electricity market</p> <ul style="list-style-type: none"> • release certain functions from governmental control • attract foreign and local investments • revitalization, modernization and development of Georgian energy sector • create favorable environment for investments • ensure reliable power supply to customers and • improve financial discipline in the sector 			<p>economic reform and the specific conditions imposed by various loan agreements formed larger context for privatization.</p>			
<u>Legal Framework</u>								
Were laws enacted to permit or support privatization?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<u>Regulatory Framework</u>								
Was an independent regulatory body established prior to privatization?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

What was/is the importance and authority of energy regulatory body?	<ul style="list-style-type: none"> • approve tariffs • approve and monitor licenses • consider and rule upon complaints and disputes between the parties and/or consumers. 	<ul style="list-style-type: none"> • approve tariffs • approve and monitor licenses • consider and rule upon complaints and disputes between the parties and/or consumers. 	<ul style="list-style-type: none"> • approve and monitor licenses • draft rules regarding pricing and regulatory framework • consumer protection • demonstrate stability and predictability of privatization to potential investors 	<ul style="list-style-type: none"> • approve tariffs • approve and monitor licenses • consider and rule upon complaints and disputes between the parties and/or consumers • promote competition. 	Review and revise laws and regulations affecting energy sector. During the negotiations with Union Fenosa regarding the acquisition of three local distribution companies, ANRE was the primary government representative on tariff and licensing issues.	<ul style="list-style-type: none"> • approve tariffs • approve and monitor licenses 	<ul style="list-style-type: none"> • approve tariffs • approve and monitor licenses • establish technical and commercial norms for sector economic agents required for an efficient and transparent operation of the national power system (SEN). 	<ul style="list-style-type: none"> • approve tariffs • approve and monitor licenses • antimonopoly regulation
Were the power markets restructured prior to privatization?	Yes	Yes	Yes	There were no power markets before privatization.	Much work was done prior to privatization to introduce a power market [none existed before].	There was no prior market restructuring. PPA's are to be restructured in the end of 2000. Power exchange to begin operation in second half of 2000.	Yes	Yes
<u>Privatization Strategy</u>								
What type of investor was targeted?	Strategic investors	Strategic investors	Strategic investors	An individual investor was targeted in each specific case. Mainly strategic investors were targeted.	Strategic investors.	Strategic investors.	Strategic investors.	At first, Ukraine focused on portfolio and mass investors. In the future, however, Ukraine intends to target strategic investors.
Was there a preference for domestic or international investors? Which assets were privatized initially - generation or distribution and what was the policy on transmission?	No, but international investors were better qualified. Ten small generation assets were privatized initially. Distribution companies are in privatization process now. Transmission will remain state-owned.	No, but international investors were better qualified. Distribution assets grouped for privatization first. Next phase focused on sale of generation assets. Transmission remains state owned.	No, but international investors were better qualified. All distribution and generation assets offered for sale. Transmission to remain state-owned. Only 1 thermal generation company and the nuclear plant remain state-owned.	No preference. Generation companies sold first. Majority of distribution companies are still state-owned.	Domestic investors could not satisfy the bid requirements. Distribution companies were offered first in 1999. Generation companies offered in 2000. Transmission and dispatch company, Moldtranselectro, will remain state-owned.	CHP and generation, transmission will remain state-owned until 2002.	No preference. The legal framework established the privatization of distribution followed by generation. The transmission activities will remain state-owned and will be the subject of concession.	No preference. Distribution assets were privatized initially. Only small packages of generators' shares were sold, mostly to employees and management. Transmission assets will remain state-owned.

Which privatization implementation strategy was employed?	Competitive bid.	Competitive bid.	Competitive bid	Negotiated sales.	Competitive bid.	Competitive bid.	Negotiated contract.	Competitive bid.
What was the percentage of the asset offered for sale --100%, less than 100% but controlling interest, minority ownership with management control, minority ownership with no management control?	100% of small hydro plant assets were sold. The government is planning to sell 80% of the distribution companies.	Controlling interest	Controlling interest.	Either property complex, or 100%, or less than 100%, but with management control.	100 % for distribution companies; 70% for generation companies.	<ul style="list-style-type: none"> • CHP – 45% (larger package negotiable) • Generators – 35% (larger package negotiable) • Distributors – 25% (larger package non-negotiable) 	Government has option to retain a golden share, determining also the entity which shall exercise the rights deriving from such quality.	Minority packages were sold, but with the packages accumulated by the same or linked offshore companies, they presented controlling packages for seven distribution companies. In the future, majority packages will be sold.
Privatization implementation								
Which government agency had the lead in implementing the privatization?	<ul style="list-style-type: none"> • Ministry of Energy • Ministry of State Property Management • Ministry of Economy and Finance <p>In the case of distribution companies, a Tender Committee leads the implementation of privatization.</p>	<ul style="list-style-type: none"> • Ministry of State Property Management • Ministry of Fuel and Energy • Regulatory Commission • Ministry of Finance • Tax department • Ministry of Finance • Ministry of Justice • Ministry of Economy. 	Privatization agency (APV Rt)	Committee of State Property and privatization of Finance Ministry of Republic Kazakhstan	Privatization Department under Minister of Economy.	Minister of State Treasury.	<ul style="list-style-type: none"> • Ministry of Industry and Trade • Local Councils • State Ownership Fund (SOF). 	State Property Fund.
Did the country employ the services of an investment banker and/or other advisors?	Yes	Yes	Yes	Yes	Yes	Advisors are selected through public tender for each privatization project.	Yes.	Yes
If the country used a competitive bidding process for investors, did it pre-qualify them first?	Yes	Yes	Yes	Yes	Yes			Yes

If pre-qualification was done, how was it publicized?	Published in international and domestic papers and in local mass media.		World-wide in international papers.	It was publicized by written notification.	Advertising, telephone contacts and press or industry conferences.	Privatization fair to enable direct contact between: <ul style="list-style-type: none"> • investors and representatives of the companies being privatized • producers of energy with the distributors and • the distributors with the entitled consumers. 	The public institutions involved shall ensure the publication of the announcement for sale and of the sale offer in a local and in a wide-circulation daily newspaper and/or on the Internet and, in appropriate circumstances, in an international newspaper.	Announcements of sales were published in the press.
If pre-qualification was done, what criteria were used?	Annual revenues greater than \$150 million	Companies were pre-qualified according to their size and experience.	Power industry background, operational practice in the same field (gen., trans., distr.) asset comparable with the offered asset.	Finance possibilities (scopes) and image of firm.	<ul style="list-style-type: none"> • Annual revenues greater than \$100 million. • Experience developing and operating power companies in a developing country 		Romania intends to prequalify investors using standards developed by the public institutions involved in the privatization.	
If pre-qualification was done, what was the minimum number of pre-qualified investors needed to proceed?	No minimum			2 investors	2 investors			Two
If pre-qualification was done, how soon afterwards was the final tender issued?	The final tender will be issued this year.		1-2 months.	The date of final tender has been determined by the notification	End of prequalification for potential investors was September 10, 1999. Bids were due on November 22, 1999.			Approximately three months.
What length of time after issuing the final tender was offered to proposing entities to conduct necessary due diligence and prepare offers?	It will be done this year.	The due diligence process was conducted from May 17 through August 20, 1999.	2 months, but it appeared to be too short.	The tender issue contains information of date and deadline to conduct necessary due diligence and prepare offers.	Approximately 2 months.	Seven to fourteen days were allocated for due diligence, followed by approximately 3-4 weeks to prepare offers.		Due diligence is being conducted simultaneously. Information on the companies on sale was prepared by the Ministry of Energy and its advisors. Some technical and financial information was given.

<p>What information on the assets was provided as part of the final tender? For example, was technical, financial, legal/regulatory, information given?</p>	<p>The final tender has not been issued. Technical, financial, legal/regulatory, information were provided as part of the second stage qualification.</p>	<p>Companies had access to any information required for them to carry out due diligence process, including company visits and conduct meetings with different officials. Potential investors also obtained additional information in the data room at the Ministry of State Property Management.</p>	<p>A detailed informational memorandum was provided.</p>	<p>Minimum of information about privatized assets was provided after tender issue</p>	<ul style="list-style-type: none"> • Business Characteristics of the companies (annexes to the privatization law) • Final Information Memorandum; • Request for Proposal; • Licenses; • Tariff Calculation Methodology. 	<p>An informational memorandum.</p>	<p>The provisions of GD 138/2000 stipulate that a study developed under a PHARE project (RO 9805-01-3) will analyze the best possibilities for the privatization of the distribution activities in the electricity sector. There are two pilot distribution entities in focus: Constanta and Timisoara.</p>	<p>Financial and technological information was provided.</p>
<p>What selection criteria were used to evaluate proposals – price and non-price?</p>	<p>Non-price criteria were used at the pre-qualification and qualification stage. The final selection criterion shall be based on cash price only.</p>	<ul style="list-style-type: none"> • financial offer • investment commitment • electricity tariff required by the bidder • extent to which the Management Contract and/or S&P Agreement was amended. • commitment to transform such generation asset(s) and the electricity sector in the State of Georgia into a world-class operation through technology transfer, human resource training and skills development; • commitment to use local skills while implementing rehabilitation and modernization of the 	<p>Price was by far most important criteria (90%). The new owners' business plans was given some weight as well (10%).</p>	<p>Biggest price (bid) and best investment offers, which matched to tender terms.</p>	<p>80% based on price, 20% based on experience, investment plan, willingness to accept existing regulatory structure, and the lack of requests for special guarantees and privileges.</p>	<ul style="list-style-type: none"> • price • development strategy, • investment package • control over company • synergy with other investors' entities • social package for employees 	<p>The criteria to be used, the terms and periods, are established by the public institution involved.</p>	<p>Price</p>

Which government entities participated in the selection process?	Tender Committee	Tender Commission	<ul style="list-style-type: none"> • APV Rt. • Ministry of Finance • Ministry of Environmental Protection • Ministry of Industry and Trade • HEO 	Tender Commission.	Tender Committee	Ministry of State Treasury.		Minenergo, Ministry of Economy
What was the proposed and actual schedule?	The process began in mid 1999 and is anticipated to be completed in 3 rd quarter 2000.	<ul style="list-style-type: none"> • official announcement of generation assets privatization - February, 1999 • request for proposals dispatched - May, 1999 • descriptive memorandum dispatched - May, 1999 • due diligence process - May - August, 1999 • preliminary non-binding bids required - July, 1999 • announce tender process (formulation of clusters) - July, 1999 • deadline for submission of binding bids - August, 1999 • deadline for closing of transaction - September, 1999 	The privatization process in Hungary, from pre-qualification to closing on a state-owned electric company, took approximately 4 months.	Generally, tender was issued one month prior to tender. Issue contained time for investor to respond, to prepare due diligence and terms of investors offers. The offers were considered and compared on tender directly.	Investors were to apply for pre-qualification by September 10, 1999. Qualified bidders performed due diligence and submit bids by November 22. Purchase and sale agreement signed on February 7, 2000. Transaction expected to close in early 2000.	Six to eight weeks after receiving information memorandum, potential investors were required to file initial offers. Several weeks provided for due diligence. Binding offers were due 3-4 weeks later, followed by negotiations with investors with best offers, followed by negotiations between winning investor and Ministry.		The schedule included only announcement, payment of deposits, and submittance of bids.
Negotiation Which government entity conducted the negotiations?	The Ministry of Energy, Ministry of State Property Management, Ministry of Economy and Finance RoA conducted the preliminary negotiations	<ul style="list-style-type: none"> • Ministry of State Property Management • Ministry of Fuel and Energy • National Regulatory Commission 	Privatization agency (APV).	Committee of State Property and Privatization of Finance Ministry of Republic of Kazakhstan.	Department of Privatization, advised by the ANRI and CCF.	Ministry of State Treasury	To date, there have been no negotiation processes in the power sector.	State Property Fund.

	negotiations. The Tender Committee will conduct additional negotiations if needed.							
What special provisions were negotiated – tariff increases, labor concerns, debt relief, tax holidays, etc.?	All mentioned special provisions are being discussed now and will be fixed in the final tender documents.	<ul style="list-style-type: none"> • tariff increases • labor issues • debt issues • tax issues 	Agreements protecting management jobs and providing funds for displaced workers	<ul style="list-style-type: none"> • new owners obligated for up to 60 days of unpaid back wages. • conditions on how new owners can manage the company including obligations to make new investments 	Items addressed included: <ul style="list-style-type: none"> • Tariff increases, • Commercial losses decreases, • labor wage increases, return of investments, • licenses conditions, • 35 kV line transferring from Transmission company to Discos, and • the tariff's reevaluation terms. 	No tariff and tax negotiations as these are regulated. Development and investment package, control over company, exit strategy for the State (sale of remaining shares) were negotiated. Labor concerns were negotiated by trade unions of the company.		<ul style="list-style-type: none"> • paying debts • increasing circulating capital • investments in technology
Did the government require specific investments or use performance – based standards to evaluate performance?	Yes		Some future investment requirements were incorporated into purchase agreements.	Investment program required.	A minimum program for investments was required.	Yes, depending on individual situation of the company.		
What special social or labor concerns were negotiated?	Some of social and labor issues will be negotiated.		Labor issues noted above.	Keeping the work places(business), liquidation of salary debts, assigning of regress plaints	Keeping the existing company work force and creating new jobs.	<ul style="list-style-type: none"> • employment guarantees • salary raises • privatization bonus 		There were social and labor conditions – firing of employees was forbidden for a certain period of time.
Were performance bonds required?	A bank guaranty will be considered.			Yes.	No.			Yes.
What documents were signed at closing?	Share Purchase Agreement, License/ Tariff Agreement will be signed at closing	Sale & Purchase Agreements Power Purchase Agreements Debt Novation Agreements		Sale-purchase agreement (contract)	Purchase and sales agreement.	Contract for sale of shares in case of public invitation to negotiation. Company listed on Stock Exchange in case of public offer.		Agreements between the State Property Fund and the tender winners were signed, as well as sale and purchase and investment agreements.

**POWER SECTOR PRIVATIZATION IN
CENTRAL/EASTERN EUROPE & EURASIA:
RESULTS AND FUTURE PLANS**

*A forum for privatization and energy officials, regulators, utility executives and
investors to share their experience and discuss the remaining challenges*

Sponsored by
U.S. Agency for International Development

June 6-8, 2000

**Thermal and Grand Hotels
Margarite Island
Budapest, Hungary
Ph. + 361 329 2300
Fax: +361-329-2429**

Facilitated by the United States Energy Association's
Energy Industry Partnership Program for Eurasia

POWER SECTOR PRIVATIZATION IN CENTRAL AND EASTERN EUROPE & EURASIA: RESULTS AND FUTURE PLANS

A forum for privatization and energy officials, regulators, utility executives and investors to share their experience and discuss the remaining challenges

BACKGROUND

Within most countries of the Central/Eastern Europe and Eurasia Region (E&E), the power sector remains the largest state owned asset. Confronted by declining public sector budgets and increased demand for capital to maintain and replace aging infrastructure, governments in the region are pursuing privatization by attracting strategic international investors as a strategy to ensure long-term sustainability.

To support privatization, most countries in the region have passed energy/electricity laws and established a regulatory entity with varying degrees of autonomy and decision making authority. To encourage competition, most countries in the region have separated generation and distribution functions from the previous vertically integrated monopoly and have begun to define the structure and operation of new electricity markets.

Hungary, Georgia, Moldova and Kazakhstan have already privatized substantial portions of their energy assets. Other countries, such as Ukraine, Armenia and Poland are taking initial steps toward power sector privatization and most countries have privatization plans in place.

The early experience with privatization in these countries indicates that a broad cross section of constituents including policy makers, legislators, privatization managers, utility regulators, utility managers and the public must confront a wide range of policy and technical challenges to ensure a successful privatization experience. Among others, these challenges include:

- Developing the strategy and process for privatization;
- Implementing power reforms including new electricity market arrangements;
- Selecting investment bankers and privatization advisors;
- Designing the privatization tendering process and evaluation criteria;
- Determining associated social and labor policies; and
- Reducing investment and regulatory risk perceived by investors.

This conference is designed to assess the power sector privatization experience to date and plans under development. It will focus on strategic privatization where international utilities have purchased power sector assets. Participants who have been or will be involved in the process are invited to attend this conference to

share their experiences in developing and implementing privatization policies, strategies and programs focused on attracting strategic investors.

OBJECTIVES

The objectives of the conference are to:

- (1) Review and assess the results of power sector privatization policies, strategies and implementation efforts to date and, identify successful approaches for future privatization in the region; and
- (2) Expand communication among energy and privatization officials, utility investors involved in the region, investment bankers and international financial institutions (World Bank, EBRD, IFC) and disseminate the results of the conference.

ATTENDEES

Attendance is limited to invitees with direct involvement in the privatization process so as to maximize the exchange of experience and the assessment of power sector privatization efforts to date:

- Senior officials from energy, privatization, finance and other relevant ministries;
- Utility regulators;
- Utility executives; and
- International financial institutions, investment bankers, private utility investors and privatization advisors.

CONFERENCE STRUCTURE

Day One will feature case studies of power sector privatizations already completed in the region and a set of presentations from countries outlining their approaches to upcoming privatizations. Building on the base of knowledge established during Day One, the second day will be devoted to comparing privatization strategies and implementation processes from a number of different perspectives, including those of government officials, investment bankers and private investors. The final day of the conference will be used to facilitate a group discussion evaluating efforts to date and identify successful approaches to future power sector privatizations.

**POWER SECTOR PRIVATIZATION IN
CENTRAL/EASTERN EUROPE & EURASIA:
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**Thermal Hotel
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MONDAY JUNE 5, 2000

7:00-10:00 pm **Conference Registration in the Hospitality Suite -- Park Room, Grand Hotel**
Register for the conference and enjoy light snacks in the hospitality suite

7:30-8:00 pm **USAID Officer's Meeting – Nador Room, Grand Hotel**

TUESDAY JUNE 6, 2000 – YBL Room, Grand Hotel

Plenary Session 1 – *welcoming/ keynote addresses followed by privatization case studies*

8:30 am

Introductions

- *Fred Guymont, Deputy Director, Office of Environment, Energy and Social Transition, Bureau for Europe and Eurasia, United States Agency for International Development*
- *Bob Archer, Deputy Chief, Energy and Infrastructure Division, Bureau for Europe and Eurasia, United States Agency for International Development*
- *William Polen, Manager, Energy Industry Partnership Program for Eurasia, United States Energy Association*

8:45 am **Keynote Address –RESULTS, ISSUES AND APPROACHES**
Speaker will provide a general overview of the technical, policy and social challenges in the privatization process as a prelude to case study presentations on Hungary, Kazakhstan, Georgia, and Moldova during which these issues will be addressed using real world scenarios
Laszlo Lovei, Lead Energy Specialist, Europe and Central Asia Region, The World Bank

Privatization Case Studies – An overview of power sector privatizations in four countries with considerable attention to the process as well as policy, strategy, roles of government agencies, investment bankers and consultants, timeframe, and lessons learned.

9:00 am **Hungary**
Presenter: Miklos Andrasi, Hungarian Privatization and State Holding Company
Commentator: Allan Walmsley, General Manager, Csepeli Eromu Rt, PowerGen International

10:00 am **Kazakhstan**
Presenter: Oraz Jandosov, Executive Director, Kazakhstan Electric Grid Operating Company
Commentator: Vitaly Lee, AES Silk Road

11:00 am **Break**

11:30 am **Georgia**
Presenter: Michael Ukleba, Ministry of State Property Management
Commentator: Michael Scholey, AES Telasi

12:30 pm. **Lunch**

2:00 pm **Moldova**
Presenter: Victor Bodi, Deputy Director, Department of Privatization (to be confirmed)
Commentator: Ignacio Ibarra, Union Fenosa

Plenary Session II -- *Updates on approaches in countries with developed privatization plans*

Country Approaches to Upcoming Power Sector Privatizations

Representatives from selected countries will provide an overview of their policy framework, strategy and implementation process for upcoming power sector privatizations

3:00 pm **Armenia**
David Vardanyan, Minister, State Property Fund of Armenia

3:30 pm **Ukraine**
Leonid Kalnichenko, Deputy Chairman, State Property Fund of Ukraine
Alexander Ryabchenko, Chairman, Supreme Rada of Ukraine Committee on Privatization

- 4:00 pm **Poland**
Grzegorz Gospkowski, Ministry of Treasury
- 4:30 pm **Romania**
Nicolae Liciu, Deputy Director General, Ministry of Industry and Trade
- 5:00 pm **Questions and Comments**
- 5:30 pm **Adjourn**
- 7:30 pm **Cocktail Reception and Dinner Hosted by the United States Energy Association**
Szechenyi Dining Room, Grand Hotel

WEDNESDAY JUNE 7, 2000 – YBL Room, Grand Hotel

Plenary Session III – *Panel discussion examining the policy framework and strategy designed to support the privatization implementation process*

9:00 am **Panel: Development of the Policy Framework and Strategy**

Panelists:

- Gabor Szorenyi, Deputy Director, Electricity Licensing, Hungarian Energy Office*
Paata Tsintsadze, Commissioner Georgian National Energy Regulatory Commission
Anatol Saracuta, Chairman, Moldova Energy Regulatory Agency
Kiron Sarkar, CIBC World Markets
Oleksei Kucherenko, Deputy Chairman, Committee on Fuel and Energy,
Supreme Rada of Ukraine
Fraser Morrison, Deloitte Touche Tomatsu

Policy Framework Issues

- The objective of the power sector privatization and how it informed the privatization policy that was developed
- How social considerations were incorporated into the privatization strategy
- Special laws/government decrees required to enact privatization
- Special provisions, if any, for dealing with power sector debt

Power Sector Reforms

- Restructuring/electricity market introduced? When? Impact on investor interest?
- Importance and authority of energy regulatory body.
- Tariff policies and pricing methodologies before and after privatization
- Key license provisions for new private owners

Approach and Strategy

- Targeting the new owners – strategic investor, portfolio investor or mass privatization
- Preference for domestic or international owners
- If strategic or portfolio investors which privatization implementation strategy was employed – competitive bid or negotiated contract

- The sequencing of privatization – generation or distribution first and policy on transmission
- The percentage of the asset offered through the privatization process – 100%. less than 100% but controlling interest. minority ownership with management control. minority ownership with no management control
- If government consulted with potential strategic investors when designing the strategy and implementation process and, if so, how their concerns were managed

10:30 am **Break**

Plenary Session IV – Panel discussion examining the early stages of implementing the privatization process

11:00 am **Panel: Preparing for Privatization—Investment Banker and Other Steps**

Panelists:

Arpad Bajkay, Hungarian Privatization and State Holding Company

Michael Ukleba, Georgian Ministry of State Property Management

Victor Bodiu, Deputy Director, Moldovan, Department of Privatization

Whether the privatization ministry employed the services of an investment banker, and if so, how it was selected – competitive bid or negotiated contract

- The criteria used to select the investment banker
- Provisions of the investment bank contract and its scope of work
- Other steps

12:15 pm **Lunch**

Plenary Session V – Panel discussions on the process of implementing the privatization and negotiating the financial closing

1:30 pm **Panel: The Implementation Phase**

Panelists:

Michael Ukleba, Georgian Ministry of State Property Management

Arpad Bajkay, Hungarian Privatization and State Holding Company

Victor Bodiu, Deputy Director, Moldovan Department of Privatization

Cyril Postel-Vinay, CCF

Vlado Vucetic, The World Bank

Selecting and Valuing Assets

- Whether the investment banker had a role in selecting and packaging assets for privatization
- Asset valuation methods: use of the valuations?

Marketing the Assets

- Information Memorandum preparation and content– technical, financial, tax, and social policies, etc.
- Pre-tender Marketing and Methods – newspaper announcements, international domestic conferences, visits

Prequalifying Potential Bidders

- Process, selection criteria and timing and publicizing prequalification of bidders
- Minimum number of responses required to proceed?

Soliciting Bids

- The contents and terms of the tender (draft buy-sell agreement, performance bonds, etc)
- Where and how it was announced
- Selection criteria clear? Price only?
- Time frame given to bidders to prepare proposals
- Ability of respondents to conduct adequate due diligence
- In-country support provided for bidders due diligence
- Process used to receive and record bids
- Process for communicating/questioning companies that provided proposals
- Process of bid evaluation, who did it and how long did it take?
- Selection decision – by committee, privatization ministry?

3:00 pm

Panel: The Negotiation Process

Panelists:

Arpad Bajkay, Hungarian Privatization and State Holding Company

Michael Ukleba, Georgian Ministry of State Property Management

Victor Bodiu, Deputy Director, Moldovan Department of Privatization

Allan Walmsely, Managing Director, Csepeli Eromu Rt, PowerGen International

Michael Scholey, AES Telasi

Ignacio Ibarra, Union Fenosa

Cyril Postel Vinay, CCF

- Roles of government entities, Investment Bank, regulator, advisors
- Process for negotiations
- Proposed time versus actual time for negotiations
- Resolution of special issues:
 - Labor issues
 - The use of performance based standards vs. specified future investment requirements
 - Tariff increases
 - Market power issues
 - Tax holidays and other incentives offered, if any

5:30 pm

Day Two Wrap-Up and Adjourn

7:00 pm

Danube River Sightseeing Sponsored by United States Energy Association

THURSDAY JUNE 8, 2000 – YBL Room, Grand Hotel

9:00 am **Conference Findings**

A summary of findings of the conference will be present. Conference participants will be asked to contribute comments and questions to stimulate discussion.

10:00 am **Evaluations, Recommendations and Lessons for the Future**

Based on the previous presentation, the participants will assess findings, propose conclusions and recommendations on what is needed for successful power privatization resulting in sale of assets to strategic international investors.

12:00 pm *Conference Adjourn*

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