

## **Energy Privatisation in Romania**

**December 2005**

*This article first appeared in Infrastructure Journal in December 2005 and was written by Charles Vernon of David & Associates and Simon Hobday of Pinsent Masons*

In recent years, Romania has begun to accelerate the opening and privatisation of its energy sector. In the process, it has become a hot spot for foreign investment.

With hopes to enter the European Union by 2007, Romania is aiming to align its energy sector with that of the rest of the EU. Importantly, being a net exporter of energy, Romania is hoping to cash in on the greater European energy market. However, it is well recognised that greater investment, particularly foreign investment, will be needed to bring Romania into line with the rest of Europe.

Electric distribution is well on the way to being fully privatised. For instance, Electrica Oltenia (the area southwest of Bucharest) was taken over by CEZ in September 2005 who paid Euro 47.4 million for 25% of the shares with an additional Euro 103.6 million in capital increases for a total of 51% of the company. Electrica Moldova, acquired by E.ON also in September, paid over Euro 100 million for 51% of the company; again by acquiring shares and through capital increases. Enel acquired both Electrica Dobrogea (covering the Constanta area) and Electrica Banat (which is the area around Timisoara) for only Euro 112 million in April and July respectively.

Currently, Electrica Muntenia Sud (the distribution business which covers parts of Bucharest) is in the process of being privatised. Interested parties include AES Corporation, CEZ, Enel, EnBW Energie, E.ON, Gas de France, RWE and Union Fenosa. Expectations are that the transaction will be completed by early 2006. This would leave three “Electrica’s” left: Electrica Transilvania Nord, Electrica Transilvania Sud and Electrica Muntenia Nord.

Foreign investors have also shown some interest in hydroelectric power, although the Government has been slow to move on these privatisations. For instance, Hidroelectrica has privatised 13 small hydro power plants this year, while the privatisation of another 19 is in progress. The winning bidder for the first 13 plants was a consortium formed by the Institute of Hydro-technical Studies and Projects (ISPH) and Luxten. However, out of 220 such small hydro power plants currently owned by Hidroelectrica, the Government has indicated that Hidroelectrica plans to

sell 150. Indications are that the Government would also look favourably on the construction of new hydro projects.

The Government claims that the open market for electricity is 83.5% (residential consumers being excluded). Interestingly, however, Hidroelectrica states that only 20% of the total output is going to the open market (including exports). Whether or not this is currently the case, by July 1, 2007 all consumers should be able to choose their electricity provider. The commercial code (or market rules) for the wholesale market was revised in 2004. In addition to bi-lateral contracts, there is a power exchange providing a voluntary day ahead market – the development of the exchange is being supported by the World Bank – and a mandatory balancing market. Although the electricity market is currently based on bi-lateral contracts with generators self-scheduling, the Minister of Economy and Trade, Mr. Ioan Codrut Seres, has recently stated that he would like to see more transparency in the markets, citing bi-lateral agreements as a concern. The development of the market structure and the treatment of long-term bi-lateral contracts will therefore be something to watch in the medium term.

Although the Government has publicly stated that they do not intend to sell Termoelectrica (the coal and oil burning electricity producer), consultants have been hired to advise on the privatisation of three of Termoelectrica's "power centres". These vertically integrated generation undertakings are Rovinari, Craiova and Turceni.

An interesting aspect of these centres is that they have been restructured to include the mining operations that supply the centres (an approach that has been seen elsewhere in South Eastern Europe). Although the mines give rise to some opportunities, they come with some risk. Since the fall of Communism, the miners have been one of the most socially active groups and more powerful unions in Romania. Having fallen from their "special status" under communism, the industry has seen a sharp decline in its fortunes. Since 1997, when Romania had over 170,000 miners, there are now fewer than 50,000 with 11 mines alone being closed during the first nine months of this year.

Some see the integration of the mines into the power centres as a way of maintaining the industry. But for any investor, dealing with the miners could be challenging. In many privatisations, the Romanian state attempts to have the investor commit to keeping employment levels high for some period of time as well as requiring that any current labour agreement be honoured. Although such issues can be addressed effectively, preparation and finesse will be needed.

Investors should also consider the quality of coal being mined and the ability to meet future commitments regarding emission of certain pollutants into the air under the Large Combustion Plant Directive . Although the Government is permitted to warrant past environmental issues, they are usually very strict on future compliance and investment; a key issue and Governmental goal during the privatisation process.

While Romania has negotiated derogations from the Large Combustion Plant Directive up to 2013, limits are imposed from 2008 onwards on a plant or energy centre basis and overall emissions limits are reduced in steps over the period 2008 – 2013. However, this may present opportunities for some to take advantage of the Kyoto Protocol's flexible mechanisms of joint implementation (JI) or clean development mechanism (CDM) projects. (Romania is an Annex B country.)

The gas sector is also being privatised with the majority of two distribution companies - Distrigaz Nord and Distrigaz Sud – being acquired by E.ON Ruhrgas and Gaz de France, respectively. Like the distribution companies, the deals were structured with share purchase and capital increase elements. As a general rule, the Romanians have allowed approximately two-thirds of the purchase price to be in investments in the company. In this model, Distrigaz Sud was purchased for Euro 311 million while Distrigaz Nord went for Euro 303 million.

Romgaz, Romania's gas producer, is also being considered for privatisation, with CSFB being hired as lead consultant. It is understood that Romania plans to offer up to 15% of the company on the Bucharest Stock Exchange next year, to be followed by the sale of a 51% stake to a strategic investor by the end of 2006. Possible bidders for Romgaz are the Hungarian company MOL, Russia's Lukoil, German Ruhrgas, French Gas de France and German Wintershall.

Work continues on the construction of the unit 2 of the Cernovoda nuclear power plant, with the unit being about 83% completed. At the same time the Government has identified nuclear as a basic power source for the future and decided to develop unit 3 of the plant. The Government has stated that it intends the new unit to be developed as an independent power project with the involvement of local or foreign investors, but without recourse to a sovereign guarantee. With the development of the new Belene NPP across the border in Bulgaria, the future development of these two nuclear plants is likely to offer some interesting comparisons and contrasts.

***Contact details:***

**Charles Vernon**

**[charles.vernon@dalegal.ro](mailto:charles.vernon@dalegal.ro)**