The World Bank Board of Directors approved on 5th May 2009, a €60 million (US$78 million equivalent) Partial Risk Guarantee (PRG) for the Privatization of the Energy Distribution System Operator of Albania (OSSH). The availability of the PRG, which was a precondition to the effectiveness of the OSSH privatization, facilitated the privatization of OSSH by enabling the Government of Albania (GOA) and CEZ, the power utility of the Czech Republic, the strategic investor, to conclude the Share Purchase Agreement (SPA) leading to the Financial Closure of the privatization in May 2009, following Parliamentary ratification.

Because of the mixed post-privatization experience of investors in distribution utilities, primarily due to tariffs not being adjusted towards cost-recovery in a timely manner, there has been heightened investor sensitivity to the potential regulatory risk of the sector, perceived to be a critical risk.

In response to these global lessons, the Bank adapted the PRG to specifically support distribution privatization by backstopping regulatory risk. The PRG for the OSSH Privatization in Albania is the second regulatory guarantee provided by the World Bank to a project company in support of a privatization transaction.

**Background**

The electricity sector in Albania has been problematic for many years. The inadequate performance of the electricity distribution, in particular, has been affecting the whole sector.

IBRD provided its first PRG in support of privatization for the Banat & Dobrogea distribution companies in Romania in July 2005 resulting in blackouts for households, firms, and state bodies. Since 1997 electricity shortages have been affecting adversely the life and work of the Albanian people; rural and poor areas suffer disproportionately from supply disruptions. The power sector also presented fiscal challenges for the government, forcing it to subsidize electricity using funds that could have been spent more effectively to provide health, education, and social assistance for the country.

**Project Overview**

In 2006 the Government of Albania decided to privatize power distribution because of persistent failure by OSSH in reducing power distribution losses and improving collections. The government initially expected to achieve the privatization without the support of the PRG. However, following strong feedback from potential investors who expressed concerns with respect to the regulatory risks associated with the OSSH privatization such as the lack of track record of the Albania’s Energy Regulatory Entity (ERE), a new regulatory framework, and the projected requirements for tariff adjustments to sustain the company’s cash flow, as well as the upcoming elections scheduled for June 2009, the government requested the Bank for the PRG to help facilitate the closure of the transaction.

The Bank was well placed to bridge the regulatory ‘credibility gap’ for the investor by mitigating the risk of a new and untested regulatory framework and lack of track record of ERE because of its experience in the sector and its ongoing sector dialogue with the Government.

The GOA initiated the privatization process in early 2008 with the help of its transaction advisers, the International Finance Corporation (part of the World Bank Group) by launching a competitive bidding for 76 percent of the share capital of OSSH. The selected bidder, CEZ a.s., an integrated electricity conglomerate, majority owned by the Government of the Czech Republic, and...
amongst the top ten European power utilities, purchased OSSH for about €102 million.

The Privatization Agreement and the pre-agreed regulatory framework provide an overall balanced approach, where the privatized OSSH undertakes significant and challenging commitments to improve performance, while the Government and the Electricity Regulatory Entity (ERE) agreed to provide reasonable returns if that performance is reached.

The privatized OSSH, which owns about 69,000 km of network and serves about 1 million customers, will operate under two licenses: (a) a Distribution System Operator (DSO) License for 30 years with exclusive right to serve all of Albania; and (b) a Retail Public Supply (RPS) License for 30 years with exclusive right to supply electricity to tariff customers.

The Partial Risk Guarantee

The PRG backstops the obligation of the GOA to compensate the privatized company OSSH in the event ERE or GOA fail to implement the regulatory framework agreed as part of the SPA. Under the structure, the PRG guarantees debt arising from a drawing of an irrevocable, revolving, standby L/C issued by Citibank Hungary (the L/C Issuing Bank) on behalf of the Ministry of Finance of Albania in favor of OSSH as beneficiary. OSSH would be entitled to draw on the L/C upon the occurrence of a guaranteed event to compensate for a resulting loss of revenues relating to the following:

(i) Distribution System Operator tariff formula and its related inputs;
(ii) Retail Public Supply service tariff formula and its related inputs including the compensation mechanism; and,
(iii) the timely approval of tariffs, which result in a loss of revenue to OSSH

Following a drawing, the GOA would be obligated to repay Citibank Hungary for the amount drawn with accrued interest, within 12 months under a Reimbursement and Credit Agreement concluded with Citibank Hungary. If GOA failed to make the required payments, then Citibank Hungary would have recourse to the PRG under its Guarantee Agreement concluded with IBRD. The L/C, with a validity period of 6

Part of the remaining state-owned shares (24 percent) is to be offered to the employees of OSSH in exchange for privatization bonuses and former owners of land that was nationalized during the communist period years, would be reinstatable for each repaid amount during this period. The L/C and the PRG are for a maximum amount of €60 million.

The Government Support Agreement (GSA) concluded between GOA and OSSH and backed by IBRD, details the guaranteed events, the claim process, dispute resolution mechanisms, as well as the pre-agreed tariff methodology. In addition to backstopping the GSA, IBRD entered into an Indemnity Agreement with Albania, a Project Agreement OSSH, and a Guarantee Agreement with Citibank Hungary as noted above.

Benefits of the Partial Risk Guarantee

- The PRG was critical to the financial closure of the privatization of OSSH which will help to reduce the country’s fiscal burden imposed by the power sector and improve the overall electricity supply situation affecting the country since 1997.
- This was the second PRG operation to be provided by the IBRD to a project company in support of a privatization transaction and for regulatory risk where the innovative L/C structure was designed to be a source of pre-allocated liquidity for the company in the event of a regulatory breach, or pending dispute resolution.
- The PRG will help to reinforce ERE’s independence and help to ensure that the regulatory authority performs in accordance with the pre-agreed Regulatory Framework.
- By facilitating the privatization of OSSH, the PRG helped to secure the interest of a new credit-worthy entity and an important regional player in the sector that is expected to procure considerable quantities of power at market prices, improve services, and help to establish, over time, a financially sustainable sector.
- The PRG is expected to help attract investments in the sector by catalyzing Euro 240 million of investments over the next five year period in OSSH.

Lead Financial Officer for this operation: Ms. Farida Mazhar at (202) 473-1235 or by email fmazhar@worldbank.org.

For more information on the World Bank Guarantee program please visit our web site www.worldbank.org/guarantees or contact:
Upali Perera at (202) 458-2801, by email at uperera@worldbank.org or Chalida Chararnsuk at (202) 458-8111, by email at cchararnsuk@worldbank.org.
OSSH Electricity Distribution Privatization Contractual Structure

Government of Albania (MOF)

Share Purchase Agreement

Equity

Government Support Agreement

Regulatory Framework

ERE (Regulator)

Reimbursement & Credit Agreement

L/C*

Citibank Hungary

Guarantee Agreement

Project Agreement

* Letter of Credit

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