Public-Private Partnership Stories

Kosovo: Electricity Distribution

The government of Kosovo faced serious problems in its power sector. The lack of a reliable supply of electricity was causing hardship to its population and was a major stumbling block to investment and economic growth. The state-owned distribution company, Kosovo Electricity Distribution and Supply (KEDS), was losing over €20 million annually through technical losses and low collection rates. It was then that the government of Kosovo turned to IFC to privatize KEDS, which would allow a private investor to modernize its system.

A Turkish consortium, Limak-Çalik, won the tender to purchase 100% of KEDS for €26.3 million in a transparent bidding process. The consortium has also committed to invest $390 million to modernize and operate KEDS. The transaction is expected to significantly reduce power outages and government subsidies. Ensuring better security of supply, this transaction paves the way for new generation capacities to be procured and improved access to power for Kosovo's entire population of 1.7 million. The agreement was signed in October 2012. Limak-Çalik is expected to take over the company in May 2013.

This series provides an overview of public-private partnership stories in various infrastructure sectors, where IFC was the lead advisor.

IFC Advisory Services in
Public-Private Partnerships
2121 Pennsylvania Ave. NW
Washington D.C. 20433
ifc.org/ppp

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BACKGROUND

Kosovo, a newly-independent, post-conflict country in the Balkans, suffered from serious technical, operational and financial problems in its state-owned power sector. Outdated generation and distribution infrastructure led to high technical losses, unreliable electricity supply and a dependence on imports. In response, the government of Kosovo undertook a series of reforms to develop its electricity market. These included the unbundling of its vertically integrated mining, generation, distribution and supply operations, where the distribution and supply divisions would be spun off into a new corporation, the Kosovo Electricity Distribution and Supply Company (KEDS).

However, with a small market of 400,000 customers, poor billing and collection practices, import subsidies, and an unstable political and investment climate, KEDS was losing over €20 million annually and was unable to supply electricity reliably, which held back the country's economic development and made life more difficult for its citizens. To address these issues, the government appointed IFC as lead advisor for the privatization of KEDS, which would allow a private sector investor to modernize and operate the distribution network in line with international standards.

IFC'S ROLE

IFC was retained as lead advisor to the government of Kosovo to execute a transparent and competitive bidding process to attract a private investor to acquire a majority stake and operate KEDS. This involved: (i) structuring a transaction that would attract private sector participation while maximizing the benefits for the seller and the population; and (ii) undertaking the marketing and the sale of KEDS.

The IFC team faced significant challenges attracting the investor community. This was mostly due to: (i) the overall European market and debt conditions and the resulting lack of interest of strategic investors to invest abroad; (ii) the small size of the market; (iii) a regulated tariff and tariff methodology; (iv) the level of commercial losses and lack of confidence in law enforcement; and (v) government expectations related to the power off-take agreement.

TRANSACTION STRUCTURE

The transaction was implemented through a four-phase process:

1. Structuring the transaction and redesigning the electricity tariff methodology;
2. Allocating risks and rewards, and marketing to potential investors;
3. Defining the criteria to be met by the buyer;
4. Managing the tender, selecting the winning bidder, and finalizing the sales contract.

During the first stages of the transaction, IFC provided advice on reforming the methodology used to calculate the retail tariff on a full-cost recovery basis. In parallel, IFC provided input to a transaction model that broadly defined the allocation of risks and responsibilities among stakeholders. These discussions were complex due to the number of stakeholders, including the European Commission and the World Bank. The main difficulty faced by IFC was managing expectations and interests to reach consensus on a deal structure attractive to investors.

The agreements reached led to the drafting of contracts for regulating the sale of KEDS and future relationships between KEDS and the various stakeholders. These contracts require the winning bidder to invest at least €300 million in KEDS to bring distribution and supply systems to international standards, as well as improve metering, billing and collection. The winning bidder is contractually obligated to meet clearly-defined targets to reduce technical and commercial losses, including a reduction by a minimum of 13.5 percent during the first five year regulatory period. Employee rights are also contractually protected.

BIDDING

An international call for Expression of Interest was launched in June 2010. Five companies initially responded, of which four fulfilled the pre-qualification technical and financial criteria. From these, the government received two fully compliant bids. A Turkish consortium, Limak-Çalik, submitted the highest bid and was selected through an open, transparent process.

Contractual agreements regulating the sale of KEDS and all future relationships between KEDS and the various stakeholders were negotiated over a four-month period and signed in October 2012.

EXPECTED IMPACT

- Improved access to electricity for 1.7 million people;
- A decrease in power outages will help stimulate economic development and investment;
- $390 million in private investment;
- $34 million in fiscal benefits (including €26 million generated from the sale and yearly subsidies avoided);
- Reduced technical and commercial energy losses;
- Reduced greenhouse gas emissions.