



# Project Finance and Guarantees

July 2005

Finance & Guarantees Group  
Finance, Economics & Urban Department

## World Bank issues first Privatization Guarantee in support of Regulatory Risk for Romania

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*The PRG helped to generate significant savings for the sector and lower tariffs for the consumer*

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The mixed post-privatization experience of investors in distribution utilities has heightened investors' sensitivity to perceived government-related risks, with regulatory risk being one of the critical risks. In response to these global lessons, the World Bank adapted its PRG product to specifically support privatizations and the backstop of regulatory risk.

The Government of Romania (GOR) initiated its privatization effort in the power sector by the launch of the bid for the majority asset (51%<sup>1</sup>) sale of the first two of its eight regional electricity distribution companies, Banat & Dobrogea (Discoms). The Discoms will operate under: a 25-year Distribution License and an 8-year Supply License for retail supply. Distribution Revenues are regulated by the National Energy Regulatory Authority (ANRE) on the basis of a price cap/price basket methodology introduced in January 2005<sup>2</sup>.

Enel SpA of Italy purchased the Discoms for about EUR35 million with a commitment to recapitalize them with additional capital injection of around EUR77 million. Enel's projected capital expenditure, including expenditure for network improvement, is about EUR171 million for the 2005-2009 period.

The PRG was designed to backstop GOR's obligation to compensate the Discoms for loss of Regulated Revenues resulting from non-compliance by the Regulator and/or change or repeal by GOR of the pre-agreed regulatory framework relating to: (i) the distribution tariff formula and (ii) the full pass through of the electricity costs<sup>3</sup>. The *Government Support Agreement* (GSA) between the GOR and the Discoms details the Guaranteed Events, the claim process, dispute resolution mechanisms, as well as the pre-agreed tariff framework. The PRG was structured to backstop a Letter of Guarantee (L/G) issued by

Citibank Romania<sup>3</sup> for the benefit of the two Discoms. If a Guaranteed Event occurs and the Event of Default is not remedied, the Discom(s) would be entitled to draw under the L/G on a 'first come first served' basis. Following a drawing, the GOR, through the Ministry of Public Finance (MPF), would be obligated to reimburse the amounts drawn, plus accrued interest, within 12 months. If GOR failed to make the necessary payments, then Citibank Romania would have recourse to the PRG<sup>4</sup>. The L/G and the PRG are for a maximum amount of EUR60 million for both Discoms. The L/G is valid for 5 years<sup>5</sup>. IBRD concluded: an *Indemnity Agreement* with Romania; a *Project Agreement* with the Discoms and a *Guarantee Agreement* with Citibank Romania in support of the transaction. Financial Closure of the *Privatization Agreement* between the GOR and Enel, as well as for the PRG was achieved in April 2005.

The PRG facilitated the successful conclusion of the transaction and caused Enel to reduce its Weighted Average Cost of Capital (WACC) requirement. This reduction will yield substantial recurring savings for the country throughout the operational life of the Discoms with positive impact on consumer tariffs. This transaction was the first PRG to be provided by the World Bank to a project company in support of a privatization transaction and for regulatory risk where the innovative L/G structure was designed to be a source of liquidity for the Discoms in the event of a regulatory breach or pending dispute resolution. Traditionally, Bank's guarantees have been for debt instruments provided to private lenders. The PRG also helped to pave the way for the subsequent privatization of three more Discoms on the basis of the lower WACC benchmark set by the PRG for the Banat & Dobrogea privatizations.

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<sup>1</sup> 49% will be retained by state-owned Electrica

<sup>2</sup> The framework provides for a tariff mechanism based on recognized costs and guaranteed return in the form of a pre-agreed WACC, incentives for performance, and full pass through of electricity costs.

<sup>3</sup> Equivalent to a Letter of Credit in Romania; Citibank Romania was selected competitively.

<sup>4</sup> In the event of a disputed claim, pending the adjudication of the claim, the Discoms would be entitled to draw provisional payments under the L/G secured by bank guarantees issued in favor of the MPF.

<sup>5</sup> to cover the three years of the first regulatory period and the first two of the second regulatory period

## Partial Risk Guarantee Contractual Structure

