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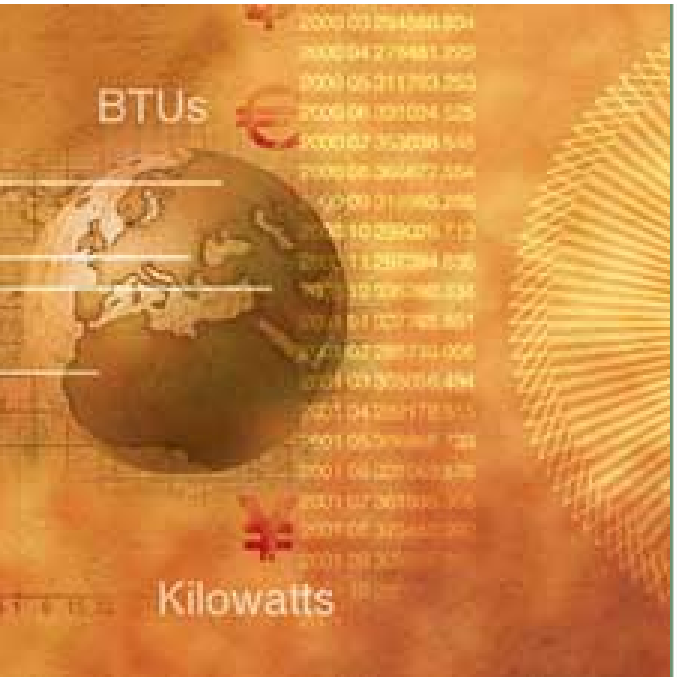

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Privatising Distcos
Lessons from Romania

Sean Gammons, Senior Consultant
Energy Charter Best Practices Workshop

MMC Marsh & McLennan Companies

How Markets Work℠

Our brief: advise on all regulatory aspects of the privatisation of two pilot distcos
Our client: Ministry of Economy & Trade

Electrica Banat

Sales: 3.7 TWh/yr
Customers: 850,000

Av. tariff: 4.5 cent/kWh
Electrical losses: c.12%

Electrica Dobrogea

Sales: 3.6 TWh/yr
Customers: 590,000

Av. tariff: 4.5 cent/kWh
Electrical losses: c.12%

The process to privatise Banat & Dobogea was launched in May 2000

- At that time, market re-structuring was already well advanced
  - CONEL had been broken up, with Electrica taking over distribution
  - An Electricity Law compatible with the IME Directive was in place
  - An independent regulator, ANRE, was up and running
  - There were some eligible customers and a nascent power pool

- At the distribution level, Electrica had started to demerge into 8 distcos and ANRE had prepared
  - draft licences for distribution and supply
  - tariff and quality of service regulations

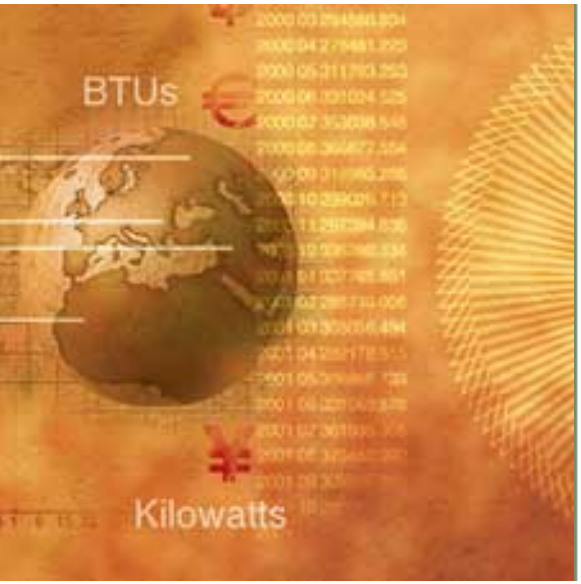
- NERA's role was to review these and propose any necessary changes

The story so far…
The initial interest of some major players has waned

- The GOR chose to sell Banat and Dobrogea to a *strategic investor* in a three-stage process:
  - 4 investor groups pre-qualified: ENEL (Italy), PPC (Greece), EVN (Austria) and BKW Energie (Switzerland)
  - ENEL, PPC and EVN made non-binding offers
  - Only ENEL made a binding offer

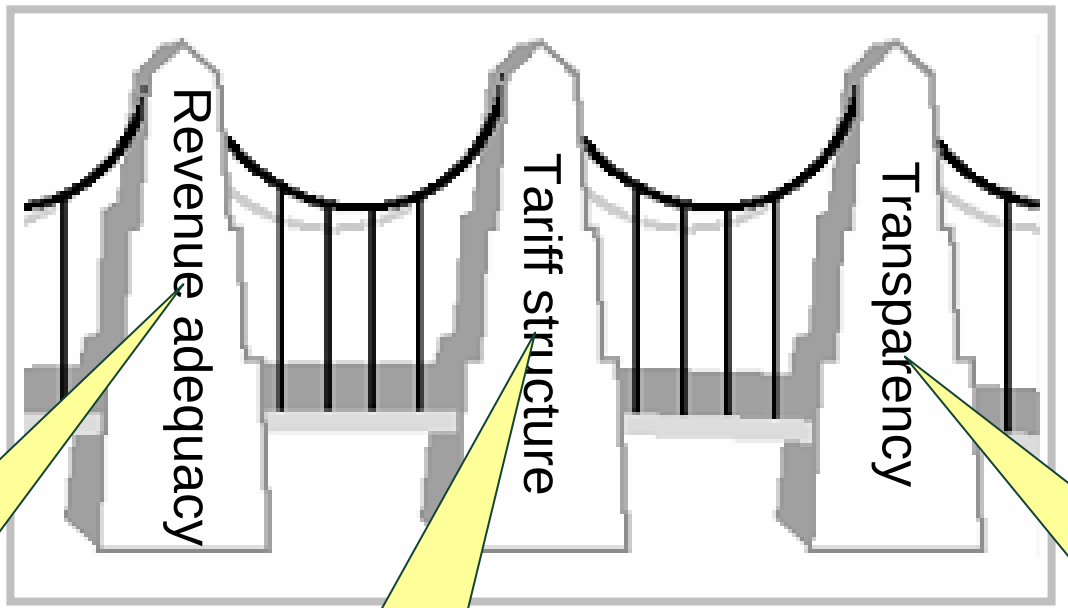
- According to press reports, the ongoing negotiations between the GOR and ENEL are centering on tariffs (and price of course!)

- Meanwhile, the GOR has already launched the process to sell three other distcos (Muntenia Sud, Moldova and Oltenia)



Price regulation in Romania
The heart of all distco privatisations

The three pillars of efficient price regulation
A bridge to successful distco privatisation

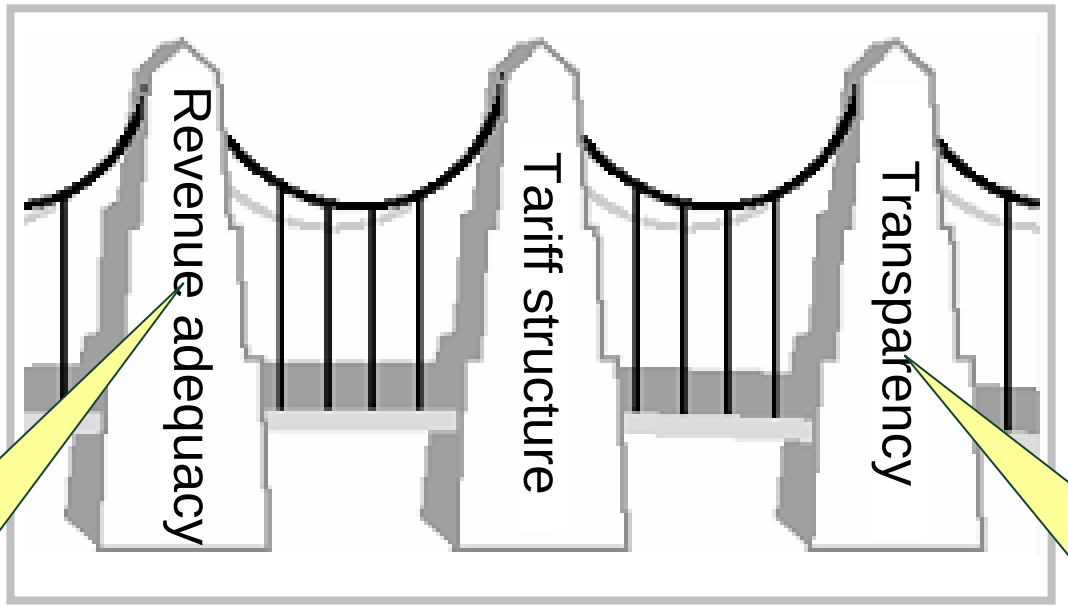


A reasonable chance of cost recovery, including a fair return on capital

Allocate fixed costs efficiently and fairly among consumers, with prices that reflect marginal costs

Binding mechanistic rules and use of objective data ensure predictability and efficiency

We concluded that ANRE needed to strengthen two of the pillars or risk deterring investors

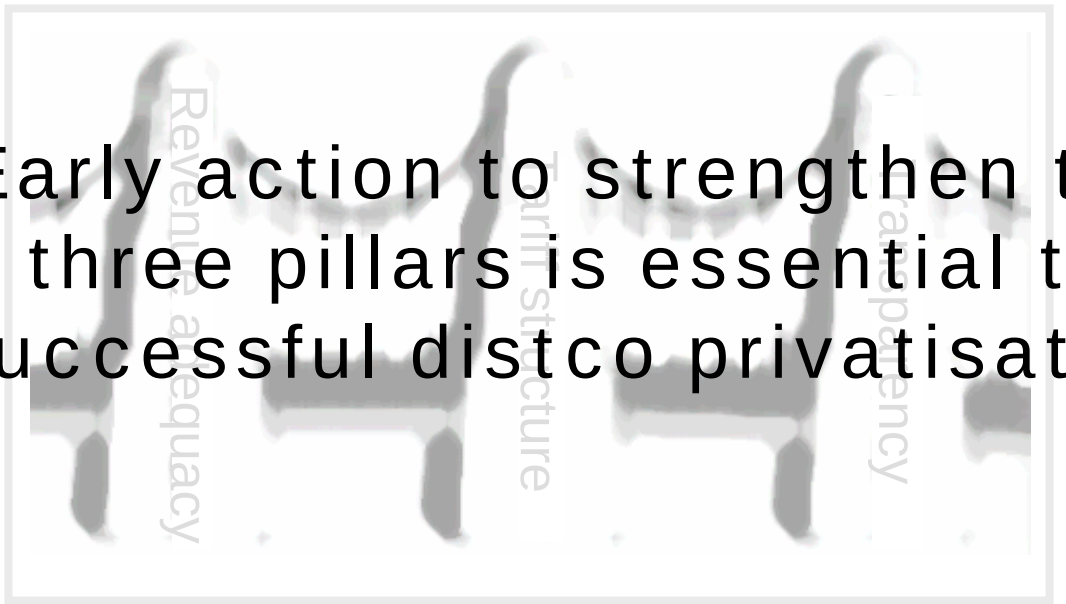


Use of a margin on turnover standard meant there was no guarantee of a fair return on capital nor incentive to invest

Mechanistic rules for allocating costs to tariffs, but not for defining costs (eg, opening RAB)

ANRE seemed to agree with our analysis, but did not implement the necessary changes

The main lesson that should be drawn from recent experience in Romania is a simple one



Early action to strengthen the three pillars is essential to successful distco privatisation