

HISTORY OF PRIVATISATION OF UKRAINE'S ENERGY COMPANIES

1. The Government's Privatization Strategy

Ukraine has had a privatization program since the State Property Fund (SPF) was established in 1992. That year the Parliament also approved the major Law "On Privatization of Assets of State-owned Enterprises", which determined the key principles for the privatization of state property. A mass privatization program started at the end of 1994, but caused continuous disputes with the Parliament. As a result, the 1995 target of privatizing 8,000 enterprises was achieved only by 50%. Resolution of Verhovna Rada of Ukraine dated March 3, 1995 "On the list of enterprises banned from privatization in view of their importance for the national economy" established a list of 5,200 companies that were not to be privatized. The following objects had to remain property the State property out of the privatization program in accordance with the mentioned resolution:

- The main power networks with voltage of 220 kV and higher;
- System of dispatch and technological control of united energy system;
- Major companies and organizations of scientific research;
- Hydro power stations;
- Nuclear power stations;
- Combined heat & power stations.

However, the Dniester Hydro Pumped Storage Station JSC was established in order to attract investments for the completion of construction based on a separate resolution by the Cabinet of Ministers.

The Law "On State Privatization Program for 2000-2002" came in force in May, 2000. It defined key objectives, priorities, targets and methods of privatization of the state-owned enterprises for the next three years. In the early stages of privatization the Government set the greatest emphasis on social aspects of privatization and on finding enterprises willing to be developed for the benefit of the population. Now the emphasis has shifted toward securing the efficient functioning of enterprises, creating a competitive environment as well as providing transparency of the privatization process. Emphasis is now also placed on raising cash for the state budget from the privatization proceeds.

2. Privatization of Energy Companies in Ukraine

Historically, privatization in the Ukrainian power sector included the following stages:

i) Preferential allocation of shares among employees of power companies

In 1997, the power companies, jointly with the Ministry of Energy (Minenergo) and the SPF, prepared a plan for the allocation of shares. This step was actually the first step taken in the privatization process. Employees were entitled to a certain allocation of shares in their companies at preferential rates. On average, about 17.3% of the shares in Oblenergos were allocated this way. The highest allocation of preferential shares was made at Kyivenergo (33.77%) and the lowest allocation at Zakarpattyaoblenergo (12.85%). Allocation of shares of energy generation companies to employees amounted to about 19.6% of total shares, with the lowest allocation made in Donbasenergo (14.23%) and the highest in Dniproenergo (22.8%). The allocation of shares among employees and the consequent purchase of these shares by intermediaries effectively reduced the level of dissatisfaction among the employees caused by unpaid wages. The sale of shares at preferential prices is now terminated.

ii) Sale of Oblenergo shares at auctions using privatization¹ and compensation certificates².

¹ Every Ukrainian citizen received one privatisation certificate from the government. The face value of such certificate is UAH 10.5.

² Compensation certificates were given to Ukrainian citizens who had bank accounts in the Former Soviet Union before 1 January 1992. The certificates were intended to compensate owners of bank accounts for the loss they incurred when the Rubl devaluated.

In 1997-1998, all Oblenergos that had prepared allocation plans, except Dniproblenergo and Kyivenergo, placed their shares for sale at auctions for privatization and compensation certificates. On average, the amount of shares sold through certificate auctions reached 5.14% of total shares, with the highest portion sold in Sumyoblenergo (8.77%) and the lowest portion in Sevastopilmiskenergo (1.66%). Shares in Vinnytsiaoblenergo, Zaporizhyaoblenergo and Rivneoblenergo were not placed for sale because these companies had not prepared their share allocation plans in time. Shares in power generating companies were not sold through the certificate auctions.

iii) Sale of shares at the Stock Exchange and OTC-market for cash.

Since the second quarter of 1997, the SPF has offered 10-15% of the shares of certain Oblenergos and Gencos in the stock market for sale in cash. The sales took place at Ukrainian Stock Exchanges or through the “over-the-counter” trading system PFTS. However, many such sales failed. The second wave of offerings took place in the second half of 1999 – beginning of 2000 when most of Oblenergo shares were successfully sold. The largest portions put up for sale were 19.25% of the shares of Prikarpatyaoblenergo, 17.07% of Odessaoblenergo and 16.67% of Luganskoblenergo. The smallest portions were 2.81% of the shares in Volynoblenergo and 2.02% in Rivneoblenergo.

iv) Sale of Oblenergos' shares through commercial tenders

In December 1997, the SPF arranged the first commercial tenders for shares in seven Oblenergos. According to the conditions of commercial tenders the winner was the participant bidding the highest price per share as well as promising to fulfill the certain required conditions (or investment commitments). As a rule, required conditions were the following: replenishment of the working capital, repayment of overdue accounts payable, financing the technical renovation program, maintenance of social infrastructure, etc.

However, five tenders were unsuccessful because there were no guarantees that the winner would be allowed to manage the state's part of the shares. There were neither guarantees regarding the possibility to restructure the debt of the Oblenergos put up for sale nor clear principles of future tariff policy. Besides the State initially offered only 20% of the shares for sale though it later increased the percentage to 35%. Only shares in Kirovogradoblenergo and Ternopiloblenergo were sold. The winners were portfolio investors First Ukrainian Privatization Fund (Ukraine) for Kirovogradoblenergo, as well as Prodexport JSC (Ukraine) for Ternopiloblenergo. According to information received later, these companies were acting as intermediaries that resold the stakes right after the tenders.

The fail of winter tenders could be explained by the following factors:

- small size of the shares offered for sale;
- inconvenient time of tenders announcement (Christmas & New Year holidays);
- short time for bid submission (one month from the day of the tender's announcement);
- absence of the State guarantees regarding the debt restructuring;
- current principles of tariff policy in the energy sector and inefficient Energy market rules;
- relatively large amounts of investments required etc.

In March 1998, the situation improved slightly. The Law "On the State Privatization Program for 1998" allowed transferring management rights for the State stake of shares (from 25% up to 51%) of energy companies to the winner of commercial tender. It efficiently allowed strategic investors to get necessary control over the company and making necessary decisions. At the same time, other conditions of the tenders remained unchanged.

Based on the updated legislation the State Property Fund started the commercial tenders for the second time in the summer of 1999. The State offered for sale 35-36% of shares in each energy distribution company. Five tenders were completed successfully, the rest failed due to the absence of bidders. Tender results for 1998 are presented in the table below. It is worth mentioning that the majority of Ukrainian companies evidently participated in tenders under the agency contracts with other companies (mainly offshore companies) or planned to re-sell these packages of shares immediately.

Results of the commercial tenders for Oblenergos sale in 1998

Oblenergo	% of statutory capital sold	Nominal price (million UAH)	Sale price (million UAH)	Bidders	Winner	Comments
Kirovograd oblenergo	20	5,968,000	7,620,000	1. First Ukrainian Privatization Fund (Ukraine); 2. Prominvest (Ukraine)	First Ukrainian Privatization Fund	Ukrainian financial intermediary
Ternopil oblenergo	20	3,054,400	5,030,000	1. Prodexport (Ukrainian) 2. Legion 95 (Ukraine)	Prodexport	Independent Electricity Supplier
Chernigiv oblenergo	35	10,440,300	14,010,000	1. Avtoaliance invest (Ukraine) 2. Liberty Market (Ukraine)	Avtoaliance invest	Ukrainian financial intermediary
Sumy oblenergo	36	15,941,300	18,600,000	1. Trading Limited (USA) 2. Arsenal Ltd. (Ukraine) 3. Prodexport (Ukraine)	Arsenal Ltd.	Ukrainian financial intermediary
Prykarpattya oblenergo	35	9,068,100	9,420,000	1. Liberty Market (Ukraine) 2. Ukrainski Tsinni Papery (Ukraine)	Ukrainski Tsinni Papery	Ukrainian financial intermediary
Lugansk oblenergo	35	18,210,800	25,263,000	1. Verona Plus (Ukraine) 2. Los Angeles United (USA)	Verona Plus	No information is available
Poltava oblenergo	36	19,886,400	44,350,000	1. Contrast Holdings Ltd. (Virgin Islands) 2. Pryvatbank (Ukraine) 3. Vostion Group (USA) 4. Los Angeles United (USA)	Contrast Holdings Ltd.	No information is available
Lviv oblenergo	35	16,972,580	40,750,000	1. Pryvatbank (Ukraine) 2. FCI 3. Kyiv-KOD 4. Orlik Enterprises	Pryvatbank	One of the biggest Ukrainian banks
Odessa blenergo	35	18,243,360	26,900,000	1. Electricite de France (France) 2. Overcon-consortium (ABB, Tomen Power Corporation, Fond Elec Group, Europa Capital Managment) 3. FS Trading (USA) 4. Vostion Group (USA)	FS Trading	No information is available

Source: INEKO-Management, EnCoG

The State Property Fund of Ukraine received 434.4 mln UAH in 1998 from privatization of energy companies. Market price of shares during the sale through stock exchanges amounted to 1.53 of initial price and during the sale via commercial tenders to 1.63 of initial price.

There were no international strategic investors among the winners. A group of offshore and Ukrainian companies known as Investment Pool, being represented by the company Court Holdings Ltd., purchased shares in Sumyoblenergo, Prykarpattyaoblenergo, Chernigivoblenergo, Poltavaoblenergo and Lvivoblenergo via tenders as well as accumulated large stakes in the secondary market. A group of offshore companies represented by Finance and Credit Bank (Ukraine) purchased shares in Luganskoblenergo and Odessaoblenergo.

The reason for such results was the lack of qualification criteria or requirements for participants in the tender rules. The only criterion for determining the winner of the tender was the price offered for the shares. The amount of investments required for the development of the company was fixed and, thus, couldn't be used as evaluation criteria. As typical example, the tender for Odessaoblenergo shares did not allow for consideration of the bidders on the basis of their energy sector experience and ability to invest in the company.

Initially, the tender for 35% of Odessaoblenergo shares attracted four bidders: Electricite de France (France), Consortium Overcon, FS Trading LLC (USA) and Vostion Group (USA). The two last companies had been

registered at the same address in Georgia (USA) known as an offshore zone. At the same time Consortium Overcon was founded by well-known companies such as ABB (Switzerland), FondElec Group Inc. (USA), Tomen Power Corporation (Japan), CMS Energy (USA), ECM (Czech Republic). After the first round of the tender Overcon was selected as a preliminary winner. According to the procedure of commercial tenders of 1998 after the selection of preliminary winner at the first stage, the bidders could raise their bids during the second stage and the winner would be the participant with the highest price proposal. In preparation for the second stage Overcon made a deal with EDF, which joined the consortium as potential operator of Odessaoblenergo. Overcon, FS Trading and Vostion Group submitted their bids at the second stage. According to unofficial information Overcon offered 23 million UAH plus 410 million USD of investments during 15-30 years (including 90 million USD in the next 5 years), FS Trading offered 26 million UAH plus 49 million UAH of future investments (approximately 25 million USD at the July 1999 exchange rate). The Tender commission selected Overcon as a final winner of the tender based on the higher amount of investments promised as well as on the considerable experience of operating energy companies. But taking into account the effective procedure of commercial tenders described above the decision of the Tender commission constituted a violation of the legislation. This led the SPF to cancel the previous decision of the Tender commission and recognize FS Trading as the winner of the tender.

Another point was the execution of the required conditions in the tenders by the winners. Using the gaps in Ukrainian legislation they could fulfill their obligations through certain kinds of commercial contracts signed with the Oblenergo without carrying out actual investments performed.

A dispute erupted in early 1998 between the Ministry of Energy and the SPF regarding the tender procedures for energy companies' sales. Minenergo was keen to sell shares on the basis of a non-commercial tender because in its opinion this would attract strategic investors and necessary investments in the companies. The SPF, on the other hand, promoted commercial tenders because it would provide the largest amount of cash proceeds to the State budget. All tenders so far have been commercial tenders. This disagreement led to the suspension of privatization of energy companies in the summer of 1998. At the time of the privatization suspension the tenders for sale of Mykolayivoblenergo and Chernivtsioblenergo were announced which led for cancellation of the tender by the SPF.

This led to idea of changing the approach to privatization of energy companies in the way of introduction of non-commercial tenders instead of commercial. In October, 1998 the Cabinet of Ministers approved the new State Program of Privatization of Power Industry that stipulated the key principles for energy companies tenders, including:

- the main criteria for the selection of the winner of the tender should be the plan of the company's development as well as the amount of investments proposed;
- individual approach to the privatization of each energy companies, including debt restructuring, tariff policy revision etc.;
- approval of the results of each tender by the Cabinet of Ministers in order to strengthen the mutual responsibility of the investor and the State;
- offering the control stakes in energy distribution companies for tender sale.

A special working group was established in December 1998 and included the representatives of the SPF, Minenergo, Antimonopoly Committee, NERC etc. As a result of its activity, the Presidential Decree devoted to the specifics of privatization of energy companies as well as the SPF's new tender procedures was prepared.

The Decree of the President of Ukraine "On peculiarities of privatization of power industry enterprises of Ukraine" No. 944/99 was issued on August 2, 1999. It contained the description of key issues during the tender sale of energy companies such as:

- Potential buyers of energy companies shares should be the companies, which have wide experience in management of power industry objects and in operations at the electricity market;
- Potential buyers have to enter into investment commitments to provide their efficient activity and development of energy companies;
- Sale of controlling stakes of shares in energy companies is preferred;

- As a rule, sale of power companies shares via the tender shall be conducted with the assistance of advisor as a rule;
- Tender conditions of each particular tender shall be approved by the Cabinet of Ministers of Ukraine as well as the State obligations as to the debt restructuring, setting of tariffs for electricity, transferring the State shares under management of the buyer.

The Decree defines that the State will set its ownership at 25%+1 share in each energy distribution company and 50%+1 share in each energy generation company. Such conditions still do not allow for acquiring the controlling stakes of shares offered for sale in energy companies. Therefore, the SPF, with support of international donor organisations, drafted the amendments to the Decree that allow selling the shares currently reserved for the State as addition to the packages offered for tenders. In case of approval by the President it will enable the sale of stakes from 50% to 75%.

Further to the Decree, the State Property Fund together with the Ministry of Energy and other State agencies approved the Regulations “On the Procedure for Holding the Tenders on Sale of Energy Companies’ Blocks of Shares” No. 1965 as of October 18, 1999. The Regulations determine the exact procedure for the preparation and conduct of the tenders for the sale of shares of energy companies based on the idea of non-commercial tenders with pre-qualification of bidders.

In parallel, the Parliament passed (in the first reading) a Draft Law “On Peculiarities of Privatization of the Property of Enterprises of the Fuel and Energy Complex” sponsored by parliament member Kostusev. The Draft Law contains the general principles and procedures for fuel & energy companies’ sale, which is in line with the Presidential Decree of August 2, 1999 and the mentioned SPF’s regulation. The second reading of the Draft Law should take place in the summer of 2000.

v) Sale of Gencos through the open tenders with a privatization adviser

Shares of energy generation companies were sold mainly through preferential subscription to the employees and the management. The only exceptions were sale of stakes of Dniproenergo shares at the Stock Exchange as well as the certificate auction for Zahidenergo shares. As of today 50%+1 share are reserved for the State.

The SPF declared its intention to offer Gencos for sale in 1998 through international tenders with participation of investment banks being the privatization advisors. In the beginning of 1998 the consortium of CreditAnstalt Investment Bank (CA IB), Arthur Andersen and NEKO became the advisor for the sale of 24% shares in Donbasenergo power generation company. Later in the spring, Union Bank of Switzerland in consortium with EPIC and Kinto won the tender for privatization advisor to sell 24% of shares of Centrenergo generation company. Neither CA IB consortium nor UBS consortium signed the contracts for advisory services with the SPF. The SPF changed the tender rules and claimed for obligatory payments as a guarantee that the banks would succeed in finding an investor and closing the deal. Both CA IB and UBS announced that the amount of pledges required from them were excessive and declined to sign the contracts. After that, there were several attempts from the SPF’s side to announce the tenders for sale of shares of Gencos that were unsuccessful.

3. Current share allocation plans of Ukrainian Energy Companies

		<i>Oblenergos' Share Allocation Plans*</i>										
#	Company	State property (%)				Private property (%)						
		Total	State share	to be sold in a tender	to be sold on the Stock Exchanges	Total	Preferential subscription	Sale for PPC**** via certificate auction	Sale for CC**** via certificate auction	via Stock Exchanges and PFTS*****	via Center of certificate auctions	Commercial / non-commercial tender
<i>Power distributing companies</i>												
1	Cherkasyoblenergo**	70.00	25.00	45.00		30.00	19.48	6.14		4.38		
2	Chernigivoblenergo	25.00	25.00			75.00	16.83	6.54		16.63		35.00
3	Chernivtsioblenergo	70.00	25.00	45.00		30.00	10.22	5.47		14.31		
4	Dniprooblenergo	75.00	25.00	50.00		25.00	18.96			6.04		
5	Donetskoblenergo	65.00	25.00	40.00		35.00	18.36	5.00		11.64		
6	Kharkivoblenergo	65.00	25.00	40.00		35.00	20.58	2.96		11.46		
7	Khersonoblenergo	65.00	25.00	40.00		35.00	16.54	5.48		12.98		
8	Khmelnyskoblenergo	70.00	25.00	45.00		30.00	17.00	4.72		8.28		
9	Kirovogradoblenergo	51.00	25.00	26.00		49.00	15.92	2.42		5.66	5.00	20.00
10	Krymenergo	70.00	25.00	45.00		30.00	18.01	3.00		8.99		
11	Kyivenergo***	62.74	62.74			37.26	33.77			3.49		
12	Kyivoblenergo	75.00	25.00	50.00		25.00	12.97	3.67	3.30	5.06		
13	Luganskoblenergo	25.00	25.00			75.00	19.33	4.00		16.67		35.00
14	Lvivoblenergo	26.98	25.00		1.98	73.02	16.97	8.05		13.00		35.00
15	Mykolaivoblenergo	70.00	25.00	45.00		30.00	11.53	6.45		12.02		
16	Odesaoblenergo	25.00	25.00			75.00	17.52	5.41		17.07		35.00
17	Poltavaoblenergo	25.44	25.00		0.44	74.56	16.14	6.80		15.62		36.00
18	Prikarpatiaoblenergo	25.00	25.00			75.00	15.63	5.12		19.25		35.00
19	Rivneoblenergo	75.00	25.00	50.00		25.00	16.07	6.91		2.02		
20	Sevastopolenergo	70.00	25.00	45.00		30.00	16.95	1.66		6.29	5.10	
21	Sumyoblenergo	25.00	25.00			75.00	15.21	8.77		15.02		36.00
22	Ternopiloblenergo	51.00	25.00	26.00		49.00	16.48	8.00		4.52		20.00
23	Vinnysiaoblenergo	75.00	25.00	50.00		25.00	21.58			3.42		

24	Volynoblenergo	75.00	25.00	50.00		25.00	15.39	3.87	2.93	2.81		
25	Zakarpattiaoblenergo	75.00	25.00	50.00		25.00	12.85	6.11		6.04		
26	Zaporizhiaoblenergo	75.00	25.00	50.00		25.00	17.17	4.90		2.93		
27	Zhytomyroblenergo	75.56	25.00	50.00	0.56	24.44	13.68	2.76		0.00		8.00

Source: SPF, INEKO-Management, EnCoG

* as of July 15, 2000

** share allocation plan not approved by the SPFU

*** state property includes shares transferred under management to Kyiv Administration (50% + 12,74%)

**** PPC - property privatization certificate, CC - compensation certificate

***** PFTS – Ukrainian over-the-counter trading system

*Gencos' Share Allocation Plans**

#	Company	State property (%)				Private property, %		
		total	State share	to be sold in a tender	to be sold on the Stock Exchanges	total	preferential subscription	via Stock Exchanges and PFTS
<i>Power generating companies</i>								
1	Centrenergo	78.29	50.00	26.00	2.29	21.71	21.71	
2	Dniproenergo	76.04	50.00	26.00	0.04	23.96	22.84	1.12
3	Donbasenergo	85.77	50.00	35.00	0.77	14.23	14.23	
4	Zakhidenergo	79.76	50.00	29.76		20.24	20.24	

Source: SPF, INEKO-Management, EnCoG

* as of July 15, 2000