

## RESTRUCTURING PROCESS OF ELECTRICA SA - ROMANIAN ELECTRICITY DISTRIBUTION & SUPPLY COMPANY – AS PREPARATORY STAGE FOR PRIVATISATION

Doru VOICU  
Oana GALINSCHI  
Electrica SA - Romania  
voicud@electrica.ro

### 1. INTRODUCTION

*Following the European Council's decision in December 1999's Helsinki Summit, EU accession negotiations started with Romania on February 15, 2000. Romania's aim is to gain EU membership in 2007. As it is mentioned in EC Regular Report on Romania's progress towards accession, published in October 2002, acquis chapter number 14 – Energy: "Romania has made progress in preparing for the internal energy market, in particular as regards the level of market opening, pricing policy and restructuring of some utilities".*

*In terms of competitiveness and the local electricity market – Directive 96/92 EC, respectively implementation of restructuring privatization plans, during the last two years a progress has been achieved in the privatization process in Romanian electricity distribution field.*

*A major concern for Electrica SA – the Romanian Electricity Distribution & Supply Company, at this moment, is getting ready for a very important stage – the privatization of the electricity distribution and supply sector, in compliance with the actions of the Government of Romania in this field.*

### 2. GENERAL BASIC GOALS OF THE ELECTRICITY DISTRIBUTION PRIVATIZATION - PREPARING THE PRIVATIZATION PROCESS

A successful and stable privatization process calls for certain general basic goals to be obtained, as follows:

- To ensure customers protection by creating a heterogeneous electricity market;
- To provide safe electricity supply throughout the country;
- To establish a capital base required to provide an appropriate level of investments;
- To optimize the social security of the sector's employees;
- To optimize privatization revenues for the state budget.

Before starting privatization, a period of preparations must be underwent, which necessarily covers:

- The establishment of a stable and transparent legal and regulatory framework;

- The implementation of a structure able to create the prerequisites for competition in the sector;
- A correct valuation of the business to be privatized.

These steps are made in parallel but the highest responsibility for Electrica SA is to put in place the necessary competitive structure, which should be able to:

- Meet all sector's applicable legal provisions and regulations;
- Implement equitable commercial mechanisms and practices;
- Exert pressure towards cutting down prices and tariffs as result of competition effects.

### 3. CURRENT STATUS OF ROMANIAN ELECTRICITY DISTRIBUTION RESTRUCTURING AND PRIVATIZATION PROCESS

Consequently, during 2001 – 2002 Electrica SA structure underwent a process of major restructuring.

In compliance with the national strategy for midterm energy development in Romania, as approved by Government Decision No. 647/2001, which stipulates the reorganization of the distribution and supply business into 8 regional subsidiaries without legal personality as of 1<sup>st</sup> of August 2001, the territorial structure was consolidated into 8 subsidiaries, Electrica SA operating as a country-wide mother-company.

In parallel, the splitting of the support activities from the core business was initiated in order to improve the specific performance indicators of the electricity distribution and supply activities. Another reason for this splitting was to try to find some roots for diversification, in such a way that Electrica SA would become a multi-services company in the near future.

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 (or support services) branches.

The core activity of the eight subsidiaries for electricity

distribution and supply 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 etc.

The restructuring process of Electrica SA has been perceived as a preparatory stage for privatization.

Besides the main purpose of creating some attractive environment for having a successful privatization, the main general goals of reorganization were the following:

- To create economically viable Subsidiaries;
- To introduce competition in supply sub-sector;
- To raise interest for capital investment in the Romanian energy sector;
- To reach an European level of specific indicators;
- To reduce the pressure over the electricity tariffs;
- To minimize the social impact.

The new structure of Electrica SA, according to GD 1342/2001, is the following:



No.	Electrica's Subsidiary	No.of Customers	Sales on 2001 -MWh-
1	Moldova SA	1293073	4151548
2	Muntenia Nord SA	1199546	6430131
3	Dobrogea SA	590299	3590835
4	Muntenia Sud SA	1064431	4255897
5	Oltenia SA	1359908	7375215
6	Banat SA	832527	3796503
7	Transilvania Nord SA	1089197	3814018
8	Transilvania Sud SA	1022578	3907181
	Total	8451559	37321328

Pursuant to the above mentioned Government Decision, the 8 subsidiary companies became operational shortly, getting specific operation licenses. The licenses were granted separately for distribution and supply and stipulate separate accounting for each business. With this new structure, the subsidiary companies of

Electrica SA are today ready to start the privatization process as the legal, economic and patrimonial situation of each of them is clear. Moreover, by improving the specific indicators of the core activities, the attractiveness of the distribution and supply companies increased, which we hope will be positively reflected in the results of the privatization transactions.

Generally, the 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 result, for the privatization of two out of the 8 electricity distribution & supply subsidiaries, respectively Banat and Dobrogea, the Ministry of Industry and Resources and Electrica SA are collaborating with BNP Paribas, under the PHARE Project RO9805-01-03 "Privatization in the electricity distribution sector".

The collaboration with the French investment bank started in May 2000 and on 4<sup>th</sup> of March 2002 Electrica and BNP Paribas signed the Success Fee Agreement. 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". Module 1 contained the following sub-tasks for the consultant: a sector's structure and privatization revenues analysis; legal and regulatory analysis; distribution service cost and price setting on economic criteria; companies' preparation for privatization. Module 2 contains two tasks: preparing the sale transaction and assisting the transaction. For the elaboration of the sale strategy and in order to outline an optimal privatization scheme, the Consultant reviewed the main types of investors and associated methods available for the sale of an electricity company: trade sale; capital increase; international and/or local public offering; private equity placement; management and employees participation.

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 12<sup>th</sup> December, the Romanian Government approved the privatization Strategy for the mentioned companies. In accordance with Government Decision, the privatization strategy for Banat and Dobrogea issues the following: a 51% shareholding is 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, will be privatized through direct negotiations to the association of employees. Regarding the 51% shareholding to be privatized to a strategic investor, 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 shares in a capital increase, representing 35% of the increased share capital, together 51% of the increased share capital. The definition of strategic investor is 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. Within the total stake of 51%, the strategic investor is allowed, at its own discretion, to take into consideration the participation of the European Bank for Reconstruction and development (EBRD), which has expressed its interest in participating in the privatization process.

The selection process for the strategic transaction is carried out in two stages: a pre-qualification stage, based on Expressions of Interest and a competitive tender stage which will consist 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 8<sup>th</sup> January 2003.

Regarding the other six subsidiaries, the next two subsidiaries to be privatized will be: Electrica Moldova SA and Electrica Oltenia SA, under PHARE privatization project RO 0005.01.03: – a continuation of the privatization process in the electricity distribution sector. At the beginning of July, on the European Commission site there was announced the selection of the Consultant that will assist in the preparation for privatization and completion of privatization of the next two subsidiaries: Electrica Moldova SA and Electrica Oltenia SA, the contracting authority being the Central Unit for Financing and Contracting under the Ministry of Public Finance.

Electrica SA is going to be subject to the procedures conducted by the contracting authority in compliance with the provisional agenda.

At the same time with PHARE projects, Electrica SA is in discussions with potential investors for participation with equity capital in certain Subsidiaries, under a similar structure with the one described above, in the section about Banat and Dobrogea privatisations. The main objective here would be to attract some minimum required capital for supporting the investments for ensuring a good level of performance in the distribution companies.

Electrica SA organized in July 2002 the tender for the selection of a consultant for evaluation and technical assistance in the process of negotiation and attraction of private capital for Electrica Muntenia Sud, the winner being PricewaterhouseCoopers and Norton Rose consortium. The activity of the consultant has started in October 2002, after the signature of the Contract for Consultants' Services between Electrica SA and the selected consortium.

Passing this international recession, most of the investors are becoming more and more prudent and selective with their investments. Therefore, what we expect would be a very tough time for successful privatisations, even if these have been required insistently by a considerable number of interested investors and also by all the international organizations. Electrica SA tried along this process to clarify as much as possible the operational, legal and economic situation of each subsidiary. The regulatory framework in Romania has also improved very much, and the perspective of accession to the EU should be guarantee for the potential investors that their investments are protected.

Depending on the international context and also on the result of our Banat & Dobrogea project, the plan today would contemplate that by the end of 2004 at least four distribution companies are expected to be privatized to strategic investors in the field, and the procedures for privatizing the other companies to be already started.

#### 4. CONCLUSIONS

- Privatisation is an instrument to attract capital and partners. Electrica SA made best efforts to render efficient its business and increase the market value of its Subsidiaries;
- Privatisation is also an instrument for bringing modern management practices and new structures and mentalities;
- The attractiveness of a distribution company is directly depending on the transparency and clarity of the regulatory framework and the commercial arrangements on the market. This is valid also for other type of companies.
- The structure is one of the most important drivers in a market. Therefore, the right structure could bring also the right commercial arrangements; the wrong structure brings always distortions to the market.
- The privatisation process in itself should be conducted very carefully, given the strategic importance of this sector and considering the international experiences in the field.
- A successful privatisation is when all the stakeholders are satisfied: investors, customers, employees, trade unions, and government. This is the real challenge.