

**Romania – PRIDE Project**  
**6th Quarterly Report – March 2005**

**To:** Virgil Musatescu  
Cognizant Technical Officer  
US Agency for International Development  
Romania

## **A. General Information**

### **1. Project Identification**

**Title:** Privatization, Investment, and Development of Energy Program (PRIDE)  
**Contract:** RFP No. PCE-I-00-97-00016-00, Task Order No. 811  
**Contractor:** Emerging Markets Group, Ltd.  
**Sub-contractors:** Deloitte & Touche Romania (DTR)  
Romanian American Enterprise Fund (RAEF)  
International Resources Group (IRG)

### **2. Project Performance Dates**

**Period of performance:** Two years  
**Start date:** 29 September 2003  
**Completion date:** 30 September 2005  
**Report date:** 31 March 2005  
**Quarterly Report:** No: 6

### **3. Project Management**

**HO Project Director:** Veronica Gilbert  
**Chief of Party:** Christopher H. Badach

### **4. Project Description**

The project has four activities:

- Activity 1 Support for privatization in a transparent and equitable manner
- Activity 2 Support for the reform of the legal/regulatory environment
- Activity 3 Support to further strengthen the energy sector regulatory bodies
- Activity 4 Support investment and credit for increasing energy efficiency and reducing pollution

## **B. Report Layout**

The reporting requirements for the Quarterly Progress Report are set out in the PRIDE project scope of work, namely:

- A. Identification of all professionals involved in rendering assistance and their respective roles and task responsibilities under this task order;
- B. Summary of progress on major implementation steps;
- C. Identification and description of implementation problems, proposed action to address such problems;
- D. Discussion of interaction with the counterpart(s), and any necessary alterations to the work plan and initial timetable;
- E. Results Achieved. A result is a change in policy or a change in behavior as a result of project assistance;
- F. Input to the Mission's annual results report including a summary of progress towards achieving targets; and
- G. Coordination with other USAID implementers, other donors or international financial institutions (e.g., EBRD, EU Phare or World Bank).

In order to present the report the sequence of the above list has been reordered as follows:

- 1. Introduction
- 2. Interaction with Counterparts
- 3. Major Implementation Steps – Progress
- 4. Implementation Problems
- 5. Results Achieved
- 6. Professionals Involved
- 7. Input to Mission's Annual Results
- 8. Coordination with others

Since the PRIDE Project comprises four main activities, the above reporting requirements have been applied to each activity.

## **C. Activity 1 – Support to Privatization**

### **1. Introduction**

In the first three months of 2005 one of main activities of the Government of Romania (GoR) was to complete personnel changes within the newly created state administration. It was an extremely slow process and these new administrative positions, in principle, may now have different responsibilities than before. The heads of the two regulatory agencies (ANRE and ANRGN) were the first to be replaced. It became clear that the new Advisor to the Minister of Economy and Commerce (Victor Ciotacu) would no longer be directly responsible for the implementation of privatization strategies for companies in the MEC portfolio. Mr. C. Nedelcu, the previous Deputy Head of OPSPI, and E. Zvirjinschi, General Director of OPSPI, were not re-appointed by the new government and subsequently left their positions.

Mr. D. Mucea, the former Senior Advisor to the Minister and Head of OPSPI, continues to supervise the work of the Agency, although to our knowledge he has not yet been officially re-appointed by the new Government. Other OPSPI officials (Mr. A. Alexa, Mrs. E. Necula) are still working for OPSPI, but it is not known how long they will stay affiliated with the Agency.

In a parallel move, the new Minister has fired all the senior managers of the Turceni Energy Complex. The new managers have a coalmining background and work experience and it is not yet clear how this change may affect the performance record of the thermal power generation unit and its readiness to effectively enter the privatization procedures.

Such a high turnover at the senior official positions alongside a prolonged work uncertainty for the lower category of employees creates a partly dysfunctional Agency and is adversely affecting PRIDE's cooperation with OPSPI and with the TEC management. The new administration has had evident problems to finalize in due time the privatization transactions for the electricity distribution networks (Dobrogea, Banat, Oltenia and Moldova). In addition, according to the latest press reports, by mid-2005 OPSPI will merge with another privatization agency of the Romanian Government -AVAS - in order to comply with the IMF's requirement to reduce the costs of state administration. AVAS is subordinated directly to the Prime Minister, rather than to the Minister of Economy and Commerce.

There has been a problematical delay in the release of a KPMG financial audit of the Turceni Energy Complex. Nominally, this audit was due by mid-September 2004, but it has to date not yet been completed. This has in turn delayed PRIDE's completion of the TEC valuation report. At our meeting with OPSPI officials (March 18, 2005) they finally confirmed their intention to sign the JBIC environmental loan in March 2005. We have also learned that during negotiation of the terms and conditions for the loan the OPSPI representatives committed to keep state majority ownership of the Turceni Energy Complex even after the company's privatization (however this is allegedly not included in the Loan Agreement). None of the Romanian specialists participating in direct loan negotiations could (or would) clarify whether the Loan Agreement contains a loan pre-payment penalty clause, if the loan is applicable only to rehabilitated power generation units or can be applied to new units as well, and what other covenants and conditions are part of the Loan Agreement.

Information on the terms and conditions of the JBIC loan is critical for the development of an appropriate privatization strategy, which is to combine the privatization of TEC with the utilization of the loan proceeds for environmental upgrade. The Loan Agreement was finally signed on March 29, 2005, but information in the press release was limited to the political values of the Agreement. The loan has an approximate amount of €210 million, a maturity period of 40 years and a grace period of 10 years and a base APR of 0.75%.

On March 9, 2005 the Government of Romania published the adopted *Strategy of Privatization and Investment Inflow for the Economic Agents in Portfolio of the Ministry of Economy and Commerce in 2005*. The available text of this document specifies a selected privatization approach (a package of capital increase combined with sale of existing shares to reach at least 51% of stake of the privatized company) and lists TEC and two other energy complexes (Rovinari and Craiova) among the companies scheduled for privatization in 2005.

The new GoR Privatization Strategy document mentioned above (for a majority privatization) contradicts the general terms and conditions (GTC) of ODA/JBIC loans, which contain a requirement for the beneficiary of loan proceeds to retain majority state ownership and control. PRIDE received from OPSPI a clarification that we had read the wrong document and that the *Strategy of Privatization ...* document available to OPSPI does not contradict the JBIC requirement for only a minority stake privatization of TEC. From the secrecy surrounding the details of the signed JBIC loan agreement we can perhaps anticipate the presence of further unknown constraints to an expedient and equitable privatization process for Turceni Energy Complex. We anticipate that as a fallback option, in case of the absence of investor interest in a minority stake privatization alternative, the Government of Romania may resort to signing a management contract with some EU operators for a period of several years.

## **2. Interaction with Counterparts**

The main counterparts that PRIDE has worked with are:

Ministry of Industry and Commerce and OPSPI senior officials – in particular Messrs. Constantin Nedelcu and Gheorghe Indre.

OPSPI officials - Alexandru Alexe and Elena Necula supported by a legal advisory group from MEC and the Ministry of Finance.

Turceni Energy Complex senior management – Constantin Marin (General Director), Mircea Giumancu (Commercial Director), Gheorghe Vaduva (Director of Production), Nicu Andrei (Technical Director), Marius Liviu Preda (International Business and Privatization Division).

Management of Jilt and Dragotesti Coal Mines) - Ungureanu Dumitru (Technical Director of Jilt Lignite Mines), and Marcian Sandru (Director of Energy Department, Jilt Lignite Mines).

In most cases the interaction had been cooperative; however financial and operational information provided by the plant and mines' management is often incomplete and not reliable. According to the TEC management, the collection rate in 2004 was in the low 70s,

with cash payments of only around 50%. The major poor payers are key state-owned energy companies, such as Hidroelectrica and Electrica.

### 3. Major Implementation Steps – Progress

The PRIDE Project Workplan identified a number of tasks to undertake in Activity 1. The progress being made in these areas is set out in Exhibit 1.

**Exhibit 1: Activity 1 – Plans and Progress on Major Implementation Steps**

| Task | Description   | Progress  | Next Steps  |
|------|---|---|---|
| 1.1  | Prepare Privatization Strategy                              | Reviewed existing legal acts and identified available privatization options. For a majority stake privatization option (if desired by GoR) we proposed applying for JBIC approval for the creation of a special purpose FGD company, 100% owned by the state, which would render commercial pollution reduction services to TEC. The FGD company would utilize all loan proceeds for FGD installation and operations. Alternatively, if the above solution is not desired by GoR or acceptable to JBIC, the buyer would accept a 49% initial stake with operating management control. On a specified date the state would offer sale of an additional 2% or more shares (newly subscribed or existing, depending on a reached agreement) to facilitate the transfer of a majority ownership into private hands. In both cases, however, we recommend a new sale announcement and the pre-qualification selection of potential applicants. | <ul style="list-style-type: none"> <li>Opening effective discussion with OPSPI on all pros and cons tied to the shrinking range of available privatization options. It is essential for the successful privatization of all the newly created energy complexes to commence with a well-designed privatization process for TEC.</li> <li>Re-establishing close contact with all potential investors to identify their privatization appetite for TEC with the JBIC loan strings attached..</li> <li>Evaluate all pro and contra reasoning for selection of rehabilitation vs. new technology option for generating blocks Nos. 3 and 6.</li> </ul> |
| 1.2  | Valuation Memorandum Preparation                            | <ul style="list-style-type: none"> <li>Reviewed several new technical alternatives for the restoration of TEC generation capacity and assessed their commercial soundness. Made an initial assessment of the accelerated market liberalization strategy promoted by the new Government upon a revenue stream projection for TEC. Change of TEC management may be followed by a new development strategy for TEC promoted by the new leaders.</li> <li>Work cannot be completed on the valuation of the Turceni Energy Complex until the consolidated financial statements and opening balance for TEC are available and a valid new business plan is offered.</li> </ul>  | <ul style="list-style-type: none"> <li>Using audited financial data (when available) to correct preliminary valuation results.</li> <li>Ensuring the satisfying flow of needed information between the PRIDE and SF team to better coordinate effort and to complete the contracted tasks.</li> </ul>   |
| 1.3  | Execute other activities listed in the PRIDE Scope of Work. | <ul style="list-style-type: none"> <li>Developed a comprehensive list of activities financed from the SF funds to avoid the duplication of work and potential conflict of interest situations.</li> <li>Providing all completed working drafts of due diligence reports to OPSPI to</li> </ul>  | <ul style="list-style-type: none"> <li>Maintaining good working contacts both with the new team at OPSPI and senior and mid-level TEC officials and monitoring the delivery of PRIDE key documents and</li> </ul>   |

|     |   |  |   |
|-----|---|--|---|
|     |   | <p>create an information base for productive discussion of key privatization issues.</p> <ul style="list-style-type: none"> <li>• Delivery of a working draft of the Privatization Strategy to initiate PRIDE-OPSPI-SF debate of several critical issues for the pace and format of the TEC privatization.</li> </ul>  | <p>memos to all authorized personnel of OPSPI and MEC.</p>  |
| 1.3 | Removal of informal barriers to privatization.        | <ul style="list-style-type: none"> <li>• Lignite reserves stipulated in actual, 1998 licenses are smaller than reserves in the homologated perimeters. Prepare more reliable survey results.</li> <li>• 2003 Mining Law requires preparation of mining closure plans, not existing at this moment.</li> <li>• Some legal aspects of newly created energy complexes are challengeable in administrative courts.</li> <li>• Position of railroad transportation in the TEC is not transparent. Investors need GoR clarifications on the possibility to obtain long-term service contract before signing SPA.</li> </ul>                          | <ul style="list-style-type: none"> <li>• Proposal to receive exploitation licenses for the marked perimeters before closing transaction, to avoid potential disputes.</li> <li>• Issuing GD on closing coal mine Dragotesti two months before closing transaction.</li> <li>• Finishing legal due diligence by a highly professional, external legal firm.</li> <li>• Obtaining the binding final GoR decision on the components of integrated entities.</li> </ul> |
| 1.4 | Info Memorandum Preparation and Due Diligence Reports | <ul style="list-style-type: none"> <li>• The preparation of the technical and commercial due diligence of TEC is well in hand.</li> <li>• New chapters (technical basis, road map, commercial &amp; contractual environment, and employment issues) for the final Information Memorandum were prepared in a draft format, subject to further coverage revisions and updates.</li> <li>• Performed extensive environmental audit of the Turceni plant and the Jilt &amp; Dragotesti coalmines.</li> <li>• Delayed activities are: <ul style="list-style-type: none"> <li>- Financial audit of the Energy Complex by KPMG</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>• Incorporating new technical and business information in relevant chapters of Info Memo, including new legal provisions (Mining Law, etc)</li> <li>• Editing existing chapters to reduce the overall size of the IM.</li> <li>• Prepare concise environmental audit report for GoR review and use..</li> <li>• Need completed financial audit report by KPMG.</li> </ul>  |

#### 4. Implementation Problems

The new administration focuses, in the short-term, on meeting its commitments to the EU energy acquis communautaire before Treaty signing in April 2005 and on closing down unprofitable units and finding mixed hydrothermal privatization solutions to make sale offers more attractive to investors. According to the recently adopted privatization strategy for 2005, all three vertically integrated energy complexes are scheduled for privatization in 2005. However, after more than 12 months of intense preparatory work with substantial USAID assistance, the Turceni Energy Complex is still not fully ready to effectively enter into privatization procedures.

In regard to the privatization of the Rovinari and Craiova energy complexes there has only been some initial steps made and all preparatory works are in the incipient stage. It is highly unlikely that these two energy complexes can be privatized this year; perhaps in the next year. If the commencement and further developments of the privatization process for Turceni Energy Complex are not appealing to potential participants it may have adverse consequences on the privatization outcomes for these other two energy complexes.

The anticipated merging of OPSPI with AVAS in June-July 2005 and the potential threat of new general elections in the second half of 2005 could further delay the new administration's implementation of ambitious privatization plans. A recent decision to accelerate the liberalization of the wholesale energy market in Romania may also increase the risk perception for the acquisition of power generation assets among investors which have expressed their interest in the privatization of the energy complexes.

## 5. Results Achieved

We have clarified our recommended TEC privatization strategies for both possible venues of privatization as:

A majority stake privatization option with the investor firm having management control over the privatized assets and the entity operations, on the assumption of the creation of a special purpose FGD company receiving all loan proceeds and remaining in 100% state ownership during the whole loan maturity period, with two "technical" alternatives:

- Installation of FGDs on rehabilitated units Nos. 4 & 5; using other existing assets until 2010; and the replacement of units Nos. 3 & 6 by new equipment; which satisfies all industrial and environmental requirements of EU; or
- Technical and environmental rehabilitation of units Nos. 3 & 6; the installation of FGDs on rehabilitated units Nos. 3, 4, 5 & 6; and the use of other operating units until Dec. 31, 2010, with unit No. 7 after this deadline (within the established work time limits for this unit).
- A minority stake privatization option (49%) (with the secured call option to buy an additional 2% of shares within a specified period of time) and secured management control of privatized assets by a minority stakeholder, that would be integrated with the Japanese loan disbursement.

These options, accompanied with relevant valuation results, will be presented soon to OPSPI.

## 6. Input to Mission's Annual Results

The privatization assistance is in process and is not yet ready for complete input into the Mission's Annual Results.

## 7. Professionals Involved

In addition to the Chief of Party, other experts contributing to Activity 1 were:

| No | Expert name | Work performed |
|----|-------------|----------------|
|----|-------------|----------------|

|     |                    |  |
|-----|--------------------|--|
| 1.  | Gabriela Baicu     | <ul style="list-style-type: none"> <li>- Overall supervision of D'TR team work</li> <li>- Developing DCF model for valuation of TEC</li> <li>- Collection of all relevant data and background information from TEC management and its quality assessment</li> <li>- Reviewing preliminary valuation conclusions and their assessment with RAEF, OPSPI and MEC experts</li> <li>- Preparing valuation on a basis of the analysis of comparable privatization transactions in the region.</li> </ul>   |
| 2.  | Eric Olcott        | <ul style="list-style-type: none"> <li>- Modifying DCF model format for specific analytical needs of TEC valuation exercise and technical alternatives.</li> </ul>   |
| 3.  | Victor Semyonov    | <ul style="list-style-type: none"> <li>- Collecting data for valuation based on sale of comparable assets (in Czech Republic, Bulgaria and in Hungary)</li> <li>- Reviewing reliability of series provided by TEC management for different investment scenarios</li> <li>- Filtering fuel consumption data by different generation units of TPP to assess their reliability for valuation calculation in DCF model</li> </ul>  |
| 4.  | Gheorghe Nistoroiu | <ul style="list-style-type: none"> <li>- Valuation technical assistance</li> </ul>   |
| 5.  | Andreea Panait     | <ul style="list-style-type: none"> <li>- Reviewing industry and GoR materials assessing price development for coal-fired power generation.</li> <li>- Assessing cost of coal extraction in associated opencast lignite pits for provided by TEC management investment scenarios.</li> </ul>  |
| 6.  | Pavel Stehlik      | <ul style="list-style-type: none"> <li>- Re-establishing working contact with most of potential investors</li> <li>- Managing overall marketing activities and relations with investors</li> <li>- Participating in investor-related meetings with MEC senior officials and taking part in working groups of OPSPI called to define response for communication received from Investors.</li> </ul>   |
| 7.  | Jonathan Ward      | <ul style="list-style-type: none"> <li>- Project management and administrative issues</li> <li>- Providing technical and editorial revision for project deliverables</li> <li>- Preparing training module and PP presentation for regulator, training delivery and gathering additional materials for broad distribution.</li> <li>- Contracting external specialists to deliver additional training services, requested by ANRE and ANRGN.</li> <li>- Continuous investor and energy market research</li> <li>- Monitoring strict budget execution and financial/contractual reporting to USAID</li> </ul>  |
| 8.  | Valeriu Binig      | <ul style="list-style-type: none"> <li>- Contribution to day-by-day management of the project by coordination of work of the RAEF team</li> <li>- Ensuring interface with Romanian counterparts: MEC, OPSPI, Turceni Energy Complex management and with potential investors</li> <li>- Developing data room in TEC</li> <li>- Participation in activities related to technical, legal, financial and commercial due diligence</li> <li>- Involvement in preparation of <i>Legal and Regulatory Framework</i></li> <li>- Continued contribution toward developing and re-drafting new chapters of the final draft of Information Memorandum.</li> </ul> |
| 9.  | Alin Giurgiu       | <ul style="list-style-type: none"> <li>- Gathering information on terms and conditions of the JBIC loan</li> <li>- Reviewing necessary changes in privatization legislation to secure effective management control for a minority stakeholder</li> <li>- Preparing a draft of recommended by RAEF privatization strategy</li> </ul>  |
| 10. | Neculai Sandu      | <ul style="list-style-type: none"> <li>- Contribution to preparation of Information Memorandum</li> <li>- Summarizing country macroeconomic development chapter</li> </ul>   |
| 11. | Valentin Tabus     | <ul style="list-style-type: none"> <li>- Contribution to data collection and financial analysis in view of valuation exercise and investment needs</li> </ul>  |

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|-----|--------------|--|
| 12. | George Darie | <ul style="list-style-type: none"> <li>- Contribution to summarizing the main data on the entity to be privatized</li> <li>- Contribution to technical due diligence</li> <li>- Contribution to environmental due diligence</li> </ul> |
|-----|--------------|--|

## 8. Coordination with others

Mr. Virgil Musatescu (USAID Bucharest) and Chris Badach (PRIDE CoP) met with Mr. Kari J. Nyman, Lead Specialist in Infrastructure and Energy Sector Unit for Europe and Central Asia Region, the World Bank. Mr. Nyman appears to be under the impression that the USAID PRIDE project provides for technical assistance to the GoR on the privatization of all three energy complexes.

The World Bank is aware of the GoR's plans to sign a JBIC environmental loan for the Turceni Energy Complex. While recognizing the attractiveness of the financial terms of the loan, Mr. Nyman pointed to some difficulties that the contract implementation can bring to the privatization process of all power generators and particularly to the expedient and equitable privatization of the Turceni Energy Complex. The World Bank appears to favor the idea of creating a special purpose FGD company, 100% state-owned, which would receive all loan proceeds and provide commercial services for pollution reduction to the privatized TEC.

It is not clear whether the privatization of the vertically integrated energy complexes will be included as a conditionality for disbursement of the PAL-2 loan, which is scheduled for the last months of 2005. The World Bank supports the idea of a new announcement for the sale of the energy complexes in order to better highlight transparency and to enhance the competitiveness of the privatization process. In the debate of rehabilitation vs. installation of new equipment for Turceni units Nos. 3 & 6, the World Bank favors the installation of new units as a more technically sound and commercially viable option.

In principle, in our understanding, the World Bank supports the ongoing process of the privatization of energy assets in Romania as it is and is satisfied with its pace and its directions and priorities (first privatizing energy distribution companies to be followed by power generators). It is unlikely that the World Bank will establish and enforce some deadlines for the privatization of power generation companies. We expressed our readiness to develop close cooperation with the World Bank in the drafting and implementation of an adequate privatization strategy for the Turceni Energy Complex.

Chris Badach also met with Ms. Rania Aikaterinari, Assistant Director, EFG Telesis Finance, and a financial arm of PPC Greece. PPC Greece is the only strategic investor among the short-listed applicants with proven operating work capacity in both power generation and lignite coal mining. PPC generates well over 50% of its power from lignite-fired power plants. The main topics discussed during this meeting were issues related to the anticipated schedule of TEC privatization and a review of the impact of the JBIC loan vis-à-vis a) the privatization process and b) investors' appetite for a minority stake privatization of this highly capital-intensive business venture.

## **D. Activity 2 – Support to Legal and Regulatory Environment.**

### **1. Introduction**

In the last quarter of 2004 ANRE requested additional assistance from PRIDE for an interactive review of the developed models for tendering Provider of Last Resort (POLR) services, which should lead to a drafting of urgently needed legislation. After a review of our budget situation and consultation with potential experts in this area we created a budget appropriation reserve for this purpose and selected Mr. Leszek Kasprovicz to deliver the requested services. In the implementation of this assistance the major problem was of a logistical nature.

ANRE personnel are currently burdened with additional tasks arising from the need to develop a tariff methodology and to draft the appropriate ANRE decisions necessary to finalize privatization contracts for the Banat, Dobrogea, Oltenia and Moldova electricity distribution networks and to allow public review of these documents by relevant foreign experts. Some additional workload was related to the GoR's decision to accelerate the liberalization of the wholesale energy market in Romania, well ahead of the schedule established recently by EU officials. Ultimately we agreed on a period in the 2<sup>nd</sup> half of March for the delivery of the requested POLR assistance.

At the start Mr. Kasprovicz has reviewed the most successful models developed in the USA and EU. In close collaboration with ANRE lead experts he selected the concept best fitting ANRE needs and reflecting Romania's market specifics. On this basis Mr. Kasprovicz prepared an initial draft of the relevant legislation and left it with the ANRE team for a more thorough review by a broader team of ANRE specialists, external experts and legislators.

### **2. Interaction with Counterparts**

Meetings were held with the electricity regulator, ANRE, to clarify the steps needed to provide would-be investors in Turceni with a degree of comfort in the credible and reliable off-take of the electricity generated by the enterprise. The new Commercial Code contains a provision for the full pass through of power purchase costs to electricity distributors. This in turn creates a favorable regulatory environment for long-term bilateral power supply contracts with power generators. Power generation costs from the Turceni plant, even under inefficient state management and questionable commercial supervision, were one of the lowest among thermal power generators in the country. Therefore, under a more efficient private management, TEC is capable of delivering power at very competitive price, both to domestic and foreign suppliers and to consumers. In the meantime, following pre-accession EU agreement provisions, there are periodical increases of the end-use electricity tariffs, which are enhancing the commercial attractiveness of power sector entities for would-be investors.

Contacts were also held with ANGRN, the gas regulator. The purpose of these meetings was to discuss a detailed scope for the accounting training program, which the PRIDE project offered to the regulators in March 2005.

### **3. Major Implementation Steps – Progress**

The PRIDE Project Workplan identified a number of tasks to undertake in Activity 2. Progress being made in these areas is set out in Exhibit 2.

**Exhibit 2: Activity 2 – Plans and Progress on Major Implementation Steps**

| Task | Description   | Progress  | Next Steps  |
|------|---|---|---|
| 2.1  | Analyze the existing regulatory and operating rules relevant to tendering POLR services.  | <ul style="list-style-type: none"> <li>PRIDE project to work on defining models which best fit ANRE's needs.</li> <li>Clarification of licensing and authorization requirements for POLR tender participants, agencies involved, procedures applied.</li> <li>Initial draft of relevant legislation for internal debate in ANRE.</li> </ul> | <ul style="list-style-type: none"> <li>Proposing further amendments and correction to reviewed draft.</li> <li>Describing process of application for participation in POLR tender.</li> </ul> |
| 2.2  | Identify other critical topics for integration of universal service obligations into the Romanian electricity market and present them in provided report (subject to availability of funds and USAID approval). | <ul style="list-style-type: none"> <li>Clarification of further assistance needs for integrating universal service obligations into draft amendments to legislation and regulation aiming at implementation of the universal service principle.</li> </ul>  | <ul style="list-style-type: none"> <li>Planned for May 2005</li> </ul>  |

| Task | Description  | Progress  | Next Steps   |
|------|--|---|--|
| 2.3  | Gas Regulatory Agency strengthening and assistance to meet EU requirements according to latest directive provisions. | <ul style="list-style-type: none"> <li>Specifying training topics with capacity and skills of available pool of trainers.</li> <li>Drafting training schedule in cooperation with ANRGN.</li> </ul> | <ul style="list-style-type: none"> <li>Defining specific agenda of other topics and workshop focuses for potential training extension. (subject to available resources and USAID approval).</li> </ul> |
| 2.4  | Technical assistance in delivery of training courses on topics selected by ANRGN.                                    | <ul style="list-style-type: none"> <li>Approval by USAID of topics and presentation modules for training program</li> <li>Delivery of requested training topics by hired trainers.</li> </ul>       | <ul style="list-style-type: none"> <li>Drafting training schedule for other accounting topics in cooperation with ANRGN.</li> </ul>  |

#### 4. Implementation Problems

This activity is progressing mainly at the pace of the process of accession-related requests to create or harmonize major regulatory documents and legal acts for a liberalized energy market in Romania with the legislative initiatives of relevant organizations within the EU executive structures. An additional factor determining the pace and direction of work for both regulators is the need for development of distribution (regulated) tariffs for privatized companies (Banat, Dobrogea, Oltenia and Moldova in power industry and Distrigaz Sud and Nord in natural gas industry) and the decision to accelerate liberalization of the wholesale energy market in Romania. The overloaded personnel of both regulatory agencies currently

lack adequate specialists with the specific expertise necessary for resolving a variety of methodological and conceptual issues, and hence there is a growing backlog of unresolved issues. Additionally, the new private owners of the distribution companies (Enel, CEZ, E.ON, Ruhrgas and GdF) are enticing away top regulatory experts by offering better-paid positions.

## **5. Results Achieved**

In respect of ANRE, the main result achieved thus far is a common recognition that the bidding documents must contain sufficient information on the current and future market arrangements, the time horizon, and the conceptual prospects for “new portfolio” contracts, in order to provide some comfort to investors about future off-take agreements. Work will commence after the development of a new trading platform for a liberalized energy market.

## **6. Input to Mission’s Annual Results**

Too early in project for results.

## **7. Professionals Involved**

Christopher Badach had several meetings and maintained routine daily contacts (when needed) with ANRE and ANRGN. Virgil Musatescu (USAID Bucharest) had several meetings with both regulators to review their progress in developing a legislative and regulatory framework for the liberalized energy market. Jonathan Ward participated in the search for suitable training experts and the contracting of expatriate specialists for assistance delivery to both regulators.

Leszek Kasproicz has delivered assistance to ANRE through the presentation of the merits of developed models used throughout the USA and EU for tendering POLR services. Following this presentation, he advised on the selection of the most appropriate for ANRE’s needs and provided an initial draft of legislation.

## **8. Coordination with others**

Apart from meetings with ANRE and ANRGN, PRIDE stayed in occasional contact with KEMA Consultants. KEMA’s work, which is financed by the World Bank, will intensify starting from Spring 2005 with a focus on the development of a new trading platform (a proxy for a power exchange) for the country’s wholesale power market. It is not yet clear whether KEMA’s project will define the trading platform before the privatization of TEC is completed.

# **E. Activity 3 – Regulatory Training**

## **1. Introduction**

As part of this program, the PRIDE project is contributing to an improvement of regulatory capacity to manage the energy market more efficiently and effectively by providing technical

expertise and training, as well as by the development of professional partnerships, institutional relationships, and regional programs, within the project's limited budget resources.

## 2. Interaction with Counterparts

Meetings have been held with both ANRE and ANRGN to specify the focus, presentation approach and coverage of accounting training sessions. Initially commencement of the training program was proposed for early February 2005. However, prolonged EU accession processes, followed by changes made to the regulatory framework and an additional workload for ANRE and ANRGN in developing a new tariff methodology for regulated services of the recently privatized power distribution companies, forced ANRE and ANRGN management to delay the start of the PRIDE training program to the 2<sup>nd</sup> half of March 2005.

In a one-week training program (March 21-25), we delivered accounting training which focused on the following major topics: IFRS Principles and Concepts; IAS Principles Impacting Utilities; and Regulatory Accounting. The major problem was to select a presentation method suitable to the wide spectrum of specialists participating in the workshop: accountants, engineers, lawyers, economists, etc. Our trainer, Mr. George Schaeffer, delivered a very highly valued training program, clear in its message and well received by all groups of specialists. Daily attendance at ANRGN was at least 16 persons (both from ANRGN and invited private operators) and at ANRE it was at least 14 every day, despite an epidemic flu in Bucharest, which reduced expected attendance by 5 to 10 persons.

Most of the attendees asked for an additional module on best practices in tariff setting. There is a lack of tariff specialists within ANRE and ANRGN and therefore a low expertise level for regulatory decisions in this area. We received an inquiry from both regulators as to whether our project (or USAID) could extend training assistance for tariff setting and additional accounting topics.

## 3. Major Implementation Steps – Progress

The PRIDE Project Workplan identified a number of tasks to undertake in Activity 3. Plans and progress being made in these areas is set out in Exhibit 3.

### Exhibit 3: Activity 3 – Plans and Progress on Major Implementation Steps

| Task | Description  | Progress  | Next Steps  |
|------|--|---|---|
| 3.1  | Desired accounting training topics for both regulatory agencies. | <ul style="list-style-type: none"> <li>Identified the best foreign candidates for training, reviewed their skills and credentials.</li> <li>Prepared a time schedule of training classes, secured needed presentation equipment and room size according to the number of attendees and budget to cover all related logistics expenses.</li> <li>Delivery of five accounting training</li> </ul> | <ul style="list-style-type: none"> <li>Review budget expenditures to date in order to identify availability of resources for additional training and discussing outcome with USAID and participants.</li> </ul> |

|  |  |  |  |
|--|--|--|--|
|  |  | modules for the ANRE and ANRGN audience. |  |
|--|--|--|--|

#### **4. Implementation Problems**

No other major problems met to date.

#### **5. Results Achieved**

The planned stage of activity is just being completed. If there will be some budget reserve to cover additional training topics, with USAID approval, we may discuss it with senior officials of both regulatory agencies.

#### **6. Input to Mission's Annual Results**

Initial results are expected in the 2005.

#### **7. Professionals Involved**

Christopher Badach and Virgil Musatescu held meetings with ANRE and ANRGN.

Jonathan Ward has been instrumental in the selection of the best short-term experts, hiring Mr. George Schaeffer and guiding him on content and format of presentation materials.

#### **8. Coordination with others**

Meetings held with ANRE and ANRGN.

### **F. Activity 4 – Increasing the Efficiency of Energy Assets and Reducing Pollution**

#### **1. Introduction**

USAID has extensive experience, both country-specific and regionally, with the previous programs that identified energy efficiency and water supply/treatment projects. USAID has developed the market for energy service firms and supported the development of new financial instruments for project implementation. One important current problem is that companies in South East Europe have difficulty obtaining capital funds from the banks on a commercial basis due to their perceived high lending risk. Consequently, based upon the successful experience of other countries in the region using the Development Credit Authority for similar projects, USAID through the PRIDE project has offered support to municipal projects for energy efficiency and water supply/treatment.

In the latest effort, in a close collaboration with the GTZ-funded program for energy efficiency, both USAID (Virgil Musatescu) and PRIDE (Chris Badach) are participating in a series of meetings sponsored by the Ministry of Transportation and Public Housing. The purpose of these meetings is to create a pilot energy efficiency project for blocks owned by homeowners' associations. The project would be financed by a commercial bank loan (provided by BCR or Libra Bank), and with positive results such an initiative could be replicated throughout the country. To date, there is no evident progress in the implementation of the GTZ energy efficiency program despite that GTZ assistance is specifically targeting Romania's obligations under the EU accession schedule.

Another attempt to investigate the readiness of the local environment to utilize commercial loans to finance infrastructure projects in small municipalities was undertaken by Mr. Mike Keshishian, Local Government Advisor (USAID, Washington, DC) with the support of Mr. Brad C. Johnson, President of Resource Mobilization Advisors. A report with relevant observations and conclusions will be drafted later and provided to USAID, Washington DC.

## 2. Interaction with Counterparts

In the last three months we discussed the prospects of DCA facility use with two additional banks: BCR and Libra Bank. BCR needed almost 6 months to reply. Presently, the bank is not interested in using the DCA facility in its commercial lending because, according to the bank's understanding, the DCA guarantee cannot be used as a primary bank guarantee. However, a more realistic explanation of the bank position is that commercial banks in Romania still have the capability to request from borrowers more liquid or easier to handle collateral instruments, such as property deeds, deposit requirements, rights to use wage payment to clear obligations to the bank, etc.

Perhaps, a similar outcome will result from our (still pending) negotiations with Ms. Cornelia Gheorge, Head of Corporate Banking Department, the Libra Bank. With this Libra Bank contact we have practically exhausted all possibilities to identify a commercial bank in Romania, which might use the DCA facility in its commercial lending to finance municipal energy efficiency and water supply/treatment projects.

We will continue to stay in close working contacts with the GTZ project headed by Mr. Frank Siegert, Energy Consulting Group, in order to monitor progress in the implementation of energy efficiency projects, as enforced by international obligations of the Romanian Government.

## 3. Major Implementation Steps – Progress

The PRIDE Project Workplan identified a number of tasks to undertake in Activity 4. Plans and progress being made in these areas is set out in Exhibit 4.

**Exhibit 4: Activity 4 – Plans and Progress on Major Implementation Steps**

| Task | Description   | Progress  | Next Steps  |
|------|---|---|---|
| 4.1  | Analyze the portfolios of potential municipal energy efficiency and water | <ul style="list-style-type: none"> <li>Maintaining a sufficient number of bankable projects to activate the DCA facility, if</li> </ul> | <ul style="list-style-type: none"> <li>USAID decision regarding DCA facility use for Romania's</li> </ul> |

|  |                            |   |             |
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|  | supply/treatment projects. | needed and define a pipeline for the identification of future bankable projects. Developing cooperation with other projects in this area. | conditions. |
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#### **4. Implementation Problems**

The major problem encountered has been the difficulty of identifying a partner bank willing to sign the agreement with USAID to use the DCA loan guarantee in municipal commercial lending for targeted categories of projects. All illustrative projects included in the FVA chapters of the Action Memorandum show positive DCF values and a high level of IRR indicator; similar positive indicators were obtained for the Lender FVA, implying the high profitability of such loans for the bank at the loan's annual interest over 20%. The recently observed sharp decline of interest rates charged by commercial banks and the steady increase of electricity and heat tariffs should further enhance the commercial attractiveness of such demand-driven projects.

Regretfully, however, at the current stage of development of the banking industry in Romania and its regulatory environment, there is no evident interest from the commercial banks in demand-driven municipal infrastructure projects and such systemic impediments are serious barriers for complying with the international obligations of the Romanian Government.

#### **5. Results Achieved**

Activity so far has not brought expected results.

#### **6. Input to Mission's Annual Results**

Too early in project for results.

#### **7. Professionals Involved**

In addition to the PRIDE team members (Christopher Badach, and Jonathan Ward), Honoratiu Piteru (APER), Mihai-Marius Voronca (FREE), Mark Velody (GEF UNDP), and Frank Siebert (GTZ ECG) were involved. From USAID we received the full support, assistance and personal involvement of Virgil Musatescu (USAID Bucharest).

#### **8. Coordination with others**

Several working meetings were held with the GEF UNDP team (Mark Velody and Stefania Racolta). The GEF UNDP team is expanding a roster of bankable municipal projects (such as the energy efficiency program for blocks managed by homeowners associations), which are of interest also to GTZ energy efficiency programs.