CHAPTER 14 (ENERGY) OF ROMANIA's NEGOCIATION WITH EU - MAIN ISSUES RELATED TO THE PRIVATIZATION OF THE ELECTRICITY DISTRIBUTION SECTOR

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INTRODUCTION

Romania’s main priority represents the accession to the European Union. For Romania, integration in the European Union means a guarantee of stability, economic growth and performances.

Mr. Jonathan SCHEELE – Head of EC Delegation in Romania stated on 6th October 2004, when the European Commission published the 2004 Annual Report on Romania’s progress toward accession, that European Commission looks forward to welcome Romania as EU member in 2007 and that: “Romania and its people have achieved a huge amount over the last years to prepare for EU membership. The goal is now in sight. I commend the Romanian citizens for their efforts so far, and I encourage them to continue in the same decisive spirit as they have shown so far.”

1. ROMANIA’S EU ACCESSION PROCESS EVOLUTION

The enlargement of the European Union (EU) to 27 countries, as it was seen from the ’90-s, has no precedent in history, being a challenge, for both the candidate countries and the member states and our country has totally engaged itself in this ambitious European project.

In our opinion, first of all it is important to mention that Romania was the first country of Central and Eastern Europe to have official relations with the European Community. In 1974, an agreement included Romania in the Community’s Generalized System of Preferences and in 1980 an Agreement on Industrial Products was signed. Romania’s diplomatic relations with the European Union date from 1990 and in 1991 a Trade and Co-operation Agreement was signed. In February 1995 the Europe Agreement entered into force and trade provisions had entered into force in 1993 through an "Interim Agreement".

On June 22, 1995 Romania submitted its application for EU membership and in July 1997, the Commission published an opinion on Romania’s Application for Membership of the EU. In the following year, a Regular Report on Romania’s Progress Towards Accession” was produced. In its second Regular Report on Romania published in October 1999, the Commission recommended starting accession negotiations with Romania. Further, following Helsinki European Council’s decision in December 1999, accession negotiations started with Romania on February 15, 2000.

One of the conditions for Romania to join the European Union is to adopt and implement European legislation. The European legislation (called the acquis communautaire) is divided into 31 domains, which are the object of the so-called negotiation chapters. Each negotiation chapter is opened for negotiations when the EU considers that Romania reached a minimal level in adopting the European legislation in the field. The negotiation process means that Romania adopts regulations similar to European ones and presents a detailed programme for adopting the entire acquis in the field. After a common position is reached, the chapter is considered “ provisionally closed”. None of the negotiation chapters is considered permanently closed until all 31 chapters are finalized. The last chapter negotiated and closed is chapter 31 – Others, which includes the regulations that cannot be subordinated to any of the other 30 chapters. Negotiations are finalized only when all 31 chapters have been negotiated and closed.

In concordance with EU accession negotiations procedure for Romania, the opening of the accession negotiations is preceded by bilateral reunions of analytical examination of the acquis for each of the 31 chapters. Based on the conclusions of the bilateral reunions of examination of the acquis implementation status by candidate countries, along with other monitoring instruments, the European Commission prepares an opinion regarding chapters at which the candidate country preparation degree allows the opening of negotiations.

During the Portuguese and French presidency of EU, in year 2000, 9 chapters have been opened and 6 chapters have been provisionally closed. In 2001 the Romanian Government has taken the necessary administrative and legislative measures to strengthen the leadership and to prepare efficiently the process of Romania’s accession to the European Union, also by establishing the Ministry of European Integration and The National Delegation for accession negotiation of Romania to the EU. The new negotiation strategy for Romania’s accession to the EU was based on approaching the negotiations as a whole process. Until December 2001, Romania has officially forwarded position papers for all the 29-negotiation chapters to the EU Council. At the end of 2001, the total number of chapters opened was 17, out of which 9 have been provisionally closed.

For 2002 the main objective of negotiation was to open all the negotiation chapters, to provisionally close as many chapters as possible, based on the advancement in accession preparations, and to fulfil the commitments taken during
negotiation. Fully aware of the fact that negotiation progress was based only on the internal preparation, the Romanian Government has intensified the measures leading to the accomplishment of the functional market economy criterion and has thoroughly applied the Action Program for Intensifying Preparation for Accession adopted in January 2002. Consequently, 13 Chapters were opened at meetings of the Conference of Accession in 2002 and seven chapters were provisionally closed. By the end of December 2003, Romania opened all 30 chapters of the communitary acquis and provisionally closed 22 chapters of them. During the Irish Presidency of EU (first semester of 2004) three Chapters of negotiations were provisionally closed and during the Netherlands, who hold the Presidency from 1 July to 31 December 2004, Romania concluded accession negotiations. Romania’s aim is to sign the Accession Treaty in 2005 and join the EU in 2007.

2. ENERGY CHAPTER OF NEGOCIATIONS WITH EU – MAIN ELEMENTS RELATED TO THE PRIVATIZATION OF THE ELECTRICITY DISTRIBUTION SECTOR

As described above, the acquis is structured in 31 chapters for negotiations, of which Chapter 14 is representing the Energy chapter. The negotiations for chapter 14 have been opened in 2002 during the Spanish Presidency of EU at the Conference on Accession held on 21st March 2002.

The chapter was opened based on Romania’s Revised Position Paper, officially registered on 10th January 2002 at EU Council with CONF-RO 2/02. Romania accepted the acquis communautaire on Chapter 14 - Energy and stated that it will be applied upon accession, with the exception of Council Directive 68/414/EEC, amended by Council Directive 98/93/EC, imposing an obligation to the Member States to maintain minimum stocks of crude oil and/or petroleum products for which it was requested a transition period until 31 December 2011. As regarding to the Romanian Energy Market, respectively the electricity sector, Romania accepted the entire Community acquis in the electricity sector and also stated that Romania does not foresee any problems in fully applying it upon accession to the EU. The Position Paper also included aspects regarding the electricity distribution privatisation, and since then the Romanian Government has given an important priority for the privatization of the electricity distribution and supply sector.

For this chapter, there were eight negotiation rounds, as well as several technical consultations with the European Commission and the member states’ experts. The negotiation team consulted trade unions, business associations, political parliamentary parties and NGOs in Romania concerning this chapter.

The negotiation chapter 14 – Energy was provisionally closed during the Accession Conference Romania-EU, held in Brussels, on 30 June 2004. Romania has been granted one transitional arrangement for the building-up of oil stocks (until end of 2011). The EC Commission concluded that Romania is generally meeting the commitments and requirements arising from the accession negotiations in this field, and is on track in its preparations for membership in the energy field.

In the 2003 European Commission Regular Report on Romania’s progress towards accession, Romania has been conditionally perceived by the European Union as a functional market economy. The conditionality referred to the continuation of the reforms and also the continuation of the privatization process, especially in the electricity sector.

Romania made best efforts to fulfil EC conditionality and as a result, the last European Commission Regular Report on Romania’s progress towards accession, published on 6th October 2004, concluded that Romania complies with the criterion of being a functioning market economy.

The main elements related to the privatization of electricity distribution in the 2004 EC Regular Report are included in “Economic criteria” and “Ability to assume membership obligations”, respectively in Chapter 14 – Energy, recognized the progress made in this field and underlines that the ongoing restructuring of the electricity sector, including privatization, should be completed.

European Commission conclusions mention: „In key sectors such as energy, mining and transport perseverance in restructuring and a more manifest strive for privatization should go hand in hand”.

3. OVERVIEW OF ROMANIAN ELECTRICITY DISTRIBUTION PRIVATIZATION PROCESS – CURRENT STAGE

The main objectives of the Romanian Government with respect to the electricity distribution privatisation are the following: attracting capital to the energy sector to be employed for replacing, refurbishing and developing the existing infrastructure; ensure safety of supply and improvement in the quality of power distribution and supply services according to European Union standards, for the protection of clients’ interests; Reaching a competitive level of technical and economic performances of the companies on both domestic and regional markets, considering the liberalisation of the sector; Facilitating liberalisation of the sector and development of competition in the energy market, in accordance with European Union requirements; and Building an efficient energy market, responsive to the principle of durable development of the energy sector and avoiding monopolistic positions.

Electrica – Romanian Electricity Distribution & Supply Company - is today in an advanced stage of the privatization process. The way Electrica went through has been very tough and will continue to be tough, having many restructuring steps, organizational adjustments, and financial and commercial efforts.

It is already known that a successful and stable privatization
First, Electrica SA was restructured in eight Electricity Distribution & Supply Subsidiaries, legal entities, the restructuring process being perceived as a preparatory stage for privatization. At the beginning of 2002, following the publication of the Government Decision 1342/2001 in the Official Gazette, Electrica SA was reorganized into 8 electricity distribution and supply subsidiary companies, as independent legal entities, and 8 maintenance and energy services branches. Electrica SA’s structure, according to GD 1342/2001, is the following:

<table>
<thead>
<tr>
<th>Subsidiary</th>
<th>No.of Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moldova SA</td>
<td>1304826</td>
</tr>
<tr>
<td>Muntenia Nord SA</td>
<td>1221128</td>
</tr>
<tr>
<td>Dobrogea SA</td>
<td>593000</td>
</tr>
<tr>
<td>Muntenia Sud SA</td>
<td>1064986</td>
</tr>
<tr>
<td>Oltenia SA</td>
<td>1362342</td>
</tr>
<tr>
<td>Banat SA</td>
<td>841329</td>
</tr>
<tr>
<td>Transilvania Nord SA</td>
<td>1089192</td>
</tr>
<tr>
<td>Transilvania Sud SA</td>
<td>1028931</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8505734</strong></td>
</tr>
</tbody>
</table>

The core activity of the eight subsidiaries with legal personality is electricity distribution and supply, while the support activities for the eight service branches includes: maintenance, repairs, consulting, engineering and design, transportation a.s.o. The eight Maintenance and Energy Services Branches are directly coordinated by the Maintenance and Energy Services Division a separate structure within Electrica SA.

With this new structure, the subsidiary companies of Electrica SA were ready to start the privatization process, as the legal, economic and patrimonial situation of each of them was clear. Moreover, by improving the specific indicators of the core activities, the attractiveness of the distribution and supply companies increased, which we assumed will be positively reflected in the future results of the privatization transactions. Taking into account that privatization is an instrument to attract capital and partners, Electrica SA made best efforts to increase the market value of its Subsidiaries.

In the completion stage of privatization are now two from the eight subsidiaries: Electrica Banat and Electrica Dobrogea.

EU pre-accession aid to Romania is provided by three main instruments, one of those being Phare Programme, which is providing funding for institution building and investment in support of EU accession preparations.

As a consequence, for the privatization of those two electricity distribution & supply subsidiaries, the Ministry of Economy and Commerce and Electrica SA collaborated with BNP Paribas, under the PHARE Project RO9805-01-03 “Privatization in the electricity distribution sector”.

The collaboration with the French Consultant started in May 2000 the activity consisted in the assessment of both regions: Banat and Dobrogea and two distinct modules were foreseen: “Pre-privatization of the regional electricity distribution companies” and “Completion of the transaction for the privatization of the electricity distribution companies”.

The sale strategy report elaborated by the consultant in July 2002, was submitted to the Government attention. According to Government Decision No. 1377/2002, published in the Official Gazette no. 905 on 12th December 2002, the Romanian Government approved the privatization Strategy. In accordance with Government Decision, the privatization strategy for Banat and Dobrogea issued the following: a 51% shareholding to be privatized to a strategic investors through negotiations based on selection of bids and an additional stake of up to 10% of the increased share capital, owned by Electrica SA, to be privatized through direct negotiations to the association of employees.

Regarding the 51% shareholding to be privatized to a strategic investor, the structure was the following: the acquisition of existing shares, representing 24.62 of the existing share capital, combined with the acquisition of newly-issued shares in a capital increase, representing 35% of the increased share capital, together 51% of the increased share capital. The definition of strategic investor was Romanian or foreign entities, experienced operators of electricity supply and distribution networks, with proven financial and managerial resources as well as technical capabilities needed to ensure the future development and viability of the subsidiaries. The selection process for the strategic transaction was carried out in two stages: a pre-qualification stage, based on Expressions of Interest and a competitive tender stage consisted of: submission of preliminary, non-binding bids followed by negotiations and submission and selection of final binding bids, followed by negotiations with the selected bidder.

The announcement of the privatization of Electrica Banat and Electrica Dobrogea was published on 8th January 2003. Following the privatization announcement, in March 2003, there have been pre-selected 4 companies: Public Power Corporation (PPC - Greece), EVN AG (Austria), BKW-FMB Energie AG (Switzerland), ENEL SpA (Italy). The pre-
selected investors purchased the Presentation Files for the two subsidiaries and beginning with 19th May 2003 they accessed the Data Rooms created at the headquarters of the two subsidiaries. Eventually, only the Italian investor maintained its interest and submitted non-binding offers for both subsidiaries on 10th July 2003. Beginning with 1st September 2003 the investor’s due diligence process began.

Also, the discussions between the Italian investor and Electrica/ MEC (Ministry of Economy and Commerce of Romania)/ OPSPI (the Office of State Ownership and Privatization in Industry)/ ANRE and BNP Paribas organized in Working Groups, were started on 11th September. The result of those discussions consisted in the clarification of most ENEL requirements. On 8th March 2004 ENEL SpA submitted the binding offers for both subsidiaries, submission followed by negotiations with the Italian investor. On 10th May 2004 a Memorandum of Understanding has been signed between Electrica, ENEL SpA and OPSPI. Memorandum which sets forth the results of rounds of clarifications and negotiations held between parties with respect to the terms of ENEL final bid.

The Privatization Contracts were signed with ENEL on 19th July 2004 and till the Transaction Closing, which will occur not later than the first half of January 2005, the process is in the stage of Interim Management.

Regarding the other six subsidiaries, the next two which entered in privatization process were: Electrica Moldova SA and Electrica Oltenia SA, under PHARE privatization project RO 0005.01.03 (EuropeAid/ 113504/D/SV/RO): continuation of the privatization process in the electricity distribution sector.

Within the frame of mentioned above PHARE project, at the end of 2002 was organized the tender for the selection of a consultant, the winner being a consortium leaded by Banc of America Securities (BofA) and the Contract was signed in April 2003. As a result, BoFA has submitted the due diligence and evaluation reports and, together with the Romanian team, has finalized the privatization strategy for both subsidiaries. Government Decision No. 531/2004, published in the Official Gazette no. 350 on 21st April 2004, approved the privatization strategy for the mentioned companies. The privatization announcement was published on 28th April 2004 and the transaction is to be finalized by the beginning of 2005.

As it was specified in the announcement, 51% of each of Electrica Moldova and Electrica Oltenia are being privatized by Electrica under the authority and coordination of the Ministry of Economy and Commerce, through the Office of State Ownership and Privatization in Industry through a combination of share sale and capital increase. Financial and trade investors, satisfying the criteria mentioned in the announcement, were invited to submit Expressions of Interest by 31st May 2004.

Based on the Government Decision No. 531/07.04.2004, the privatization of Electrica Oltenia and Electrica Moldova shall be conducted in accordance with the “Selection based on Binding Bids preceded by Preliminary Negotiations based on Position Papers” method (the “Strategic Transactions”). The privatization shall consist of: a 51% shareholding in Electrica Oltenia and/or Electrica Moldova to be privatized to an investor, individually or in a consortium, and a 10% shareholding of the increased share capital of each Company to be privatized (from shares owned by Electrica) to the employees of the Companies and Electrica, through a direct sale process (the “Employees Transaction”).

As regard to the 51% shareholding in Electrica Oltenia and/or Electrica Moldova to be privatized to an investor, individually or in a consortium, the structure is the following: the acquisition of existing shares, representing 24.62% of the existing share capital combined with the acquisition of newly issued ordinary shares issued simultaneously by way of a capital increase, representing 35% of the increased share capital, together representing 51% of the increased share capital.

Within this 51% shareholding, the investor will have the right, at is own discretion, to secure the participation of the European Bank of Reconstruction and Development (EBRD) and/or the International Finance Corporation (IFC), which have expressed their interest in participating in this privatization, with a maximum participation of 5% of the increased share capital of Electrica Oltenia and/or Electrica Moldova.

The selection process was carried out in two stages: Pre-qualification stage based on Expressions of Interest and competitive tender stage. The competitive tender stage consisted of: preliminary negotiations, based on comments submitted by pre-qualified investors with regard to the transaction and company documentation, and submission of binding bids followed by negotiations with all investors submitting binding bids, submission and evaluation of improved binding bids, and subsequent selection of preferred improved binding bid and negotiations for the finalization of the Privatization Contract.

18 October 2004 represented the deadline for submitting the binding offers, and from the pre-qualified investors, CEZ from Czech Republic and EoN AG from Germany submitted binding offers. As mentioned before, the transaction is to be finalized by the beginning of 2005.

Obatining another subsidiary, respectively Muntenia Sud, Electrica SA organized in July 2002 a tender for the selection of a consultant for evaluation and technical assistance in the process of negotiation and attraction of private capital, the winner being PricewaterhouseCoopers and Norton Rose consortium.

PwC team has performed the due diligence and evaluation for the subsidiary, currently preparing various strategic
versions for continuing the process of private capital attraction.
The last 3 subsidiaries will soon enter the privatization process, the final deadline for the transactions being the year 2007, when Romania will effectively join the European Union.
The Ministry of Economy and Commerce has approved Electrica request for including these subsidiaries in the assistance program PHARE.
Regarding Electrica Transilvania Nord and Electrica Muntenia Nord, the steps for listing up to 10% of the equity on the Bucharest Stock Exchange are already in progress.

4. CONCLUSIONS

- Romania is part of the present EU enlargement process, which is an irreversible process and Romania is willing to sign the Accession Treaty in 2005 and effectively join the European Union in 2007;
- Finalizing negotiations for the chapter 14 (Energy), on 30 June 2004, contributed to a positive decision concerning the functioning market economy status for Romania within the last European Commission Regular Report published on 6th October 2004;
- The conclusions of the 2004 EC Regular Report on Romania’s progress towards accession underline the importance of completing the restructuring and privatization in energy sector;
- The goal of privatization is to attract the capital necessary for the consolidation of the electricity distribution companies, to create more competitive and stronger companies and to obtain competitive electricity prices;
- The privatization process in itself should be conducted very carefully, given the strategic importance of this sector and considering the international experiences in the field.
- Romania wishes to find solutions so as to successfully complete the privatizations transactions and the sequential privatization, practically applied in Romania, offers also a good learning opportunity while acquiring experience;
- Electrica SA tried along this process to clarify as much as possible the operational, legal and economic situation of each subsidiary and the regulatory framework in Romania has also improved very much;
- Today’s advanced stage of Electrica’s privatization process and the conditions created for investors, conditions which are flexible enough and comply with international practices, together with the perspective of Romania’s Accession to the European Union in 2007, should be a guarantee for the potential investors that their investments are protected;
- The way Electrica went through in order to be possible to reach finally the main goal - a successful transaction - has been very tough and may continue to be tough, but this is the way it should be followed in order to improve Romania’s position in the economic and political global context and join with full rights the European Union starting with 2007.

REFERENCES