Workshop on Best Practices for Restructuring and Privatisation in the Energy Sector

Brussels, 12 May 2004

Bernard Snoy, Director
Working Table II

STABILITY PACT FOR SOUTH EASTERN EUROPE

The Stability Pact is involved in the energy sector in SEE through its sponsorship of the Athens Process, leading to the creation of a SEE Regional Energy Market and to its integration into the EU internal energy market

STABILITY PACT
FOR SOUTH EASTERN EUROPE

Athens Process

Involves the adoption by the SEE countries of the EU Electricity and Gas Directives, involving among others,

- opening of access for cross-border trades in electricity and gas
- The setting up in each country of an independent energy regulator
- Unbundling of generation, transmission and distribution (at least in terms of management)
- But not privatisation (left to the appreciation of each country)

STABILITY PACT
FOR SOUTH EASTERN EUROPE

The Athens Process aims at creating a Regional Energy Market – Three steps

UCTE

Non UCTE

Synchronous Borders

REM member

REM observer

First "Athens" Memorandum of Understanding on electricity was signed in 15th Nov 2002 in Athens

Inclusion of Gas Market at 8th December 2003 ministerial meeting

Int. legally binding agreement expected in 2004

STABILITY PACT FOR SOUTH EASTERN EUROPE

Objectives of the REM

- Larger market and predictable regulatory environment will attract investment and financing
- Level playing field with fair conditions for all groups of market participants
- Increased reliability and security of systems
- Greater efficiency and more competitive prices

STABILITY PACT FOR SOUTH EASTERN EUROPE

Objectives of the REM (continued)

- Enhanced transparency, greater market discipline and lower corruption
- Regional framework for determining critical investments
- Reduction in overall investment needs thanks to enhanced national and regional strategies
- Better integration of economic, energy and social policies

STABILITY PACT
FOR SOUTH EASTERN EUROPE

Legal reforms aiming at making energy supply a fully commercial service

- energy supply must be paid for
- enable denial of supply to those who do not pay
- make theft of energy a criminal offence
- enable speedy recovery of arrears

STABILITY PACT
FOR SOUTH EASTERN EUROPE

Tariff Reforms

Tariffs should ensure full cost recovery
Reduction of internal cross subsidies to the extent possible
Depoliticisation of tariff adjustments through the establishment of a professional and independent regulator
Tariff unbundling helping to make price setting more transparent
Social protection measures for the targeted poorer segments of society

STABILITY PACT
FOR SOUTH EASTERN EUROPE

The European Directives on electricity and gas

- establish timetable for removing legal restrictions on large consumers choosing their energy suppliers
- require “accounting unbundling” of the monopoly and the potentially competitive parts of vertically integrated companies
- require that access to the monopoly parts be objective, transparent and non-discriminatory

STABILITY PACT
FOR SOUTH EASTERN EUROPE

The European Directives on electricity and gas (continued)

- restrict legal barriers to entry into electricity generation or national gas facilities
- require the designation of transmission system operators with certain powers and obligations, including independent management from other businesses
- environmental requirements

STABILITY PACT FOR SOUTH EASTERN EUROPE

The Key importance of the sequencing of reforms

Privatising the energy sector in transition countries in advance of policy development and proper regulation poses great risks to efficiency gains, consumer welfare and the political acceptance of reforms.

Proper sequencing involves:

- Formulation of energy policies and rules for implementing them, giving special attention to energy efficiency and demand-side co-operation.
- Establishing appropriate legislative and regulatory framework
- Preparing for privatisation through commercialisation

STABILITY PACT FOR SOUTH EASTERN EUROPE

Commercialisation

Cutting the utility from routine annual budget support and compel it to operate with revenues it generates.

Functional accounting to identify costs and revenues by function.

Organising generation, transmission and distribution functions by business units within the framework of the existing company.

Evolving contract based relationships and transparent transfer pricing among the business units.

Commercialisation (continued)

- Developing meaningful internal and external audits and disclosure procedures.
- Compilation of clear, comprehensive and unambiguous inventories of all real and fixed assets and debts.
- Improve metering, billing and collection procedures and mechanisms to monitor payment defaults and take corrective actions

STABILITY PACT
FOR SOUTH EASTERN EUROPE

Best practices for privatisation

- Privatisation should follow reforms not precede them
- Privatisation should be undertaken in a transparent manner to maximise the value of the transaction
- Privatisation through transparent international competitive bidding among pre-qualified investors results in optimal privatisation receipts and sustainable privatisation deals

STABILITY PACT
FOR SOUTH EASTERN EUROPE

Best practices for privatisation

It is advisable to offer majority shares to attract strategic investors in a manner that enables them to implement prudent investment and operating decisions. In any case the strategic investor should have management control.

It is better to sort out labour agreements, issues related to associated coal or lignite mines and discontinuation of fuel allocation practices before starting privatisation

Provision for international arbitration makes it easier to attract strategic investors

Best practices for privatisation

If there is lack of interest on the part of strategic investors, it is worthwhile to encourage “franchising” and second best solutions, such as concessions, leasing and management contracts as interim solutions.

The best insurance against lack of investor interest is to focus on continued commercialisation, improve corporate governance and take the utility up to a stage of its being able to provide the equity from the internally generated cash for the investment needs and being able to access the debt market on the basis of its cedit rating