Romania – PRIDE Project
8th Quarterly Report – September 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) Troutman Sanders LLP

2. Project Performance Dates

Period of performance:	Two years
Start date:	29 September 2003
Completion date:	29 November 2005
Report date:	5 October 2005
Quarterly Report:	No: 8

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

During this vacation quarter there was no major advance in the privatization process for Turceni or the other vertically integrated energy complexes. The Government of Romania published in March 2005 its document (GD 184/2005, *The Strategy for the Acceleration of Privatization and Investments Inflow for the Economic Agents in MEC portfolio for 2005*) confirming its wish in 2005 to advance the privatization of TEC, REC and CEC but without offering a specific timetable. According to the latest assessment of OPSPI, after the GoR approves a TEC privatization strategy (sometime in October-November 2005) a new tender announcement will be published (before the end of 2005). Potential applications will be submitted one month from this announcement and the pre-qualification selection of applicants could be finalized by the end of 2005 or at the beginning of 2006.

During our working contacts, OPSPI has reiterated its intention to publish a new sale announcement. OPSPI also announced its intent to have talks with the Japan Bank for International Cooperation (JBIC) regarding the removal of the bank's requirement for state majority ownership as well as to waive a prerequisite of Romanian management control over TEC operations and assets. On a company level, more land was registered in TEC ownership and a more favorable (covering all of 2004) KPMG audit report was completed.

Further, more evident progress was made in the privatization of the electricity distribution grids. There are finalized transactions (51% of shareholding) for Oltenia (by CEZ) and Moldova (by E.ON) and the GoR is offering for sale 67.5% shareholding of Muntenia Sud (electricity distribution company). It is likely however that the potential buyers for riskier power generation assets may expect the same or better trade terms of sale from the Government. Muntenia Sud has attracted interest from a large number of reputable investors and thus a high transaction value can be expected. The rationale is unclear for the GOR's past offering of a minimal majority shareholding for moderately attractive assets and putting now for sale a much higher majority of shareholding in the case of a highly attractive asset.

The Government of Romania continues to undergo personnel changes. In the Ministry of Economy and Commerce (MEC) all state secretaries (or Vice-Ministers) were released from their positions and some positions are still vacant. A newly nominated Secretary of State in charge of Energy Politics and Privatization, Mr. Darius Mesca, is not widely known in the sector. Mr. Mesca has worked on ultrasound technologies, which are used for the production of nuclear submarines and which to our knowledge Romania is not manufacturing.

In its letter of July 4, 2005, OPSPI has confirmed the receipt of the draft PRIDE Recommended Privatization Strategy and stressed that under the PAL-2 agreement the major IFIs (e.g. World Bank, IMF, etc) must also be consulted with regards to the final, official Privatization Strategy. According to the latest information, GOR/WB negotiations on PAL-2 will be resumed in the Fall 2005. In the letter OPSPI encouraged the continuation of PRIDE technical assistance under Activities 2 and 3, i.e. for making the regulatory environment of the sector more responsive to investors and consumer needs.

An ambitious agenda for a PRIDE training program for ANRE, OPCOM and ANRGN specialists was prepared for June-August 2005. However, the Government of Romania decided to accelerate liberalization of the wholesale energy market with the opening of 83.5% of the market (instead of a previous 55% level) as of July 1, 2005. By this date all commercial customers are nominally placed into an eligible consumer's category, with the right to switch power suppliers and freely negotiate electricity prices.

The GoR decision to accelerate the energy market liberalization has put an additional burden on specialists of the regulatory agencies. These personnel already have conceptual and work schedule problems from the need to meet several detailed EU acquis requirements for the final closing of Chapter 14 (Energy). An additional obligation is the modification of tariff methodologies in line with the GOR's obligations arising for the privatization transactions of Petrom, Distrigaz Sud and Nord, and the electricity distribution networks Banat and Dobrugea and Oltenia and Moldova.

On a parallel move there has been a new ANRE obligation to create a coherent regulatory environment for spot market transactions. The spot market is lacking satisfactory metering and telecommunication infrastructure. On top of all this, ANRE and ANRGN specialists have also been working to implement a politically sensitive long-term strategy for electricity and natural gas tariff increases as earlier agreed with the IMF and the World Bank.

Consequently, the starting date of our training program was moved to September 12 and a project extension until end October was necessary to implement the intense training activities, with perhaps some overflow of activities to early November 2005. To implement the cycle of training requested by OPSPI and the electricity and gas regulators, PRIDE requested from USAID a 60-day no cost extension. It was granted in September 2005 with a scheduled date for closing PRIDE operations of November 29, 2005.

2. Interaction with Counterparts

The main counterparts we have worked with are:

OPSPI officials – Mihai Bogdan Catuneanu, Alexandru Alexe and Elena Necula, and Robert Neagoe (Director of Legal Division), supported occasionally by a legal advisory group from MEC and the Ministry of Finance.

Turceni Energy Complex newly nominated senior management – Nicolae Simonescu (General Director), Dan Gavrilescu (Commercial Director) Gheorghe Vaduva (Director of Production), Lionel Leu (Production Director), Laviniu Danciu (Director of FGD Program), and Marius Liviu Preda (International Business and Privatization Division).

In most cases the interaction had been cooperative; nevertheless the financial and operational information provided by the plant and mines' management has been neither complete nor commercially sound or technically reliable in view of historically weak/erratic operational and financial accomplishments with much newer assets and equipment. Most of the newly nominated senior managers at the Turceni Energy Complex have a background in mining and have not yet demonstrated sufficient expertise on power generation issues. The developed projections of gross and deliverable energy outputs at Turceni are still being based upon the questionable opinion of TEC management on the market potential for doubling output, which disregards the present market capacity for power generated at TEC and makes unrealistic assumptions of high operating and technical parameters for power generating units. Particularly disturbing is the lack in the MEC and TEC documents of a professionally developed and documented analysis of the long-term electricity needs of the national economy and population, reflecting the declining energy intensity of the Romanian economy and the adoption of an EU economic space carbon-constrained development strategy.

3. Major Implementation Steps – Progress

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

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

Task	Description	Progress	Next Steps
1.1	Prepare the final version of Privatization Strategy and the Privatization Strategy Report	Reviewed recently issued legal acts and the development on investment markets to verify privatization options. Revised the working draft of the Recommended Privatization Strategy which was presented to OPSPI in June 2005 with no objection from the OPSPI side. It will be considered (along with the opinions of WB and IMF) by OPSPI in drafting a relevant GoR document The latest draft was somewhat amended to incorporate new domestic and regional market developments in energy.	• Preparation of the final version for USAID approval and distribution to OPSPI. • Continuation of editing/ amending of individual chapters of Information Memorandum. Materials delivered by RAEF are not matching EMG expectations and editorial standards. • Responding to inquires from new investors and consulting groups to maintain a high level of interest in the privatization of energy assets in Romania. • Assessing time schedule of next stages of privatization process to plan activities of PRIDE in the final two months of the project's activities.
1.2	Preparation of the final version of Valuation Report	Amending five basic TEC development scenarios in response to the latest conclusions from the KPMG audit and for adjusted power generation data in January-June 2005 and defining their impact on valuation. This year's breakdown of sale between DAM and other transaction is assessed for TEC at 40:60 and the discount rate assumed is around 13%. The change of TEC senior management was not followed by new ideas for power generation.	• Using audited financial data and marketed power supplies in 2005 to correct the initial figures.

1.3	Removal of informal barriers to privatization.	An investor presently needs to obtain a locally issued environmental permit through an unclearly defined "negotiations process" with a local agency. A legal amendment or the issuance of implementation guidelines is needed. The ownership status and ecological liabilities of several large parcels of land that TEC wants to return to local communities are unclear. TEC was to return the land in order to remove them (temporarily) from the company's responsibility. There is an unsatisfactory vertical and horizontal cooperation of the state administration. The restructured mining sector entities have offered to TEC to transfer (any) coalmining debt into shares of TEC. If approved as the law this may overstate the volume of share capital for TEC. Additionally, the CNLO mines' management has requested the repayment of substantial past-due debt for unpaid lignite supplies to TEC. Turceni cleared this payment by (not confirmed) offset transactions. There is an emerging issue of missing financial documents for transactions conducted by head organizations.	• The proposal for defining ecological requirements is the same for a new owner as for the old owner. This avoids delays in the execution of privatization procedures and later ownership disputes. • Continue to clarify land ownership issues and potential environmental liabilities issues before closing transaction and signing SPA. • Draft of relevant document is under GoR review. There is a danger of overstating the magnitude of mining debt and the share capital value. • Improving work coordination between MEC/OPSPI and Ministry of Public Finance to resolve this dispute.
1.4	Finalizing /Editing of Information Memorandum	The collection of documentation used for the preparation of the technical and commercial due diligence of TEC is well in hand. But there are serious doubts as to the relevance of adopted approach for liberalized energy market conditions as it is related to pre-2005 period, which is not relevant anymore. Updated extensive environmental audit of the Turceni plant and the Jilt & Dragotesti coalmines. Updated legal due diligence by RTPR. Completed KPMG audit for TEC covering 2004.	• Incorporating new normative and business information in the relevant chapters of the Info Memo, including new legal provisions (Mining Law, etc.) • Editing remaining chapters to reduce the overall size of the IM - cutting irrelevant technical details and focusing on the commercial value of TEC.

4. Implementation Problems

During working meetings and within the PRIDE Recommended Privatization Strategy, the PRIDE project has represented the concerns expressed by some investors regarding the low transparency of the applied privatization procedures and the disputable objectivity of Romanian adopted approaches in defining pre-qualification criteria. PRIDE has also been concerned about the ranking methods for received technical and financial offers as well as their use by the same narrow group of persons involved in privatization. Such concerns were not well received by OPSPI senior management and by some RAEF (PRIDE sub-contractor) team members. According to their opinion it was a fully unjustified concern in view of the spectacular results accomplished in the privatization of Petrom, Distrigaz Sud and Nord, and the electricity distribution networks.

However, the transparency of the process and the objectivity of the applied scoring criteria in the Petrom privatization is presently a subject of heated public discussion and a state inspector's audit of relevant privatization documentation. The same issue was raised by the President's office and the Prime Minister despite having received all requested transaction documentation. The sole fact of the raising of this issue by the leaders of the country with full access to existing information on transaction is symptomatic and signalizes the existing problems with an inadequate transparency of applied procedures and a disputable objectivity of adopted selection methods. Initially, there were 15 applicants in the Petrom privatization and applications from four of these were rejected as offered by unqualified investors. In a lengthy and secretive privatization process all but three bidders were then removed before the final bid. From three final bids - by OMV (Austria), MOL (Hungary) and Occidental Oil and Gas (USA) - only OMV submitted a valid bid. MOL ruled out itself by offering share swaps instead of purchase of shares while Occidental was interested only in drilling and production.

In the privatization of Distrigaz Sud and Nord, OPSPI functionaries agreed in the transaction to a natural gas rate structure and composition. However an attempt to implement that privatization in Spring 2005 caused a consumer upheaval. Consequently, the ANRGN proposal was cancelled both by the Minister of Economy and Commerce and the Prime Minister.

A disturbing transaction pattern has been observed in contrasting the sale of electricity distribution networks in Romania vs. similar transaction results in nearby Bulgaria. Bulgaria sold in 2004 all seven its distribution companies in one transaction while Romania has gradually sold four similar companies so far in 2004-2005. Although there may be no full commercial comparability of the Romanian and Bulgarian power entities, the Romanian networks, per km of distribution grid, are being purchased at 50-60% of that offered in Bulgaria. CEZ, which has purchased electricity distribution companies in both countries, has paid at ∈221 per account as compared to ∈ 141 per account in Romania. Based upon this, it would seem unlikely that the privatization of Romania's thermal generation capacities (Turceni, Rovinari and Craiova energy complexes) will come close to the sale results obtained in Bulgaria in 2005 for 1 MW capacity of CHP plants in Russe and Varna.

The Bulgarian approach, focusing on attracting a high number of qualified investors and the simultaneous sale of a few companies, has appeared to generate a higher price competition. With the provision of more information about the process and intermediate results, the Bulgarian privatization authorities apparently have offered a more balanced combination of protecting the commercial confidentiality of the conducted transaction and providing maximum information for the public use. As there is not a major difference in the provisions of privatization legislation in both countries, the method of managing and implementing the process appears to be producing a wide differentiation of privatization results.

The Turceni Energy Complex has not been free of mismanagement. In the past, its management has shown a greater interest in designing and executing costly and endless repairs and modernization programs for the grossly underutilized power generation units than in producing actual power generation. All the former senior managers of Turceni were fired after KPMG derived in Septembrer 2004 an adverse audit opinion for TEC. There is still a pending investigation regarding the excessive investment costs of a few capital projects in the coalmining sector, which has been integrated into the Turceni Energy Complex.

5. Results Achieved

After taking into account the latest developments on the energy and investment markets, the expected slowdown of growth rates for aggregate electricity demand following the strict implementation of a carbon constrained development orientation in the EU economic space, and the presence of excess low cost power generation capacity in Bulgaria and Ukraine, we have proposed the following privatization strategy for GoR review:

- The GoR should make a new tender announcement to attract additional reputable applicants (last announcement was in December 2003). OPSPI will support our recommendation.
- Applicants should be subject to a transparent and objective pre-qualification procedure meeting international best practices in order to eliminate from the more advanced privatization stages those applicants not fulfilling the minimal quality criteria. Those investors not able to fulfill the GoR's broad privatization objectives due to a shortage of capital and lack of operational experience in coal-fired power generation should be eliminated. OPSPI has intended to apply the procedures that are vaguely described in the Romanian privatization legislation. Some investors and sector specialists have questioned the transparency and objectivity of the procedures applied by OPSPI in past privatization transactions.
- The GoR should offer to private investors a majority ownership stake (of at least 51% of voting rights) as well as operating management control from the outset of the acquisition. This is an essential condition for many investors in the privatization of power generation assets, particularly in view of the GoR's decision to offer for sale 67.5% of shares for the much less risky distribution company Muntenia Sud. OPSPI intends to support our recommendation.
- A recommended transaction structure as follows: a combination of state share sales and capital increase. Depending upon the package selected by GoR the transaction at 51% stake level should bring ca USD 120-130 million for sold shares and capital increase. The presently established market value of TEC is ca USD 150 million and book net assets value is ca USD 180 million. OPSI will support our recommendation.
- The GoR should insist on securing from the new owner of TEC future power generation capacities of at least 6 TWh per year and the supporting lignite annual production of a minimum 8 million tons. OPSI's desire is to privatize TEC with four technically rehabilitated generation units with installed FGDs capable of generating TWh 8.0-8.5 if needed. However, the market demand in the near future for TEC power may not reach such a level.

6. Input to Mission's Annual Results

Basically, the Turceni Energy Complex is by now almost fully prepared for privatization. However the energy supply situation in 2005 is opposite to 2003, when a weather-related shortage of output by hydro- and nuclear generation was compensated by an increased market demand for power from coal-fired plants. Due to current favorable weather conditions for hydro-generation, the low cost Iron Gate plant output may exceed in 2005 the desired level of 25% or less total power generation, which defines the IR 1.3.3 target for increased competitiveness of private companies and markets. This availability of low-cost power from hydro-generation has pushed down the market demand for the more costly output from coal-fired plants.

So far in 2005 foreign investments from the sale of all four electricity distribution networks (Banat, Dobrogea, Oltenia and Moldova) have amounted to about USD 500 million, i.e. above the IR.1.3.3 target of USD 300 million for the whole year. All these transactions were closed in 2005.

As of September 2005 four electricity distribution networks and two major natural gas distributors have been privatized and the privatization process of Muntenia Sud is well advanced. The IR 1.3.3 target for improving the process of transferring state-owned assets to private ownership is so far short a completed privatization of one big power generator, such as TEC. TEC is ready for the process and should have a sufficient number of bidders. The GoR has already hired a transaction advisor to assist in the privatization of TEC and conditions are fulfilled for the accelerated process of the ownership transformation.

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	- Overall supervision of DTR team work. - Tailoring DCF model for valuation of TEC. - Final verification of all relevant data and background information from TEC management and its quality assessment. - Reviewing final valuation conclusions and their assessment with RAEF, OPSPI and MEC experts. - Preparing valuation on a basis of an analysis of comparable privatization transactions in the region.
2.	Stefan-Nicoara Moise	- Further adopting DCF model format for specific analytical needs of TEC valuation exercise for five valuation scenarios.
3.	Andreea Panait	- Reviewing industry and GoR materials assessing price development for coal-fired power generation under capped electricity tariff constraints. - Assessing cost of coal extraction in associated opencast lignite pits for provided by TEC management investment scenarios. - Reviewed applicability of reviewed value scenarios for presented by TEC development strategies.
4.	Jonathan Ward	- Project management and administrative issues. - Providing technical and editorial revision for project deliverables. - Supporting training schedule for regulators, training delivery, and gathering additional materials for broad distribution. - Continuous investor and energy market research. - Monitoring strict budget execution and financial/contractual reporting to USAID.

8. Coordination with others

During the course of the work on privatization there has been interaction with ANRE specialists on developing new formats for short-and long-term bilateral contracts with incorporated risk management instruments and developing a capacity market in Romania. Both issues are of prime interest to power generators and the investors assessing the acquisition of power generation and distribution assets.

As part of a PRIDE quality assurance review, Mrs. Veronica Gilbert, Director of EMG's Public Sector Services unit, met in September with the following officials from OPSPI: Alexandru Alexe, Elena Necula, and Dan Codescu. Their comments on the helpfulness of PRIDE's privatization assistance were solicited and discussed and will be detailed in a report submitted to USAID.

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

1. Introduction

As a part of this program PRIDE has contributed to the institutional development of regulatory bodies and to the capacity building of local experts. In several areas the executed training program (Activity 3, below) is leading to the development of regulatory documents, such as ANRE's new regulation on Supplier of Last Resort (SOLR) and the development of a bilateral contract template for natural gas and power trade. Assistance to ANRE and ANRGN on SOLR issues was provided by EMG consultant Mr. Leszek Kasprowicz. Assistance to the regulators on bilateral contacting was delivered by Mr. John Varholy, a managing partner of the London's office of Troutman Sanders. The Troutman Sanders legal firm, operating both in the US and EU, has unrivaled legal expertise in bilateral contracting for trading. Troutman Sanders is closely affiliated with the European Federation of the Energy Traders and has participated in the development a bilateral contracting template for gas and power trade that is widely used throughout the EU economic space.

Additionally, due in some part to the enhanced professional skills of ANRE and ANRGN personnel resultant of the implemented training program, both regulatory agencies have been able to develop several regulatory documents and decisions and new tariff setting methodologies and to set domestic market rules that meet EU standards and the EU acquis specific requirements. Both ANRE and ANRGN have facilitated a transparent consultative process by placing drafts of their decisions and secondary legislation on websites for public review and comments.

To facilitate further legal and regulatory reform of the energy sector our short-term specialists are preparing additional training modules as follows:

- A review of the incentives to eligible customers for free selection of power/gas providers and free negotiation of contracted energy prices, used in other countries and recommended in the EU publications.

- Review of the conceptual framework, approaches and methodologies for defining load profiles for selected groups of customers presented with application conclusions from other countries.
- Concepts and measures for attracting investments needed to secure sufficient generation capacity through different schemes/mechanisms/approaches and for developing a sound capacity market. The conclusions would be based on a WB-sponsored NERA study and materials of Eurelectric and FERC. The presented issues will cover the issues of financial contracting for capacity, reliability contracts, reserve capacity contracts, capacity tickets, capacity payment schemes and capacity procurement with the major pros and contras of individual approaches.

In addition, to advance ANRGN's institutional reform and to enhance its personnel's professional skills, Herbert Emmrich has presented to ANRGN on the regulatory framework established for the natural gas industry in the US and specifically, in California. Special interest was given to the approaches used to secure gas consumption by low-income population. Addressed training issues include the developed instructions and regulatory decisions and approaches used by the US regulatory body for effective regulatory oversight of natural gas market operations.

2. Interaction with Counterparts

Several meetings were held with the electricity regulator, ANRE, to clarify the actions needed to provide would-be investors in Turceni with a degree of certainty of a credible and reliable regulatory environment for a liberalized energy market of Romania. Another group of topics discussed with ANRE were the critical components for smooth future operations of the wholesale energy market such as: bilateral contracts, load profiling of customers, incentives/approaches used to increase number of eligible customer, and investment policies supportive of the maintenance of power generation capacity adequate to secure supply of needed power.

Mr. Leszek Kasprowicz made presentations on customer education and customer switching at a September USAID/USEA seminar on monitoring, measuring and assuring the competitiveness of energy market monitoring. The aim was to advance the professional skills of ANRE/Transelectrica/OPCOM experts in charge of the monitoring and oversight of the energy market and to introduce market reporting requirements for key stakeholders.

3. Major Implementation Steps – Progress

The PRIDE Project Workplan, as amended and updated 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 newly evolving regulatory and operating rules and procedures in the liberalized electricity market, in mining and environmental legislation affecting power generation.	Specification of rules for SoLR service, organization of SoLR selection process, terms of services and customer-service related issues. Clarification of licensing and authorization requirements, agencies involved, procedures applied. Preparing a draft of ANRE regulation on SOLR for placing on website for facilitating a participatory and consultative process. Defining of key legal terms, payment conditions and obligatory content requirement to develop a portfolio of bilateral contract templates for use in Romania.	Final correction of relevant chapters of the Information Memorandum with description of changes to affected regulatory frameworks. Further streamlining and simplification of the application process for transfer and/or renewal of licenses and permits. Preparing list of training topics for post-vacation period.
2.2	Identify main topics for integration of public service rules into the Romanian electricity market and present them published ANRE document.	Clarification of further assistance needs for integrating public service obligations and selection of SoLR service provider, drafting amendments to legislation and regulation needed for implementation of public service principle.	Technical assistance planned for October 2005, including a stakeholder workshop.

Task	Description	Progress	Next Steps
2.3	Approaches for Gas Regulatory Agency strengthening and assisting to meet EU and REM SEE requirements.	Delivery of additional training topics requested by ANRGN.	Establishing contacts with the newly starting USAID project (REP3).
2.4	Assessment of presentation and supporting materials for training program requested by ANRGN.	Distribution of presentation and supporting materials before starting the training program to facilitate better understanding of presented topics and higher level of interactive education.	Supplementing delivered materials by regulatory materials requested by participants.

4. Implementation Problems

This activity progressed at the slow pace of the process of producing major regulatory documents and legal acts for a liberalized energy market in Romania and closed privatization transactions. The personnel of both regulatory agencies have been lacking expertise in some of the specific methodological and conceptual issues of a rapidly liberalized energy market and hence there has been a growing backlog of unresolved issues. In our assistance we have focused on assisting in the removal of these methodological and implementation bottlenecks.

5. Results Achieved

In principle, the adopted licensing procedures, audits, tariff setting methodologies and domestic energy market rules are already mostly conforming to EU standards. With the final closing of Chapter 14 (Energy), the EU would implicitly confirm the full compliance of Romanian regulatory framework with other EU members. Practically all new regulatory documents are being issued through a transparent consultative process.

Both ANRE and ANRGN are self-sustained. They are entirely financed from funds outside the state budget, i.e. through fees obtained by licenses, authorizations and other regulatory activities levied upon the regulated companies. Thus, the 2005 target for USAID's IR 1.3.2 has been reached which stipulates that 75% of the ANRE & ANRGN budget will be obtained from their service payment.

6. Input to Mission's Annual Results

The procedures for the business registration of new energy participants were simplified and standardized and no major problems were signaled by EU officials during the provisional closing of Chapter 14. Energy market rules are being developed with technical assistance from foreign advisory groups hired by EU programs. Thus, it is unlikely they could or will differ substantially from the rules adopted in other EU countries. The tariff methodologies of both energy regulators were scrutinized by IMF/WB specialists to verify Romania's eligibility to WB/IMF programs and based upon this methodology review both parties agreed on a long-term strategy of energy tariff adjustments to world prices.

7. Professionals Involved

Christopher Badach, Leszek Kasprowicz and Virgil Musatescu had several formal and working meetings with ANRE and ANRGN senior management. Jonathan Ward provided assistance for the identification of the best candidates for EMG consultant short-term assistance, hiring selected specialists, and resolving occasional contractual problems.

8. Coordination with others

During these vacation months we could maintain only occasional contacts with senior management of ANRE and ANRGN.

In September, as part of a PRIDE quality assurance review, Mrs. Veronica Gilbert, Director of EMG's Public Sector Services unit, met with Alexandru Sandulescu, Lusine Caracasian, and Adrian Borotea of ANRE and Mirela Plesca of ANRGN. Their comments on the helpfulness of PRIDE's regulatory assistance (both technical assistance and training) were solicited and discussed and will be detailed in a report submitted to USAID.

E. Activity 3 – Regulatory Training

1. Introduction

As part of this program, the PRIDE project is contributing through technical expertise and training to an improvement of the regulatory capacity of ANRE and ANRGN to manage the energy market more efficiently and effectively.

2. Interaction with Counterparts

Meetings have been held with both ANRE and ANGRN to narrow the focus and coverage of individual training topics. Regulators have usually asked for the delivery of services well above our financial and implementation capacity and without taking into account the limited time availability of hired experts. Due to the vacation period and the priority of other tasks to the regulators any meaningful training activity by PRIDE could be resumed only in mid-September.

3. Major Implementation Steps – Progress

For capacity building activities under the PRIDE Project Workplan, we identified a number of tasks to be undertaken 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	Designing training program affordable to PRIDE under existing project budget and availability of experts before November 29 project ending.	Identified the best candidates for training from the existing pool of specialists, defined their time availability and developed detailed work schedule. PRIDE established contact with the EMG Financial Market Reform team in Bucharest to discuss the potential participation of its experts for delivery of training in the use of financial instruments in energy trading.	In August – corrected the final time schedule for a training program and coordinated it with the projected work schedule of both regulatory bodies. Implement training and leaving behind additional materials.
3.2	Amended list of training activities and logistics needed to implement training program. Developing cost estimates for execution of training and secure their covering by available budget resources.	Preparing operative plan of training activities Established budget and logistics for training sessions. Confirmation of availability of selected candidate (s) for service delivery on dates suggested by both regulators.	Requesting CC for incoming personnel in due time and confirming hotel reservation.

4. Implementation Problems

With the still ongoing EU accession negotiations, especially over the Environmental, Competition and Legal Chapters, and the closing of the privatization transactions for the energy sector entities recently sold, both regulatory agencies have had a fairly tight work schedule (also subject to changes from GoR decisions and responses needed to EU requests). In such circumstances it was very difficult to prepare a dependable training schedule that would not be changed within a few weeks.

According to the assessment of the Financial Market Reform project (EMG), the development of capital market institutions and professionals is still in its incipient stage. It will take at least two more years to train and establish a group of dealers and brokers capable to service energy trading needs. The risk management terms and concepts and the applicability of presented financial instruments is fairly unknown to the sector practitioners. The essence of a financial contract (vs. physical contract) and relevant instruments seems to be quite confusing to many well-trained managers with a solid general education but without a business background.

5. Results Achieved

The second phase of the training program started by mid-September 2005 and may continue until mid-November. To complete the training program on time all training modules need to be delivered with a minimal departure from the present time schedule of modules delivery.

6. Input to Mission's Annual Results

Implementation of the training program further strengthens the regulatory bodies in the energy sector and through this has improved utilities' competitiveness and increased competition. Thus, it supported the achievement of the IR 1.3.2 (Strengthened capacity of GOR counterparts to serve market economy goals) and the IR 1.3.3 (Increased competitiveness of private companies and markets)

7. Professionals Involved

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

Jonathan Ward has been in contact with USEA and potential training candidates from the US and other countries.

Leszek Kasprowicz conducted a training workshop on the SOLR topics and is scheduled for an October delivery of a training module on the variety of conceptual and implementation issues related to load profiling for selected groups of customers. Another training module in late October will address the incentives for switching power/gas suppliers by the eligible category of customers and other approaches to increase a number of customers freely negotiating prices for energy supplies.

Herbert Emmrich delivered training on several regulatory aspects of natural gas company operations and the management risk instruments used to stabilize the volatility of gas prices in contracting of gas supplies.

John Varholy has delivered the first part of a training module for ANRE, OPCOM and Transelectrica experts on the most popular contract formats in use in the EU and USA incorporating risk management instruments for financial and physical bilateral contracts (both short-and long-term), invoicing and payment schemes, performance assurance issues, resolving disputes, and limitation of liabilities. The same topics in contracting of natural gas supplies will be presented to ANRGN personnel. The final training module delivered by John Varholy to ANRE will focus on drafting a bilateral contract template for Romania's wholesale electricity market needs. This is of prime interest to all power generators, electricity distribution companies and suppliers, investors with interest in power sector assets, the electricity regulator (ANRE), as well as the system operator (Transelectrica) and market operator (OPCOM).

Sam Kang will present his training module to ANRE on a financial institutional platform best fitting needs of the wholesale energy market in Romania, based upon the experience of other countries and taking into account the underdeveloped financial service sector in Romania.

A training module for reserve capacity mechanisms, scheduled for delivery in early November, will focus on capacity schemes/tickets/payments approaches providing the best market signals to power generators (and the sector's regulators) to secure needed power generation capacity of the market. The presented implementations and their results will cover the experience of key EU countries and the US. However, the highest importance will be given to the experience gathered in EU countries with an advanced liberalized energy market and a similar regulatory structure to Romania.

8. Coordination with others

Meetings were held with ANRE senior management (Nicolae Opris, Horia Bogdan, Alexander Sandulescu, Adrian Borotea) and ANRGN (Mihai Ciociodeica, Mirela Plesca, Cristian Selevardeanu).

In September, as part of a PRIDE quality assurance review, Mrs. Veronica Gilbert, Director of EMG's Public Sector Services unit, met with Alexandru Sandulescu, Lusine Caracasian, and Adrian Borotea of ANRE and Mirela Plesca of ANRGN. Their comments on the helpfulness of PRIDE's regulatory assistance (both technical assistance and training) were solicited and discussed and will be detailed in a report submitted to USAID.

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

Mr. Petru Tulin (of the National Bank of Romania and in charge of its regulatory framework) left his position. His replacement is not yet fully familiar with the respective decision of National Bank of Romania which limited the attractiveness of the Development Credit Authority (DCA) instrument in banking lending activities in Romania. According to the existing banking regulation, the DCA-type of guarantee is considered as the secondary category of banking collateral and so no private commercial bank in Romania was willing to sign a cooperative agreement with USAID. Consequently, DCA instrument has not been used to assist with municipal energy efficiency projects.

No activities were scheduled for the last quarter. In the absence of new USAID instructions the project operations for Activity 4 were suspended.