Privatisations in the Energy Sector: EBRD Experience and Lessons

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The EBRD has participated in several landmark energy privatisations

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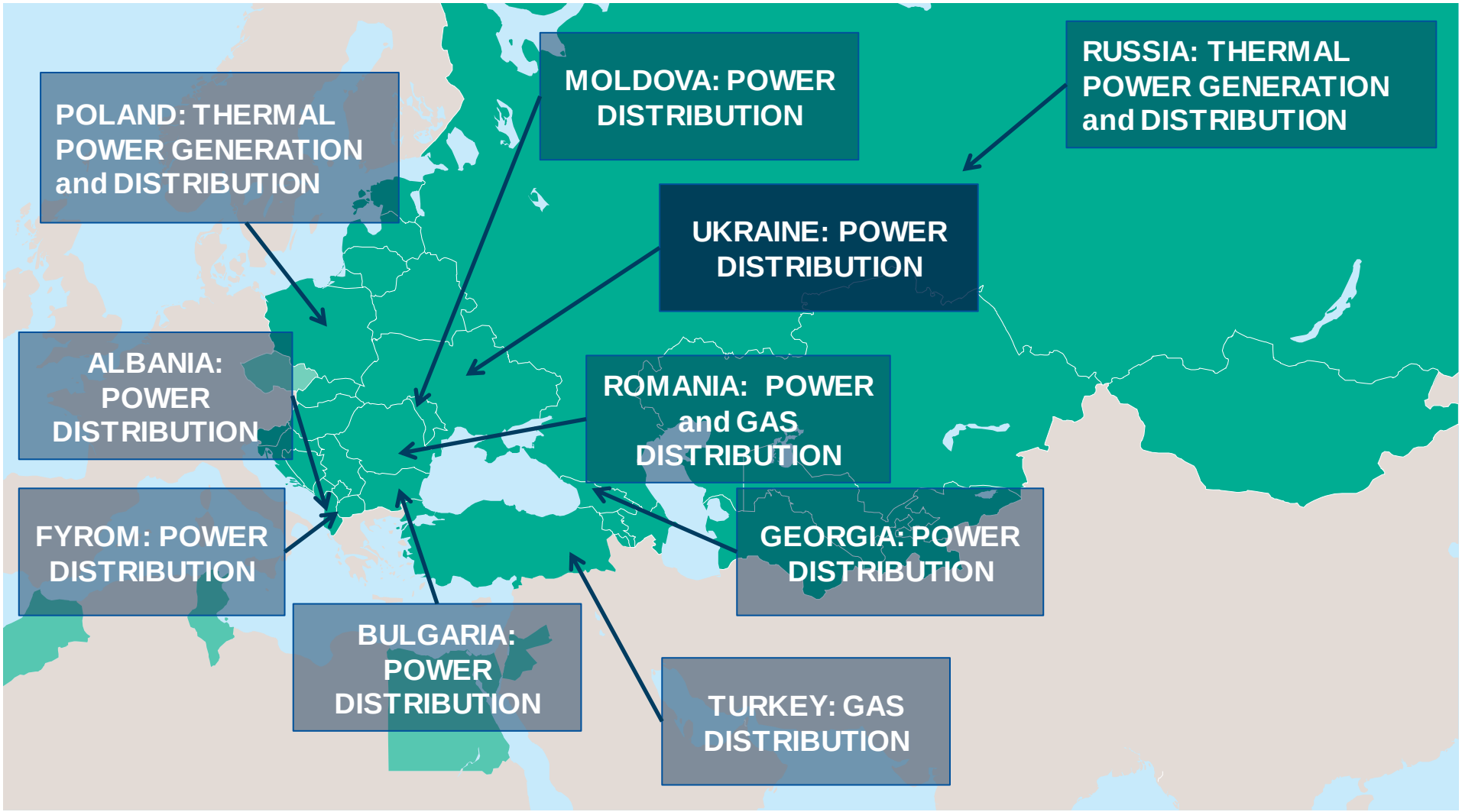

Privatisations: Electricity and Gas Distribution

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Moldova	• Government of Moldova privatised three power distribution companies (REDs) to Union Fenosa (UF) in 2000 • EBRD provided €5 mln equity, valued at price per share paid by UF, for 19.9% stake in REDs with a put right attached • EBRD also provided €25 mln limited recourse debt financing with 10 years maturity
Romania	**Distrigaz Sud** • Company privatised in 2004 to Gaz de France • EBRD and strategic investor invested €31 mln, representing 5.1% beneficial ownership **E.ON Energie and E.ON Gaz Romania** • Distrigaz Nord privatised to E.ON Ruhrgas in June 2005 and Electrica Moldova privatised to E.ON Energie in October 2005 • EBRD acquired two indirect equity participations in E.ON Gaz Romania (formerly Distrigaz Nord) and E.ON Moldova (formerly Electrica Moldova) for a combined value of approx. €44 mn
Poland	• EBRD participated in the first IPO by a state-owned Polish power company in November 2008 • Government of Poland privatised 23% of the ENEA Group in this landmark transaction • EBRD invested approx. €48 mln, representing a 2.5 % stake, to encourage other investors to provide financing and to facilitate the company's expansion plans
Turkey	**Izgaz Gas Distribution Company** • Izgaz privatised to Gaz de France Suez in 2009 • TL 128 mln (EUR 60 mln), 9 year loan for capital investments and refinancing **Sedas Electricity Distribution Company** • Sedas privatised to AkCez, a JV between Akenerji and CEZ in 2009 • USD 175 mln A/B loan to complete the privatisation and capital expenditures

EBRD Offering in Privatisations

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	Description	Example
Advisory	• Privatisation / Market Advisory through provision of independent consultants using Technical Cooperation funding	• Bulgaria Power Distribution
Equity	• Pre-privatisation and At Privatisation Equity • Pre-privatisation conditionality to include put to Government if privatisation deadline not met • Equity At Privatisation – Straight and Portage Equity, usually with put to investor • Investor at IPO • IFI carve out of share sale / purchase restrictions	• Pre-privatisation – FYR of Macedonia • At-privatisation – Moldova, Romania, Bulgaria • IPO – Poland, Russia
Debt	• Pre-privatisation and At privatisation debt financing • Portion of debt to be linked to capital investment	• Moldova • FYR of Macedonia • Turkey • Russia

Lessons from privatisations 1: strong government commitment and track-record is key to attracting investors

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- Potential investors need to have assurance that **privatisation is strongly supported by the government**
  - A credible reform agenda is a key part of the privatisation process
  - Investors will look to the country's track-record of privatisations
  - Investors will look to see whether the government's strategy reflects lessons learnt from past experience – how is this time different?

- **Privatisation needs to be preceded by necessary actions to attract investors:**
  - Creation of viable companies (which may require restructuring) and corporatisation
  - Broader sector reforms that are consistent with, and support, privatisation goals
  - Establishment and track record of an independent regulator, as well as a sound regulatory framework, is particularly important for regulated sectors

- **Vital for the policy makers to be fully ready for the process** (better to postpone than to rush)

Lessons from privatisations 2: a well-structured, fully specified, and transparent process is needed

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A **well-structured, fully specified and transparent process** is a key requisite for attracting a broad pool of investors.

- **Investors need to have certainty over what is being privatised:**
  - Clarify any legal uncertainties over ownership of assets
  - For partially privatised assets, status of current minority shareholders
  - Existing liabilities of companies (outstanding debts, legal disputes, etc.)
  - Operating state of the company (e.g. asset conditions, network losses, etc.)
  - Policy commitments the company is expected to honour (e.g. status of staff)

- **The bidding process needs to be carefully designed and managed:**
  - A credible partner to manage the process
  - Development of detailed pre-qualification criteria to ensure the desired bidders are attracted (e.g. identifying who is the bidder, better attracting the right technical expertise)

- **Outreach activities are critical for attracting bidders:**
  - Data rooms for due diligence and roadshows. Investors will judge the quality and completeness of the information
  - Opportunity for investors to meet key stakeholders (government, regulator, companies)

Lessons from privatisations 3: the need for a well-designed, transparent and predictable regulatory framework

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A well-designed, transparent and predictable regulatory framework is a critical prerequisite for a successful privatisation. In particular, it is vital to provide clarity over key issues:

- **Valuation of the assets**: clarity over the value of the assets to avoid future disputes (avoiding undervaluing assets and/or use of artificial depreciation profiles).

- **Investment commitments and regulatory rules for treatment of future capital expenditure**: regulatory methodology must accurately reflect investments needed to improve outcomes (e.g. higher service quality, lower losses). Essential to have clarity over rules for remunerating capital expenditure.

- **Allowed rate of return (the WACC)**: one of the most important elements of the regulatory settlement. Clarity over the levels of the WACC (and the methodology for updating it in future regulatory periods) is essential. Need to reflect political risk, maturity of regulatory framework, etc.

- **Enhance the credibility of the regulatory framework**:
  - Establishing a robust appeals framework / Anti-Monopoly Committee, Arbitration
  - Certainty over longer time periods by adopting regulatory periods covering several years (this can include certainty over specific elements of the regulatory settlement)

Preparing for a post-privatisation world

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The post-privatisation role of policy makers and regulators is critical to ensure its success:

- Need to have **realistic expectations about privatisation outcomes**. Outcomes will take time to materialise in sectors where investments have very long time horizons.
- Important to **anticipate and prepare for challenges that will emerge**. For example, delivering better outcomes may entail higher prices.
- **Market monitoring agencies** (e.g. regulator and anti-monopoly committee) **will need to prepare for new responsibilities** (for generation asset privatisations)
- **Regulatory frameworks will need to be adaptable and evolve** to reflect changes in circumstances and market reforms (e.g. increased role of renewables, smart metering, etc.)

Privatisation is a continuous process of learning for policy makers and investors. <u>Important to recognise that investors will look to a country's track-record in future privatisations.</u>

Case Studies

Ukraine's 6 Oblenergos privatisation experience in 2001

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- In 2001 Ukrainian authorities had a positive experience of **six oblenergo privatisations:** Kyivoblenergo, Rivneenergo, Zhytomyrolenergo, Sevastopol'energo, Khersonoblenergo, Kirovogradoblenergo;

- **Preparation for privatization:** Ukrainian authorities were assisted by a team of consultants and IFIs which secured a transparent process, and proposed the maximum possible controlling share packages proposed for sale;
  - Multilateral organizations involved: EBRD, WB, EC, USAID, US Embassy
  - Advisors: USAID financed Deloitte and KPMG; on fee basis SWFB and Hunton&Williams

- **An extensive set of pre-qualification criteria developed**; although in the rules of the prequalification the beneficial ownership was not fully specified in line with best practice

- **The new tariff methodology** was attached as a GoU's commitment to investors prior to privatisation. It guaranteed to investors an IRR of 17% (under condition of 100% cash collections).

- Reasonable **investor interest** was attracted and a strategic investor arrived to two discos (Kievoblenergo and Rivneenergo). Privatisation generated USD 150m revenues to the budget.

- **Operational performance** of privatised oblenergos demonstrated positive effect of privatisation, and it was used as a model for the following Bulgarian experience.

The framework of privatisation of electricity distribution in Bulgaria and Romania

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Market context

- There has been major reform to the Power and Energy sector in Bulgaria and Romania in the lead up to joining the EU in 2007
- Spurred by a desire to rehabilitate aging distribution (as well as transmission and generation assets) and comply with EU membership requirements in the field of energy policy and regulation, both countries unbundled their electricity monopolies and prepared carefully for privatisation of the more competitive segment, namely distribution and retail
- Bulgaria has the lowest domestic and industrial electricity tariffs in the EU circa 60% of EU average

Bulgaria privatization in 2005

Buyer	Price in Million Euro	Target
CEZ	281.5	EDC Sofia, EDC Greater Sofia and EDC Pleven
EVN	271	EDC Plovdiv and EDC Stara Zagora
E.ON	140.7	EDC Varna, EDC Gorna Oriahovista

Romania privatization 2004-2006

Buyer	Price in Million Euro	Target
CEZ	151	Electrica Oltenia
Enel	932	Electrica Banat, Electrica Dobrogea, Electrica Muntenia Sud
E.ON	100	Electrica Moldova

Source: Company website data and EBRD

The privatisation of electricity distribution in Bulgaria

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The preparation phase is important for the ultimate success of the privatisation process.

- **Unbundling:** In Bulgaria the preparation began in 2000, after the National Electricity Company (NEK) was restructured and by 2002 seven distribution companies were spun off.
- **Corporatization and restructuring to attract investors:** These were corporatized and it was decided that they would be further grouped into three distribution companies, each servicing at least 500,000 customers. This size was considered necessary to attract foreign investors.
- **Competitive auctions:** It was also decided that a minimum of five bidders should be attracted, so that a competitive auction could take place.
- **Investment plans:** The reduction of technical losses called for significant investment into the infrastructure of each distribution company. Investment stipulations in each case of privatization were conducted differently. For example, Romania stipulated in the privatization agreement the amount of investment, while Bulgaria left investment conditions to be decided through the regulatory framework.

The EBRD supported the preparatory phase of the Bulgarian privatisation through technical co-operation advisory services

- **Technical assistance:** The advisor was expected to collect, review and organise all relevant financial, technical, commercial and legal data with regards to the distribution companies and set up data room files;
- **Outreach facilitator:** it also had to prepare and distribute high-quality marketing material and the information memorandum ahead of the tender process.
- **Support for policy makers:** The advisor had to maintain close contact with the government throughout the entire preparation process.

The privatisation of electricity distribution in Romania

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One of the first obstacles for the Romanian government to privatize the first two distribution companies was a **failure to attract a sufficient amount of bidders**. Originally, there were 3 to 4 companies expressing interest, but only Enel went forward with its bid. The main reasons for this were:

- **The perceived investment risk**: high for companies entering the country. As result of a **lack of transparency** in the country's regulatory or legislative frameworks:

- The **valuation of the assets:** a valuation conducted by PricewaterhouseCoopers raised the asset value by three to seven times the original book value, essentially giving the replacement value for all assets. There were a number of objections to this on the part of the Romanian Government, including the Regulator as the rate of return and prices would be linked to asset value, thereby substantially raising tariffs. In the end, the Regulator, ANRE, based the initial tariff levels on the final price paid by Enel and the other investors.

- **The role of multilateral organizations:** Initially, Enel proposed 16% to 18% rate of return. The Romanian Government and Regulator (ANRE) objected to this on grounds that tariffs would have to be raised substantially to justify such a high asset valuation. They counter-offered a 12% rate of return. Ultimately, a solution was provided through a Partial Risk Guarantee from the World Bank, which would have compensated Enel for any loss of revenue resulting from any change or repeal of the agreed regulatory framework by the Government or the Regulator.

Thank You

Contact

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