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# PRIVATIZATION, INVESTMENT, AND DEVELOPMENT OF ENERGY PROGRAM (PRIDE)

FINAL REPORT



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It was prepared by Emerging Markets Group, Ltd.



# **PRIVATIZATION, INVESTMENT, AND DEVELOPMENT OF ENERGY PROGRAM (PRIDE)**

## **FINAL REPORT**

**Submitted by:**

PRIDE Project  
Emerging Markets Group, Ltd.

**Submitted to:**

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# **Romania's Privatization, Investment and Development of Energy Program (PRIDE) Emerging Markets Group, Ltd.**

## ***Final Report***

*November 19, 2005*

### **I Introduction**

Romania started institutional and structural reforms and privatization with some delay as compared to the other transitional, post-communist economies of Central and South East Europe. One of the reasons was the country's relative self-sufficiency in fossil fuels, so that the energy system of Romania had very limited inter-connections with other countries and a lower dependence upon imported energy. Besides the Soviet Union, Romania was the only country of the Council of Mutual Economic Assistance (CMEA) bloc with substantial production (and deposits) of crude oil and natural gas. The CMEA bloc collapse and the resulting price spikes and reduced energy supplies of Soviet oil and gas had less of a damaging effect on the Romanian economy than on other countries. In other CMEA countries the acute energy crisis triggered by rapid changes in the payment terms and volumes of Soviet energy supplies prompted extensive institutional and structural reforms and the introduction of bold restructuring and reform programs for the energy sectors.

Thus Romania's relative self-sufficiency in hydrocarbons was also one of major reasons for its slow pace in the transformation and restructuring of the state owned power monopoly – RENEL RA. The continuing operation of highly polluting and inefficient state energy entities performing at output prices below cost, coupled with unpaid energy and heat bills from a weak commercial sector and impoverished population, resulted in the build up of large debts and arrears throughout the economy and created major macro-imbalances, which put the country into a prolonged economic recession and skyrocketing inflation.

### **II Present Status of Power Sector in Romania**

USAID has been providing assistance in the reform of Romania's energy sector since 1994. Without significant reform and restructuring of the energy sector in Romania, major macroeconomic distortions will continue to exist and hinder reforms in other sectors. Initially, the assistance program focused on unbundling the state owned power monopoly - RENEL RA. By 2000 the Romania's power sector had been sub-divided into five new state owned companies, each of which still comprised a number of entities:

- Translectrica – a transmission company and system operator with a separated entity OPCOM, market operator.
- Hidroelectrica, a hydropower generation company.
- Nuclearelectrica, a nuclear power generation company.
- Termoelectrica, a thermal power generation company.
- Electrica, a power distribution & supply company.

After unbundling the power sector USAID has assisted with the establishment of independent regulatory bodies (ANRE for the power sector and ANRGN for the natural gas sector) to improve the legal and regulatory framework and operational environment for a competitive, liberalized energy market, and to continue sector restructuring through the privatization of the sector entities. Under a conceptual framework for the liberalized, competitive energy market promoted by USAID and all major international donors (WB, EBRD, EU), the transmission and system operator Transelectrica will remain in the state domain while other power assets would be offered for privatization. Power distribution services will remain regulated and power generation, in principle, should be a fully competitive activity governed predominantly by the rules of the liberalized energy market. The full liberalization of Romania's wholesale energy market should take place no later than by mid-2007.

The full liberalization of the wholesale power market stipulates energy trading at prevailing, competitive market prices, basically free of undue regulatory interventions. This move from the former fully regulated and predictable prices to a liberalized market's competitive and perhaps highly volatile energy prices puts power generators in a very difficult position. Market liberalization offers both attractive business opportunities as well as serious challenges for management not accustomed to work in the new operating environment. In addition, the accelerated liberalization of the power market complicates the simultaneous process of ownership transformation through privatization. Trading electricity at competitive, market prices usually increases the volume risk from increased market behavior risk. Competitive markets provide a very shaky methodological basis for the reliable prediction of future revenue streams, which in turn are a crucial component of the business plans requested by bankers and financiers to support loan applications for investments.

Power generation in general is a very capital-intensive industry. Under the EU-promoted carbon constrained development orientation (including most of the CEE and SEE countries with a high share of coal-fired power generation), the replacement or rehabilitation of decrepit technical capacities will require high capital expenditures for the environmental retrofit of coal-burning technologies to meet the EU zone's strict emissions limits. This substantially reduces the investment attractiveness of coal-fired power generation and thus requires more innovative transaction offers and attractive acquisition terms from the Government to compensate for the increased level of investor risk. It also extends the time needed to conclude an average privatization transaction and will magnify the importance of the transparency and objectivity of used process procedures as well as the applied pre-selection criteria for applicants and the ranking criteria of bidders' technical and financial offers.

Usually the packaging of smaller hydro generation assets with coal-fired plants makes for more attractive privatization offers from investors. However, a few years ago the senior officials of Romanian Government were not supportive to this idea. The Government was more supportive to the mitigation of another investor fear - regarding the reliability of fuel supplies to remotely located lignite-fired power plants - and decided in April 2004 to integrate some lignite-fired power plants with their associated coalmines (mainly open

pits) and to offer for privatization such vertically integrated energy complexes. The USAID project implemented by Hunton & Williams provided technical assistance to the Government of Romania on these issues and provided the core elements for the conceptual framework of privatization for these entities.

Perhaps an additional rationale behind the GoR's support for integrated energy complex options was the desire to avoid the expected social problems from the privatization of power plants alone. The newly-created energy complexes are located in economically depressed areas where the only employment opportunities are offered by operating power plants and coalmines supplying lignite for the power generation. Since 1990 Romania has a disturbing record of miners' revolts and their opposition to a restructuring program of coalmining sector. In June 2005 the successful privatization bid of a lignite-fired plant in Bobov Dol in Bulgaria by PPC (Greece) was cancelled after 11,000 coal miners from the associated mines went on strike in protest for their non-inclusion in the privatization deal.

It was predictable that investors would show more interest in the acquisition of less risky power distribution assets and that the initial transactions would be in the privatization of electricity distribution networks. By Fall 2005 Romania closed privatization transactions (for 51% of shareholding) in four (out of a total of eight) power distribution companies and has started the privatization process for the sale of 67.5% of shares in the fifth company – Muntenia Sud - with that transaction closing expected in Spring 2006.

However the best terms and conditions being set by the Government in the sale of these less risky distribution grids would be considered just the bottom line by investors for the privatization of riskier generation assets. Therefore, the outcome and pace of the privatization for generation assets depends to a great extent upon the GoR's ability to appreciate the linkages between the sale of different categories of power assets with a different risk level and the GoR's desire/ability to offer to potential investors in the acquisition of generation assets equally attractive or better terms than those agreed in the distco privatization deals.

The large capital needs and looming environmental liabilities of the lignite-fired power generation plants are not the only reason behind the lower investment attractiveness of these capacities. Perhaps even more important for investors is a stable and consistent regulatory base for sector operations and predictable regulatory decisions. The rapid liberalization of the energy market has introduced new and unpredictable processes into the marketplace, increasing its volatility and uncertainty.

The conceptual framework of a new energy market design is already defined and described in a newly published Wholesale Electricity Market Commercial Code. The document describes the rules, principles and mechanisms that govern market operations and define the market structure and its major components, stakeholders, the format of contractual arrangements in force, etc. However only a very limited and unreliable performance record of the liberalized energy market exists to date (the Commercial Code was introduced in January 1, 2005). Generators will perceive higher market risks associated with volatile spot

prices and untested market rules on top of a perception of high regulatory risk of new market formats.

Additionally, the ongoing rapid transformation of the energy market and the emerging new operating environment for power sector entities needs to be well correlated with the EU *acquis communautaire* chapters on energy, environment, competition, and the movement of capital and services, which are defining the EU accession conditions for Romania. Compliance with the EU *acquis* provisions requires the full harmonization of the Romanian energy sector's legal and regulatory frameworks with relevant EU Directives. These Directives govern the operations of internal energy markets in EU countries by amending those laws and regulations which could hinder market liberalization and increased competition.

At this stage, a conceptually attractive design of the Romanian wholesale energy market and its trading platform still lacks the necessary technical and organizational infrastructure for proper functioning. Basically, new metering infrastructure for the wholesale energy market needs to be installed as well as HW and SW for OPCOM, the market operator. ANRE has not yet decided what financial service infrastructure to choose for day-ahead markets and for trading physical and financial products.

Although the nominal voluntary opening of the power market is at 83.5% as of July 1, 2005 (well ahead of the initially planned level of 55%), the actual opening is only 35%. However these figures could change rapidly in the coming weeks and months if the needed elements for a functional energy market are put into place.

Power Purchase Agreements, which formerly dominated the contractual arrangements for power sales for eligible customers, are now practically non-applicable. Internationally acceptable templates for new bilateral contracts (both for short and long-term and applicable for internal and external transactions) are still in draft format. Contractual arrangements for captive customers, which are still subject to ANRE regulatory decisions, are also not yet developed. The initial spot market prices are attractive but there is a very limited volume of market transactions and due to their inadequate metering, telecom and IT infrastructure, the OPCOM decisions can be easily contested by the market's growing number of private participants.

Romania is also joining the Regional Energy Market (Energy Community) for South East Europe, which is integrating the energy sectors of major eight Balkan countries (Albania, Bosnia & Herzegovina, Bulgaria, Greece, Macedonia, Romania, Serbia-Montenegro and Turkey) and might be soon an important player in another regional energy bloc, the Black Sea Regional Market linking the economies of the Black Sea region. Both blocs would create a common regulatory platform for attracting the needed increased investment inflows for the development of major international energy supply networks (NABUCCO, SEEL) from the oil and gas rich regions of the Caspian Sea and Middle East to the energy-scarce European Union.

Thanks to its geo-political and transit importance the Romania energy sector will be an important link in securing sustainable energy supplies for EU member countries. This would complete a remarkable transformation of the Romanian energy sector from a centralized, inefficient state monopoly to an influential regional market player of the international importance.

### **III. Legal, Regulatory and Institutional Basis of Privatization**

#### ***Privatization Legislation in Force***

The legal base governing the selection of a privatization method and structuring the process and procedures in the power sector is already rather established. Key documents defining the legal base for the privatization of power sector assets are:

- Law on Commercial Companies of 1990 (law 31/19990), as further revised and amended;
- Law on Accelerated Privatization of the Power Sector of 2002 (law 137/2002) as further revised and amended;
- Government Emergency Ordination of 1997 on the privatization of the commercial companies (GEO 88/1997), amended by law 99/1999 regarding measures for the economic reform acceleration, further revised and amended; and
- Government Decision (GD 577/2002) on approval the Methodological Norms for the Application of the GEO 88/1997 and law 137/2002.

These legal acts define the general process of privatization for power sector assets and can be used in the privatization of both the electricity distribution companies and power generation entities (as well as other energy sector assets – oil, natural gas, etc.). This may wrongly imply their simplicity and straightforwardness. Unfortunately, there are several blind spots and overlaps in the coverage and applicability of the existing laws. Under a non-transparent privatization process, this may permit GoR and/or OPSPI officials to implant their own subjective preferences into the process by unduly extending or speeding up a preparatory stage or negotiations. This can inflict some irregularities into the process and has not always led to the best transaction outcomes in past transactions.

In late 2003 OPSPI, without due consultations with PRIDE management, decided to make an announcement about the GoR's intention to privatize energy complexes (which did not yet exist). The announcement was published in the *Financial Times Europe*, on December 29, 2003, i.e. during holidays and the vacation period. The announcement requested replies within 30 days. Additionally, the text of the announcement was not in compliance with the requirements given in Methodological Norms (GD 577/2002). Consequently, it resulted in a modest response from a few suitable investors.

The vertically integrated energy complexes (Turceni, Rovinari and Craiova) were created in April 2004 and were organized on the basis of two Government Decisions (GD):

- GD 102/2004, and
- GD 103/2004.

The first document (GD 102/2004) had approved a vague GoR strategy for accelerating the investment inflow and privatization in the thermal power generation sector. GD 103/2004 listed the measures undertaken to restructure the thermal power generation and lignite coal mining into the three energy complexes named above. The legal and administrative procedures utilized to create these new energy complexes were implemented by internal government specialists, without involving qualified outside experts. Consequently, the subsequent necessity to eliminate major legal and administrative irregularities and re-establish procedural discipline delayed by several additional months the preparedness of Turceni Energy Complex for privatization.

In March 2005 the Government of Romania published its GD 185/2005 approving another version of the strategy for increased investment inflows and accelerated privatization of the energy sector in 2005. For the first time the official strategy specified 51% of shares sale as the minimum acceptable privatization and had a direct reference to the Government's intention to advance in 2005 the privatization of the Turceni, Rovinari and Craiova Energy Complexes.

However, these legal acts at the GD level often contradict each other and the more important legislative documents. This was a case with GD 103/2004 that transferred into Turceni Energy Complex ownership the railroad assets that were firmly defined by other acts (GD 12/1998 and GD 27/2004) as publicly owned assets.

Another hybrid normative document that could influence the privatization outcome in the energy sector is the *Roadmap for the Energy Sector*, published by the GoR in July 2003. The major objective of the *Roadmap* is to develop an energy strategy up to 2015 which harmonizes the Romanian legislative and regulatory framework with the EU acquis on energy. The aim is to secure sufficient supplies of environmentally friendly power.

One of the major GoR objectives in the privatization of power sector assets is to reach the sector development objectives described in the *Roadmap*. However the *Roadmap* is outdated on cost and price assessments and projections of energy consumption and is based on pre-liberalized market development assumptions. In our opinion already in 2005 the *Roadmap* needs serious revisions to be more useful as a reference base for the privatization of power assets.

The privatization legislation in force recommends the following key acquisition methods:

- sale of existing company's shares, or
- purchasing newly issued shares from capital increase, or
- combination of both methods.

Privatization by capital increase is less advantageous to investors as the same amount of payment buys much less control of a company than in an outright sale of existing shares. To make acquisition by capital increase more attractive to investors, the Romanian law permits all sale proceeds to be kept in the company, while proceeds from shares sale go to the state budget from which a company might not benefit directly.

However, the proceeds from capital increase fall into a web of corporate governance, fiscal, accounting, and banking restrictions and funds may not be fully and/or immediately available to a payer (investor). The by-laws of Romanian companies usually require approval by the general shareholders' meeting of any financial operation in excess of a certain amount (e.g. 20%) of fixed assets nominal values. Additionally, the proceeds from capital increase do not provide any benefit to investors in reducing his/her risk of assuming an excessive financial burden to cover undisclosed monetary liabilities and historical environmental charges.

According to the Romanian law in force, the GoR may not assume responsibility for undisclosed debt or ecological liabilities higher than 50% of the cash paid in sale of company's shares. This explains why in the concluded privatization transactions investors have selected a combination of two methods rather than the capital increase option alone.

The transaction structure and amount of payment received in the sale of energy assets depends on what method is used. If the market value of the company is below its nominal (book) share capital value the law permits shares sale (or a mixed method with the majority proceeds from the shares sale). In this case the GoR may have an obligation to publish a sale announcement. Only if the market valuation of a company is above its nominal share capital value is a capital increase method mandatory and there is no firm legal obligation to publicly advertise the privatization opportunity. The selected privatization method determines the privatization procedures utilized and the process structure and the transaction options.

### ***Regulatory and normative basis***

Although the major regulatory documents of the power sector such as the Electricity Law of 2003 (Law 138/2003), GD 540/2004 (On Approval of Licensing and Authorization in the Power Sector of Romania) or the new Wholesale Electricity Market Commercial Code and all its complimentary documents: network codes, metering code, technical and commercial regulations, tariffs methodologies, authorizations and licenses performance standards, etc. do not directly address privatization or add new privatization requirements, these regulatory documents do define the operating environment for power companies, for the design and structure of the wholesale energy market, and for rules governing market operations and rights and the obligations of the market participants. These are all essentials for appraising the attractiveness of any privatization venture. Most of the regulatory documents and regulatory decisions of ANRE are fully aligned to the EU acquis for energy sector; however, Romania has only a very limited performance record in new market conditions to mitigate the justified regulatory risk perceived by many investors.

Investors are also concerned by the formal ANRE subordination to the oversight authority of the Ministry of Economy and Commerce (GD 300/2000), which de facto limits the regulator's decision-making autonomy. This was somehow overlooked by major donors and could emerge as the major non-compliance issue with the EU acquis.

The performance of the vertically integrated energy complexes, combining thermal power plants with lignite coalmining and railroads, is the subject of regulation of its coalmining component by another regulatory agency (ANMR or National Agency for Mineral Resources and ANRS or National Administration of State Reserves) and by general provisions of the Mining Law 2003 (Law 85/2003). These agencies, operating under the Ministry of Economy and Commerce, are issuing prospecting, exploration, processing and exploitation licenses, controlling preservation and closing of mines (including works for environmental recovery and land reclamation) and issuing methodologies for calculation of the production value subject to mining royalty payment by license holders.

The railway activities of the energy complexes, both public railroad infrastructure and non-public industrial tracks, are extensively regulated by AFER (Railroad Regulatory Agency), Railway State Inspectorate and Railway Register. Railroad regulators, created and functioning on a basis of GEO 12/1998; GEO 581/1998 and GD 626/1998, are defining licensing procedures, traffic safety measures and technical norms for public transport operators as well as for an administrator or operator of railroads. These categories are applicable to the railroad activities of the energy complexes.

The operations of all three components of the energy complexes are heavily regulated by the provisions of the Environmental Protection Law of 1995, as further amended by GEO 91/2002 and law 294/2003 (Law 137/1995), Law 654/2002 and GEO 34/2002 transposing for Romania EC IPPC Directive, GD 537/2002 and GD 918/2002. These define the emission and discharge norms to reduce pollution of air, water and soil and procedures to obtain relevant Environmental Operating Permit and various environmental authorizations and to have an approved Environmental Impact Assessment Study, etc. Special (and costly) procedures and requirements are applied for land reclamation after coalmining operations are completed and these are regulated both by environmental and mining legislation.

Following its signing of the Kyoto Protocol and adherence to a carbon constrained development orientation promoted within the EU economic space, Romania has assumed additional environmental obligations to reduce the emission of Greenhouse Gases (GHG). This is given in the government decision on the establishment of measures for the limitation of emissions of certain pollutants into the air from large combustion plants (GD 541/2003), which is transposing EU Directive 2001/80/EC for Romania. In October 2004 the GoR issued the Implementation Plan for Directive 2001/80/EC containing many retrofit requirements addressed specifically to Turceni Energy Complex, which have to be considered among the privatization objectives for TEC.

Each participatory country receives countrywide emission limits and the implementing government body (Ministry of Water and Environmental Protection in Romania) will allocate adequate emission limits to individual large combustion plants (over 50 MW rated capacity). Through this the GoR receives another powerful regulatory tool to influence the power sector development through its capability to assign more relaxed emission norms to power generators favored by the GoR and requesting adopting more costly modernization steps by others.

Additional obligations are arising from the need to maintain appropriate work safety, reduced noise level, and retain sanitary norms in the work place on activities that are regulated by different agencies.

### ***Institutional basis***

Presently in Romania there are two privatization agencies:

- Office for the State Ownership and Privatization in Industry (OPSPI), and
- The Authority for State Assets Recovery (AVAS).

OPSPI is a public institution within the MEC structure with a separate legal status. It was created by GD 88/2004 to implement the GoR privatization strategies for entities in the Ministry of Economy and Commerce portfolio. The MEC portfolio includes state owned, strategic assets in: mining, steel, oil, gas, power & heat and the defense sectors.

AVAS, subordinated to the Government, is in charge of the privatization transactions of all other assets, with a special state mandate for the recovery of banking assets and for recovering fiscal, budget and trade receivables. There are periodically emerging rumors that AVAS will be merged with OPSPI, with the later downgraded to a department structure within AVAS. AVAS implements the GOR privatization strategy for companies within its broad portfolio. An additional mandate granted to AVAS is in the monitoring of the implementation of privatization contracts.

For the management of the privatization process and assistance in developing its documents, OPSPI is empowered to announce a restricted tender for providing consulting services in the mining, steel, oil, gas, power & heat and the defense sectors and to hire the winner. PRIDE is not aware of any specific tender announcement for the selection of the consortium (DTCE and RAEF) for the privatization of the Turceni Energy Complex. In GD 2168/2004 the Government informed that such a transaction contract was signed with DTCE and RAEF as members of the consortium selected by USAID for the implementation of the Romania PRIDE program. This may not however reflect USAID's position on that issue as the consortium selected for the implementation of the PRIDE project was not selected to serve as a transaction advisor to the Government of Romania.

According to OPSPI's understanding, by virtue of involving non-OPSPI specialists (although fully submissive to the agency through the contractual arrangement), the Government has fulfilled its obligation to secure all needed objectivity and transparency of the privatization process. Acting upon the GoR's instruction OPSPI has developed a draft of a privatization strategy for the GoR's review and approval. After the GoR's approval of the strategy and following the procedural instructions provided in the Methodological Norms (GD 88/19997 and GD 577/2002), OPSPI could (in Turceni case, should) publish a sale announcement (notice) drafted accordingly to the relevant provisions of GD 577/2002 to invite investors to submit Letters of Interest.

OPSPI may use some eligibility criteria for the potential applicants to eliminate unsuitable investors from entering further stages of the privatization process. Applicants invited to the

later stages of the process will have access to various documents and facilities (e.g. Information Memorandum and Data Room) and will have the possibility to discuss individual topics with ANRE, ANMR, AFER, etc. However Romanian law does not anticipate the obligatory participation of regulatory agencies' representatives in the privatization process. Ultimately, short-listed applicants will submit their technical and financial offers.

Again, applicants' offers will be ranked by a scoring grid proposed by the same team which is evaluating the bids. Investors have voiced justified concern about whether they could receive equal treatment under such a selection scheme and as to whether the selection of qualified investors will be fair and objective and the developed procedures will be transparent enough to meet the tender requirements.

#### **IV. Investment Climate**

##### ***Background Information***

In 2004, as a result of strong multilateral pressure and the demanding EU acquis compliance terms, there was a sharp increase into Romania of Foreign Direct Investment (FDI) inflows of €4.1 billion as compare to €1.0-1.6 billion magnitudes in the best previous years. This accomplishment was possible thanks to the successful privatization transactions of several large energy companies:

- Petrom, a leading Romanian oil/gas production and distribution company acquired by Austrian OMV,
- Natural gas distributors: Distrigaz Nord acquired by Ruhrgas, Germany and Distrigaz Sud, acquired by GDF, France. These two privatized gas distributors cover about 90% of the country's market,
- Electrical distribution companies Banat and Dobrogea, privatized by Enel SA, Italy.

All energy companies were privatized by a simple method: acquisition of 51% shareholding by sale of 24.67% of shares and the balance through the purchase of new shares from capital increase.

In the same year GOR offered for sale two more electricity distribution grids: Moldova and Oltenia to CEZ (the Czech Republic) and E.ON (Germany). The transaction was concluded in the early spring of 2005. By mid-2005 GOR also put up for privatization the electricity distribution network Muntenia Sud, which services the Bucharest Metropolitan area. The approved privatization strategy for 2005 (DG 185/2005) offers more privatization opportunities in the energy sector, including an advance in the privatization of the Turceni Energy Complex.

As a comparison, Bulgaria had also experienced a sharp increase of FDIs from the privatization of its power sector assets. In one transaction Bulgaria sold all seven its electricity distribution networks to four strategic investors. It was followed by the highly successful sale of two CHPs in Burgas and Varna to the Russian company, UES RAO. We understand that for the third thermal plant in Bobov Dol an acceptable price was offered by

PPC (Greece) but under the political pressure arising from the general election and coalminer riots against the privatization of the power plant (without the inclusion of associated coal mines), the deal was denied as not meeting the Government's expectations.

Foreign investors' interest in 2004-2005 in both EU accession countries (Romania and Bulgaria) is much higher than a few years ago and reflects a trend (labeled as an investors' domino effect) observed three-four years ago in other CEE transitional economies that are now EU members (Czech, Hungary, Poland, Slovakia). However, this interest may not last forever and the Romania's thermal power generation seems to be less cost competitive than similar plants in Bulgaria and Hungary today. Romanian plants may require higher necessary capital expenditures for the technical retrofit/replacement and environmental upgrade of its generation assets.

A valuation report prepared by DTR implies a low commercial viability for TEC if all the necessary capital outlays for meeting EU industry and environmental standards will be required for four generation blocks and the sale price of thermal generated power will be less than USD 47/ MWh.

In addition to the unappealing prospects for recovery of large capital expenditures and high operating expenses, investors will be concerned with the low ranking of Romania as a business-friendly place (the country in 2005 was placed in 125<sup>th</sup> place, among 161 surveyed countries and between Russia and Cameroon). Romania is behind its major neighbors in improving its perceived country risk.

## V. PRIDE Project

### *The Project Background Information*

In order to support the development of positive tendencies to date in power sector restructuring and reforms, to facilitate harmonization of the sector's legal and regulatory frameworks with the EU *acquis* requirements, and to assist in overcoming transformation problems, particularly for thermal power generation entities, the USAID-funded project *Privatization, Investment, and Development of Energy Program (PRIDE)* was tasked with the provision of assistance in the following key four areas:

- **Privatization:** *Support to transfer of energy sector public assets to private ownership* by providing technical assistance to help the GoR and local authorities to introduce appropriate privatization instruments and transparent procedures and objective selection criteria in the privatization of power generation assets. Special focus was in assisting the launch of the privatization process of the Turceni Energy Complex in a transparent and equitable manner.
- **Legal and Regulatory Reform:** *Reform the legal and regulatory environment* for electricity and gas companies by adopting legislation adequate to the new market design and conditions, especially in the area of regulation and competition. No less important is to adopt sound policies and regulatory practices and establishing and implementing transparent and coherent market rules.
- **Competition and Competitiveness:** *Improve utilities competitiveness and increase competition* by restructuring power and gas generation and distribution companies

through institutional strengthening of regulatory agencies and the enhancement of the professional skills of their personnel.

- **Investment and Credit:** *Increase efficiency of energy consumption by more efficient use of energy assets and reducing pollution per unit of GDP* through implementing private energy projects, specifically municipal energy efficiency and water supply/treatment projects financed through commercial lending with the support of the USAID DCA credit facility.

A consortium headed by the former Deloitte Touche Tohmatsu Emerging Markets Group, Ltd. (now Emerging Markets Group, Ltd or EMG) implemented the PRIDE activities. In addition to EMG the consortium included: the Romanian-American Enterprise Fund (RAEF), Deloitte & Touche Romania (DTR), and the International Resource Group (IRG). USA. The two US companies Troutman Sanders LLP and the Aries Group also provided some discrete assistance towards the end of the project for Regulatory Training Assistance.

EMG's team comprised a resident Chief of Party supported by a part-time Project Manager working in Washington, DC and short-term expatriate and local experts hired to deliver specific services. EMG provided the overall conceptual supervision for all diversified project activities and managerial oversight of all project operations. EMG maintained cooperation with the State Privatization Agency (OPSPI), departments of the Ministry of Economy and Commerce, ANRE and ANRGN, and other governmental agencies engaged in the privatization and reform efforts in the energy sector.

EMG directed the efforts of the consortium specialists involved in the implementation of the scheduled and ad hoc project activities, provided general and financial management services for the project, and maintained close cooperation with USAID, WB and relevant EU, EBRD and UNDP projects.

RAEF participated in the implementation of the project with an 18 person team of local and foreign experts given a lead role in many areas such as: ensuring the interface and maintaining working contacts with all key Romanian counterparts for the project activities and providing in-depth knowledge of the Romanian legal and regulatory framework as well as on the organization of the Romanian wholesale electricity market. RAEF was responsible for performing technical, commercial, financial, environmental and legal due diligence reports tailored to the OPSPI requirements and carrying out the technical assessment and preparation of a final Information Memorandum of the Turceni Energy Complex.

The Deloitte & Touche Romania team was assigned the leading role in performing a comprehensive valuation exercise for the Turceni Energy Complex in three statutory forms of valuation: Net Assets Value, Comparative Company Analysis, and Discounted Cash Flow. DTR was in charge of the Investor Research, Marketing and Short-listing and the Identification of Barriers to Investments with a concluding advisory memo to the GoR on final mitigation actions required.

The Deloitte & Touche team was in charge of working contacts with potential investors, designing a marketing strategy and assessing investors' sentiment toward the privatization of Turceni. DTR was the main contributor of materials on financial analyses and statutory and IAS-formatted accounting information used for the Valuation Report for the Information Memorandum's Chapter 9, and for the assessment of the commercial viability of the Turceni Energy Complex.

International Resource Group helped to assess the viability of a DCA credit facility to stimulate municipal energy efficiency and water supply/waste management projects through commercial lending. IRG also provided a training specialist to enhance the professional skills of ANRE and ANRGN personnel.

PRIDE started its activities on September 29, 2003 with an initial scheduled ending of operations two years later, on September 30, 2005, with an option for no-cost extension, subject to available funding and USAID approval. The request for a no-cost extension was approved and the PRIDE project will terminate its activities by November 29, 2005.

In order to prepare and manage the tendering stage of the privatization process (after PRIDE's departure) to attract necessary capital to the energy complexes, the Ministry of Economy and Commerce hired a Consultant (GD 102/2004, Art. 4 (f) and 4(i) in December 2004. In total the overall consulting/advisory activities for the Turceni Energy Complex privatization were funded from three sources:

- USAID-funded activities sponsored by USAID under the PRIDE program. For PRIDE tasks USAID is the Client, while the Ministry of Economy and Commerce and OPSPI are the beneficiaries of the services;
- A fixed component remuneration activities for the law firm (RTPR) paid by Turceni Energy Complex;
- The variable component of the Consultant remuneration ("the success fee") ensured via the "Success Fee Agreement" signed by MEC/OPSPI. These services will be provided by a consortium of Deloitte & Touche Central Europe (DTCE) & RAEF. The relevant agreement was signed and approved by GD 2168/2004.

### ***Project Implementation Action Taken***

Under Activity 1: *Support for a Transparent and Equitable Privatization* the PRIDE project covered a broad range of preparatory and diagnostic work for the privatization of the Turceni Energy Complex. This included:

- Developing a Preliminary Information Memorandum;
- Performing a due diligence analysis of the Complex which covers technical, commercial, regulatory and financial review, environmental and labor due diligence, and legal due diligence;
- Undertaking a preliminary valuation of the Complex by three statutory approaches: Net Assets Value, Comparative Company Analysis, and Discounted Cash Flow;
- Drafting a privatization strategy analysis including: a) issues identified with USAD and during the due diligence process that could block, hinder, delay or complicate the privatization process and to which the Romanian Government should seek remedy and b) the lessons from other similar privatization transactions in both EU

- Member States and in Eastern Central Europe, concluding with a Privatization Strategy Report, which included a Recommended Privatization Strategy for the Turceni Energy Complex (as its Chapter 4);
- Developing the final Information Memorandum on the Turceni Energy Complex containing abstracts from elaborated due diligence reports and analytical and background materials describing developments in the energy market and operating environment for power generation with a focus on lignite-fired power generation;
  - Assisting investors during their visits to the Turceni Complex and responding to investors' inquiries regarding the Complex. Interest in the acquisition of Turceni was firmly expressed by: Enel (Italy), PPC (Greece), Washington International Group (USA), Bateman (Israel) and AES (USA). The leadership of CEZ (Czech Republic) has also made several public statements expressing its definite desire to participate in the privatization of the vertically integrated energy complexes, preferably TEC;
  - Participating in periodical, scheduled working meetings with MEC and OPSPI and responding to their ad hoc requests;
  - Initiated creation of a website of the Turceni Energy Complex with updated English translations of major legal and regulatory documents, and background information about TEC, Ministry and OPSPI privatization documents and privatization events in Romania.

During the preparation of due diligence reports several irregularities were identified resulting from mistakes made by government personnel involved in the formation of the energy complexes and from missing records and reporting documentation in the Complex, as well as a multitude of other unresolved problems of a land ownership nature, violation of procedural and administrative registration requirements, potential environmental liabilities, liabilities for loans taken by head organizations, inter-company arrears, and disputable off-set payments for delivered power.

The Complex management had a deficient accounting system and unreliable records and consequently KPMG Romania, the auditor hired to audit the opening balance, was only able to issue an adverse audit opinion. Hence, all senior managers of the Turceni Energy Complex were fired and a new team of managers was appointed. There is also still a pending investigation of overstated payments for several investment projects in coalmining.

While obviously the Government underestimated the scope and complexity of the work needed for the proper formation and registration of the energy complexes, the PRIDE due diligence work has triggered the correction of many Complex registration and licensing problems and advanced registration of ownership titles for many land parcels. Consequently, there has been a correction of share capital valuation by incorporating the land value and this has also prompted resolution of many other unsettled issues.

Another major reason for the slow pace of privatization progress for the Turceni Energy Complex has been the bureaucratic process for a Japanese Bank for International

Cooperation (JBIC) loan approval. The Romanian Government held intensive negotiations on this loan from November 2003 without disclosing it to the PRIDE team and investors.

The Government of Japan had offered very attractive financial terms for a loan of USD 260 million to finance Flue Gas Desulphurization (FGD) installation. The loan maturity period is 40 years, with a grace period of 10 years and annual interest rate of 0.75% plus some nominal administration and utilization fees. According to the terms of this loan and additional supporting declarations made by Romanian officials participating in the loan negotiations, both the state ownership of assets and their Romanian management, as existing on a date of the loan agreement approval (December 4, 2004), would remain unchanged during the period of the loan maturity.

However the potential investors have made majority (51% or more) shareholding and an operational management control over the Complex performance and assets one of their bottom-line conditions for participation in the privatization of Turceni. The loan agreement with a firm requirement to maintain state ownership and Romanian management was officially signed by the GoR on March 31, 2005 and is now seeking confirmation by a Government Decision.

In our opinion, the GoR's intention to integrate the JBIC loan benefits with the privatization objectives for Turceni Energy Complex may put its privatization prospects on the sidetrack for the time being.

In principle, the PRIDE project has reached its objectives under Activity 1 to create the conditions necessary for an immediate start of the tendering stage of the privatization process at the Turceni Energy Complex and to expedite transaction closing:

- a) Turceni Energy Complex is now prepared to enter its privatization process. Major legal and administrative irregularities committed during the formation process of the Turceni vertically integrated complex and during its registration that were identified under PRIDE due diligence works were eliminated or corrected. Most of the outstanding ownership and land registration issues of parcels of land used by the power plant and coalmining were successfully resolved, although the existing Romanian privatization legislation allows for closing the privatization transaction with the land ownership and registration issues being resolved later. KPMG has released its second TEC financial audit (for year 2004), which provides a more favorable assessment of the financial performance of Turceni than the first KPMG adverse audit opinion of financial statements as of March 31, 2004 and the TEC opening balance.
- b) The Government of Romania has published its decision (GD 184/2005) to accelerate the privatization of energy assets in 2005, including spelling out the Government's intention to advance with the privatization of Turceni, Rovinari and Craiova Energy Complexes. It is the first GD specifying a formal requirement of at least 51% shareholding that can be offered for sale in the privatization of energy assets. Such a threshold shareholding level is recommended by the PRIDE deliverable *Privatization Strategy Report, Chapter 4*.
- c) The Government of Romania has hired (GD 2184/2004) its transaction advisor to

- assist GoR in the tendering stage of the privatization process.
- d) During the last two years the PRIDE team was successful in preserving the interest to participate in privatization of Turceni by a sufficient number of suitable investors: Enel SA (Italy), Washington International Group (USA), AES (USA), Public Power Corporation (Greece) and Bateman (Israel). Additionally the PRIDE project has conducted intense marketing activities to attract more reputable investors such as CEZ (the Czech Republic) and other credible applicants to participate in TEC privatization.
  - e) The Government of Romania has finally accepted the PRIDE recommendation to publish a new sale announcement in local, regional and major international newspapers that are popular among potential investors as well the sale announcement in electronic formats, on MEC and TEC websites. This would increase the number of qualified applicants and enhance the competitiveness of the privatization process.
  - f) The PRIDE key deliverable (*Privatization Strategy Report*) provides a recommended privatization strategy for TEC suitable under the existing privatization legislation and responsive to the present investment climate and investors' sentiment for energy assets in the SEE region. Implementation of the PRIDE recommended project privatization strategy for TEC would secure an adequate transparency level and objectivity of privatization procedures and applicant pre-selection criteria and in the ranking of bidders' offers, and should bring an equitable transaction outcome.

Under Activity 2: *Legal and Regulatory Reform* the project provided a broad range of services focusing on continuing reform of the legal and regulatory environment, adopting sound policies and establishing and implementing rules for the liberalized wholesale energy market and other regulatory improvements aiming at supporting the privatization process.

Through its activities PRIDE has promoted sound policies and provided advanced regulatory interventions learned from the EU Member States, the US and East Central Europe. The key areas of assistance have included:

- Assisting the GoR in restructuring thermal power generation through the creation of operationally sound vertically integrated energy complexes, which are more attractive to foreign investors being asked to make large capital expenditures in the technical retrofit of worn-out capacities and their environmental upgrade;
- Providing a working paper on "Transaction Risk and Contractual Options".
- Providing comprehensive legal assistance for developing new contractual trade arrangements, mainly long-term bilateral contracts with incorporated risk management instruments such as hedging, forward contracts, performance based ratemaking and insurance-based solutions;
- Assisting in developing a contractual framework for spot market energy trading by assisting in the adoption of template contracts, payment terms and instruments, and settlement procedures approved by the European Federation of Energy Traders to enhance the liquidity of the market and widely accepted in international energy transactions;

- Collaboration with ANRE in developing an English version of a new Wholesale Electricity Market Commercial Code and supplementary documents in order to make it accessible to foreign specialists for their evaluation and comments;
- Developing the conceptual framework, tender procedures and regulatory document on "Provider/Supplier of Last Resort" for captive consumers;
- Designing measures, procedures and incentives for eligible customers to switch power suppliers in order to benefit from market openness and competition;
- Assessing applicable load profiling approaches in the context of their suitability to Romanian conditions and data sources for better forecasting of load demand and optimization of power generation costs;
- Aligning Romanian Accounting System (RAS) to reporting requirements of International Financial Reporting System (IFRS) and amending accordingly the regulatory accounting practices and tariff setting methodologies;
- Assisting in selection of pragmatic approaches and methodologies used to assess investment efficiency in electricity and gas sectors for regulatory applications;
- Introducing a conceptual framework of the EU Emission Trading Scheme for regulators and senior managers of energy companies to present new business opportunities and management challenges arising from the carbon constrained development strategies promoted throughout the EU economic space. Providing comprehensive assessment of developments on essential aspects of green certificates origination and their trade options. Providing examples of US emission trading schemes;
- Applicability of most popular capacity mechanisms and schemes for Romania from the EU area, Latin America, PJM Interconnection (Pennsylvania-New Jersey-Maryland) and the Resource Adequacy Requirement of FERC's to support creation of a capacity market in Romania; and
- Enhancement of market monitoring techniques to make them adequate to Romania's conditions and tailored to ANRE preferences.

Special attention was given to establishing a participatory process involving the principal stakeholders and a transparent consultative process in issuing new energy related laws and regulatory decisions as a routine work approach for both regulatory agencies. The assistance focus and details of its scope were established in close consultations with the ANRE/ANRGN senior management and USAID. In most cases the assistance program was customized to help with resolving the immediate and urgent needs of both regulators and was adapted to rapid changes in their work schedule.

Under Activity 3: *Support to Further Strengthen the Energy Sector Regulatory Bodies* the project provided a customized training program to introduce the needed methodological and conceptual background to proposed changes in legal and regulatory environment of the sector operations. In general, the modules of delivered training programs were to provide support for further legal and regulatory reform of the sector. Depending upon the subject and objective of the training there were two major formats of delivery:

- a) to a broader audience of ANRE/ANRGN experts and invited major stakeholders: Transelectrica, OPCOM, Electrica, privatized gas and power distribution companies, state-owned vertically integrated energy complexes, other donors'

projects, sector's research institutions, NGOs, professional associations and individual professionals active in the sector;

- b) to a narrow group of pre-selected ANRE or ANRGN experts with a focus on regulatory and legal details necessary to draft regulatory document or decision.

Training was provided to the electricity regulator (ANRE) and the gas regulator (ANRGN) on the following topics:

**ANRE**

- Risk Management and Financial Instruments in Power Trading
- Overview of Regulatory Framework for Power Supplies from Renewable Energy Sources
- Emission Trading Schemes – EU and US models and experience
- Public Service Obligations
- Accounting training in IFRS requirements and related regulatory accounting issues for power industry
- ANRE internal and Stakeholder Workshop for Development of a Provider of Last Resort (POLR) mechanism for the power industry
- Bilateral contracts with risk mitigation templates
- Load Profiling
- Financial Trading for the new WEM platform
- Incentives to Switch Power Suppliers
- Capacity Reserve Mechanisms to secure sufficient level of power generation capacity

**ANRGN**

- Risk Management and Financial Instruments in Natural Gas Trading
- Assessment of Investments for Energy Efficiency in Natural Gas Industry
- European Natural Gas Market. Sources for Reliable Information on Prices and Demand/Supply Developments
- Public Service Obligations in Natural Gas Regulation
- Accounting Training in IFRS requirements and related regulatory accounting issues for gas industry
- Introduction to the POLR mechanism for gas industry
- Performance standards and commercial rules for supply, distribution, transmission, underground storage, for natural gas activities
- Balancing rules for distribution and transmission systems in gas industry
- Results of Price Cap/Revenue Cap methodologies –California's experience
- Cost of gas capacity reserves
- Rules for gas distribution system access
- Security of natural gas supplies
- Customer protection/public service obligations with regard to low-income gas customers
- Bilateral contracts with risk mitigation in gas trade

As a rule, the PRIDE trainers have provided additional information and samples of regulatory materials to participants of their training program. The implementation of the training program has further strengthened the institutional and professional capacities of the regulatory bodies in the energy sector. This has improved utilities' competitiveness, increased overall competition, and helped the regulatory agencies to be self-sustaining. Presently, fees for licensing and other regulatory services finance all ANRE and ANRGN activities. Thus, the training has supported the strengthened capacity of GOR counterparts to serve market economy goals and the increased competitiveness of private companies and markets.

Under Activity 4: *Increase efficiency of energy consumption by more efficient use of energy assets and reducing pollution per unit of GDP* PRIDE identified dozens of bankable municipal energy efficiency and water supply/treatment projects that would qualify for financing through commercial lending with the support of the USAID DCA credit facility. These projects would secure the desired reduction of energy use or improvement of water supply/waste treatment or reduction of pollution level within the period of the loan maturity. Pay-back periods for reviewed projects by energy saving or other commercial effects was 2.5 to 5.0 years.

On this basis PRIDE prepared an *Action Memorandum* for DCA/USAID Washington – a basic document documenting the technical feasibility and commercial viability of proposed municipal projects both from the borrower and lender point of views.

Activity 4 aimed to improve the weak availability of commercial credit for many bankable energy saving municipal projects. Municipal infrastructure in Romania faces critical investment needs that are not currently being met. Poor performance, exacerbated by the lack of maintenance and investment by municipal district heating and water/waste water systems, has resulted in deteriorating service and increasing tariffs, making the service unaffordable to many customers. In response, many customers have responded by not paying for the inadequate service, which has further eroded system revenues and the opportunity to make the necessary investments, and in many cases by disconnecting from the district heat networks, which is jeopardizing the ability of the systems to remain in operation.

Similarly, the non-payment of water/waste water bills is depriving the revenue needed to maintain the system, and makes the water systems among the largest non-payers of electricity, which represents one of the most significant expenses. Clearly, there is need for investments among the district heat and water/wastewater networks and among end-use customers to help them control the rising costs.

The purpose of Activity 4 was to facilitate the increase of municipal access for bank financing of energy efficiency, water and waste disposal programs in Romania. A portfolio guarantee was offered to one or more private commercial banks willing to expand lending activities to the municipal sector in these target areas. The bank would make loans to the municipalities, municipal enterprises, or engineering service companies to finance efficiency and capital improvements on a variety of infrastructure projects including water

supply, wastewater disposal, district heating systems, cogeneration systems, energy consumption by residential multi-family homes, schools, and hospitals, etc.

This program or facility allows the U.S. government to issue a guarantee on 50% of the amount of loans. This guarantee covers the secured loan principal amount only within the duration of this activity. In the given Romanian environment the DCA loan guarantee could serve as a substitute for a lack (or a weakness) of collateral in commercial bank/municipality credit operations and this could lower the perceived credit risk for commercial banks. Therefore, the DCA facility could contribute to a significant increase in the number of municipal projects qualified for commercial lending.

The total estimated amount of loans to be issued under the project is \$2.5 million. During the preparation of the Action Memorandum the PRIDE team reviewed a host of municipal projects. The value of these projects ranged between \$5,000 to several million dollars. Smaller loans below the amount of \$100,000 may not attract the banks' attention, due to the high costs associated with the preparation of documents and servicing of the loan. However, it may be possible to package a few smaller loans as a bundle to increase the investment value to \$100,000. We envisioned that a typical loan size for a DCA-backed loan in Romania might be in the \$100,000 to \$500,000 range.

In addition to providing assistance to bring a credit market and private sector orientation in municipal lending, PRIDE played a critical role in coordinating other donors' assistance in the energy and water sectors. This collaboration enhanced the program's effectiveness. Two other important sources of collaboration in implementation of Activity 4 included the USAID GRASP program and the USAID regional initiative Municipal Network for Energy Efficiency (MUNEE).

However, and unfortunately, despite intensive PRIDE and USAID Bucharest and Washington marketing of the DCA facility among all qualified private commercial banks operating presently in Romania, no bank was eager to sign a collaborative agreement with the USAID Bucharest for implementation of the DCA credit guarantee under the offered terms.

## **VI Major Obstacles and Challenges Encountered**

Despite the many accomplishments cited above, the PRIDE project was not able to accomplish all of its goals. USAID and other donors had as their objectives support to the reform and restructuring of the energy sector and accelerated privatization of the energy assets. Although under strong international pressure there was a spike of successful privatization transactions in the Romanian energy sector in 2004 the Government of Romania selected for privatization the easiest sellable assets in gas and power distribution companies.

However, due to the limited transparency of the adopted privatization procedures, the sale results were well below figures for similar transactions in Bulgaria (in a case of electricity distribution grids) or are the subject of public scrutiny and the state audit organs investigation (in the case of Petrom and to some extent this also pertains to the Distrigaz Sud and Nord transactions).

In the case of the Petrom privatization there is still some justified doubt as to whether the company was privatized according to acceptable tender rules and whether its sale has produced equitable results. In general, a reasonable conclusion made from the observation of the past privatization transactions is that strong international pressure rather than the Government of Romania's political will was the driving force behind the latest ownership changes in the energy sector. A substantial acceleration in the privatization of the newly created vertically integrated energy complexes is unlikely without strong international pressure.

Without substantial technical rehabilitation and environmental retrofit of the lignite-fired generation capacities of Turceni, Rovinari and Craiova energy complexes, a highly capital-intensive and time sensitive task, the Romanian power sector may experience the shortage of power generation capacity sufficient to supply needed electricity. Without the needed modernization some power generation blocks in these energy complexes could be removed from operations as soon as 2007 with practically all of them closed by December 31, 2010.

An adequate return from the implementation of PRIDE Activities 2 and 3 may be endangered by ANRE and ANRGN's limited abilities, in the absence of a needed metering and telecommunication infrastructure, to execute an accelerated program of wholesale energy market liberalization, involving the creation of an energy trading platform for spot market transactions.

The final implementation of Activity 4 was constrained by an inability to identify a commercial bank in Romania willing to sign a collaborative agreement with USAID Bucharest for utilization of the DCA facility for financing municipal energy efficiency and water supply/waste treatment projects. One of the frequently cited reasons provided by banking managers was the regulatory decision of the National Bank of Romania to include DCA-type credit guarantees in the lower class of collaterals, which are not recommended for banking use.

## **VII Conclusions and Recommendations**

The conclusions to be drawn from the successes and some setbacks of the Romanian power privatization project would inform the debate about the policies that defined the scope of work for this assignment. These conclusions would likely require examining the larger trends and policies that have been promoting power sector privatization in many emerging markets around the world. Romania is not an island unto itself and many of the issues faced in Romania are similar to those faced in other CEE and SEE countries joining the European Union.

Over the past few years, USAID, the World Bank and the European Union have funded many extensive studies on the topic of power sector reforms and privatization and the lessons learned from the successes and failures in emerging markets. In order to better inform USAID policy makers, Emerging Market Groups Ltd. can point to a bibliography of many well researched reports speaking to conclusions that can only be addressed in a

limited way in this summary report. The experience in other SEE region countries and other emerging markets have common threads to what is transpiring in Romania. Based upon EMG's experience working on the Romania power privatization advisory assignment, there are three overarching conclusions and recommendations as below:

- The process of power market reform and privatization needs to take the political and economic conditions in the Romania or any country into account in a more effective manner. The narrow focus on often imported legal and institutional reforms in the energy sector and the promotion of a power privatization transaction without a better understanding of the political, economic, and cultural context for these reforms may have contributed to a policy that ultimately was considered alien and politically unattractive. The ensuing decline in political support for the privatization process could be seen as a natural outcome. There was insufficient attention to understanding the needs of each of the relevant stakeholders and how to obtain greater buy-in from these stakeholders to support the power sector reforms and privatization.
- The role of strategic private international versus regional state capital (CEZ, Enel, PPC, EdF, etc.) and the relative merits of each needs to be examined within the context of the objectives desired. In an extended period of international private strategic investor capital shortages, regional state capital is often seen as better than no capital. Crafting tighter and more stringent short-listing criteria to exclude unsuitable regional state investors on the grounds that they represent private sector *sensu stricto* may need to be reconsidered. The question of how policy makers can harness regional state capital to support reforms rather than undermine them is worth considering particularly in an extended climate where foreign investors are simply not available in the numbers that are needed to meet the sector's investment needs. Regional state investors have been playing an expanded role in many emerging markets in the face of a foreign private investor retrenchment - this is a trend that needs to be recognized and harnessed rather than simply opposed. As has been demonstrated in the Romania privatization and in those of other countries in the region, regional state capital and its interests will find a way of getting into the sector.
- Effective coordination between other donors and USAID contractors was sometimes not as effective as it should have been, resulting in occasionally un-aligned objectives and tactics. While donor coordination was achieved over time, the delay and complications disrupted the effectiveness of the project and the timely delivery of services. The GoR also sometimes received confused or mixed messages that contributed to problems in implementing the policy defined in the scope of work.

While many other factors can also be cited to explain the results of this project, the three cited above are perhaps the most important. Despite the lack of a privatization transaction under PRIDE, there are various enduring outcomes in energy sector reform that should leave a positive legacy for Romania. The most important achievements are as follows:

- Power sector reforms were achieved that led privatized but also state-owned entities to substantially improve their performance by such measures as cash collections and operating efficiency;
- Substantial capital was raised for the power sector and the state budget of the GoR and most investors from the concluded privatizations showed greater transparency and compliance with reform objectives and in some instances expanded urgently needed investments;
- The GoR was effectively induced to focus on the most critical barriers to reform (i.e., monetizing the power system, addressing debt restructuring, enhancing ANRE's financial independence, implementing an effective tariff methodology and rate hearing process, etc.) and thus progress is being achieved, albeit at a slower pace than desired by some.

In total, the project led to some major accomplishments that will benefit Romania and also provided valuable lessons learned that can help USAID and the donor community to refine their development policies going forward.

