

Prerequisites for concession in Kyrgyzstan

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SWOT Analysis of the Kyrgyz Energy Sector

Strengths

- Developed hydropower without debts
- Almost 100% access to electricity
- Minimal investment needs in the internal market

Weaknesses

- Shortage of resources
- Mostly hydropower
- Import of fossil fuel
- Weak functioning
- High losses, corruption
- Poverty

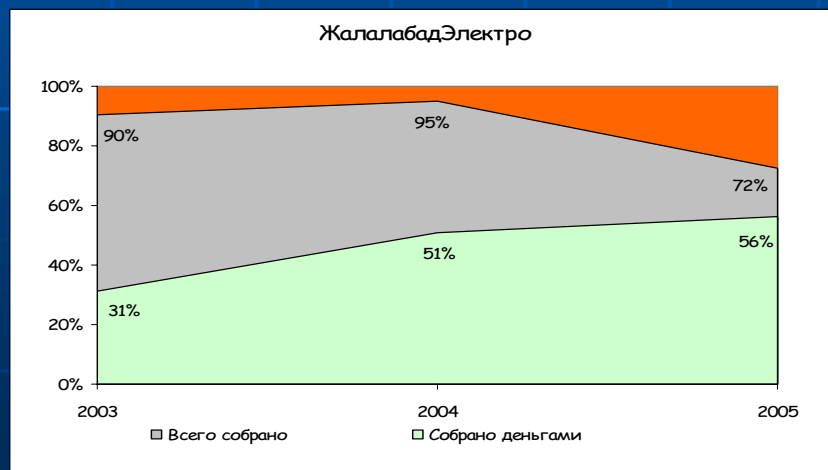
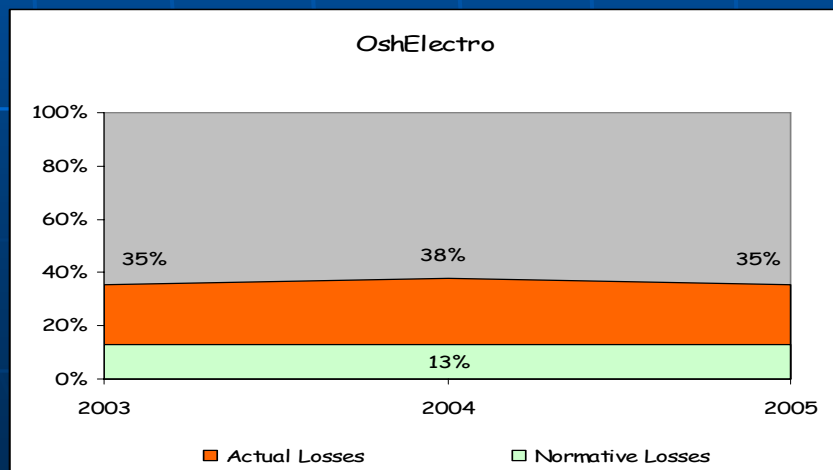
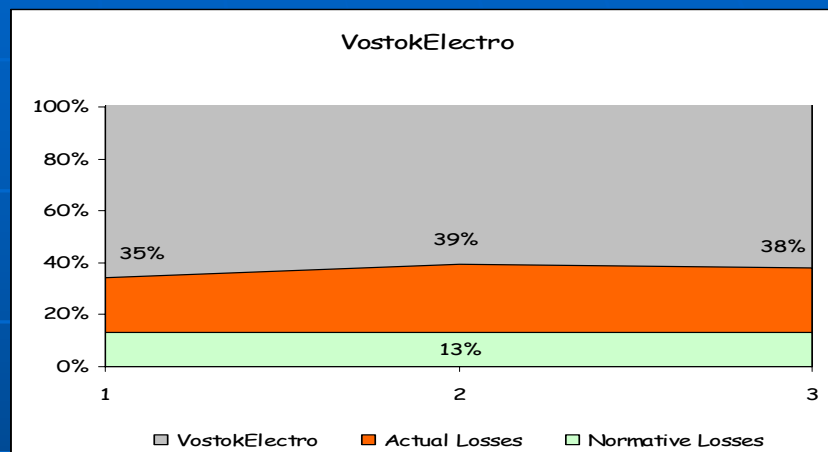
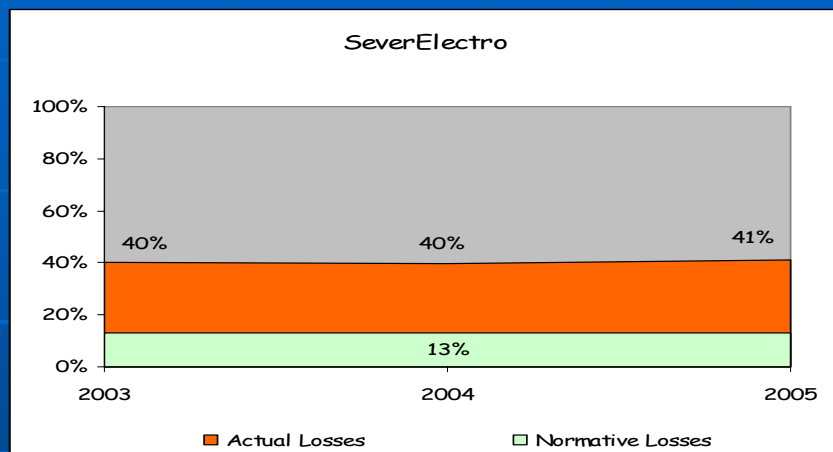
Opportunities

- Stabilization and strengthening of macro situation
- Poverty is reducing
- Better chances for export of electricity
- Growth of consumption in the region

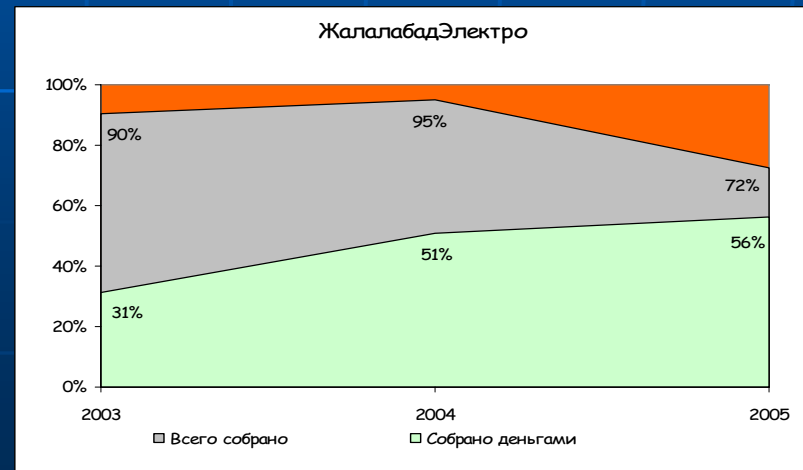
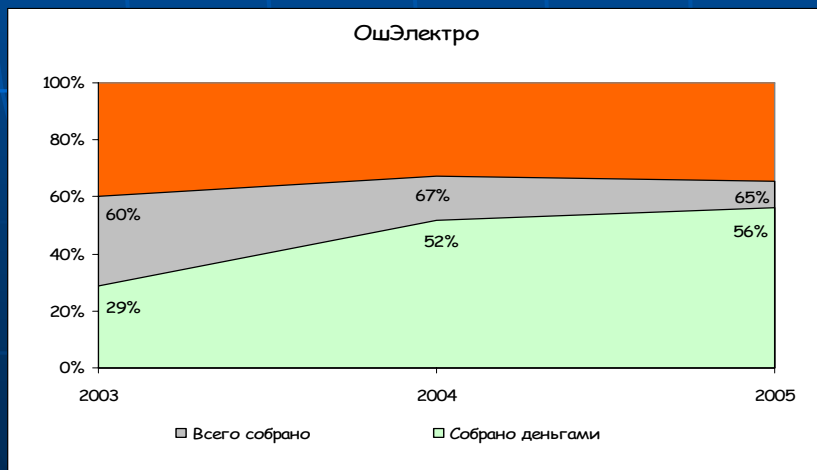
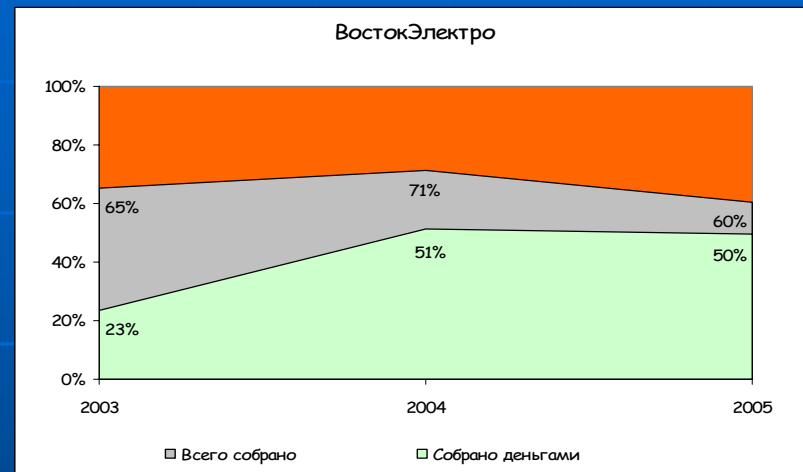
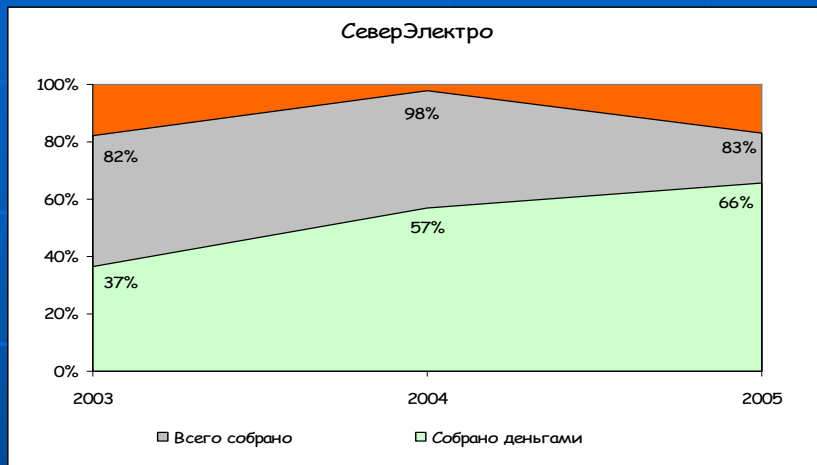
Threats

- Energy security
- Growing prices for fossil fuel
- Lack of regional cooperation

There is no real reduction of losses.
Losses are still high – 43% in 2005



Cash collection is getting better, but is still pretty low – 47% for the system in 2005



Tariff structure by functions

(US cent/kWh)

| Function | International | Kyrgyz Republic |
|--------------|---------------|-----------------|
| Generation | 3.5 | 0.3 |
| Transmission | 0.5 | 0.3 |
| Distribution | 2.0 | 2.0 |
| Total | 6.0 | 2.6 |

Advantages of the Kyrgyz Republic:

- Fully developed hydropower generation, therefore, costs are lower

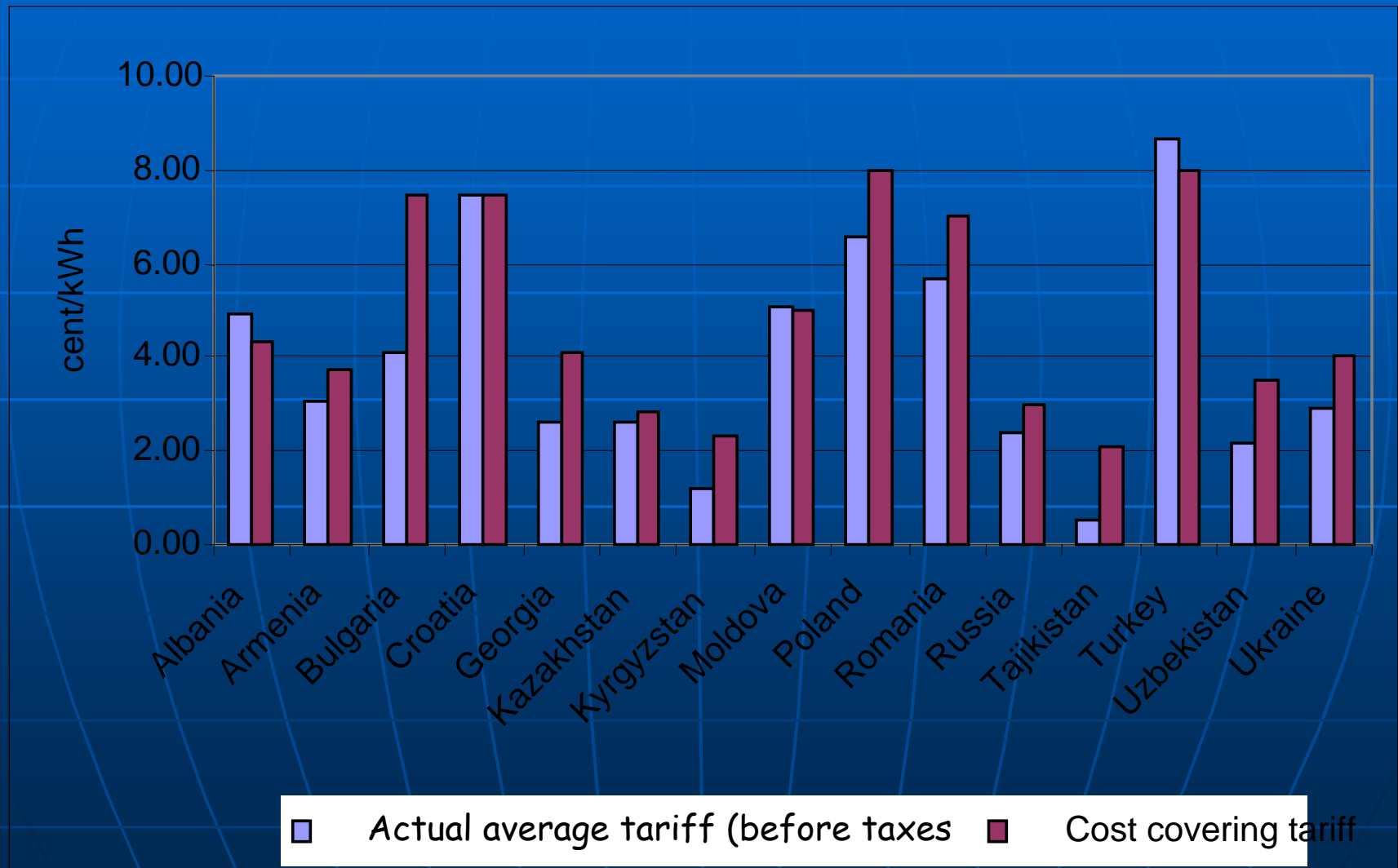
- No need in significant investments in transmission

- Mostly needed investments in distribution –

 - but low costs for employees decrease investments

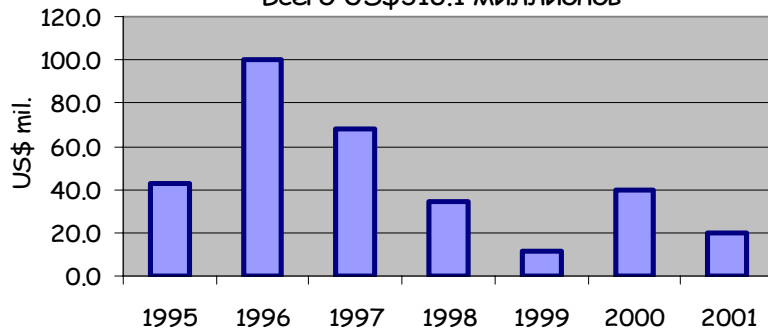
Important – the level of 2.6 cent/kWh does not include investments in Bishkek CHP 2, Kambarata 2, etc.

Tariffs in Kyrgyzstan in comparison with other countries

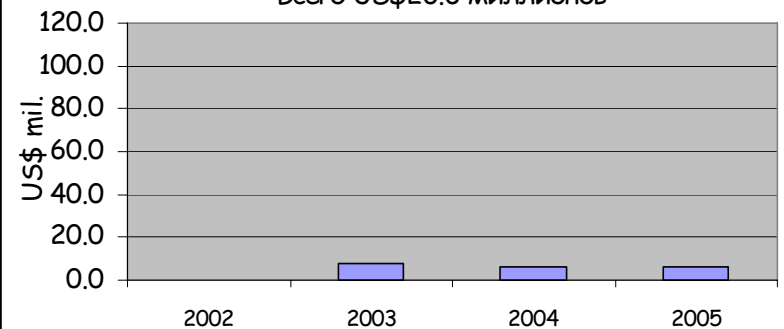


As a result, there were no new investments in the energy sector since 2002

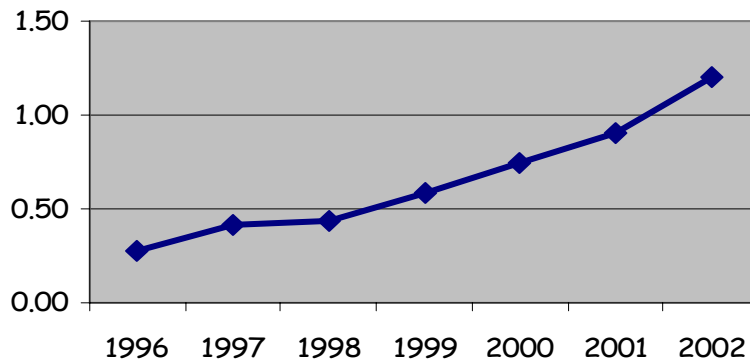
Иностранное финансирование инвестиций в
сектор энергетики в 1995-2001 годах,
Всего US\$316.1 миллионов



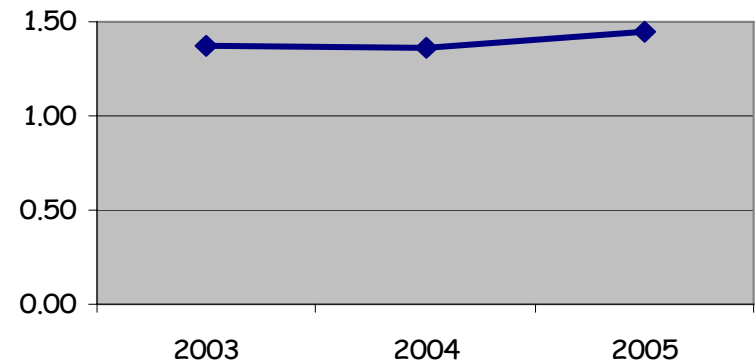
Иностранное финансирование инвестиций в
сектор энергетики в 2002-2005 годах,
Всего US\$20.0 миллионов



Тариф по выписанным счетам (US цент/кВтч)



Тариф по выписанным счетам (US цент/кВтч)



Investment Measures

- Investments aimed at energy security
 - Investments in distribution – the highest priority - 250 – 300 million US dollars
 - Investments in production
 - Rehabilitation of Uch-Kurgansk HPP
 - To create winter capacities
 - Rehabilitation of Bishkek CHP 1 to use greater amounts of coal
 - To build Biskek coal fired CHP
 - Requires import of coal and/or coal extraction projects are necessary
- Growing export of electricity would lead to economic growth aimed at
 - Investments in transmission
 - Datka substation, power transmission line Datka – Kemin – high priority
 - Investments in generation
 - Kambarata 2; a lot of projects of medium sized HPPs

Private Investors for Kyrgyz Energy Sector

- The interest is still rather low, but there are interested investors
 - Inter RAO UES of Russia
 - AES from the U.S.
 - Aga Khan Fund
 - More investors would come if the implementation policy is reliable
- Investors say:
 - We need the Government as a partner
 - They would work only with the IFI in financing
 - First, is that policy frameworks would be unchangeable
 - The second is that other investors would not come
- IFI would come only when correct political framework is in place

Actions that Have to Be Taken in Order to Attract Private Investors

- Actions by the Parliament:
 - To approve Phase IV of the Kyrgyzenergo Privatization Program
 - To make changes in the laws allowing privatization of Bishkek CHP 1 and CHP 2, etc.
- President's action related to adoption of Medium Term Tariff Policy
- Actions by the Government:
 - To formulate and adopt the Energy Sector Development Strategy
 - To prepare a list of projects for private sector participation
 - To promote investment conferences
 - To implement transparent investor selection process

1. Main Objectives of the Concession

- Attraction of private investments into the sector without guarantees from the Government.
- To implement the best methods of management and best commercial practices in order to reduce commercial losses
 - And, thus, to strengthen finance in the whole power sector

Private Sector Participation in the Power Sector

Supports Priorities

■ **Growth:**

- High «signaling» effect of attraction of direct foreign investments in the sector for other private investors
- Investments in distribution are necessary :
 - To reduce technical losses in the domestic market and to increase the amount of electricity available for export
 - To guarantee that other production activities (agriculture, manufacturing, services) would continue to have access to good quality power supply
- The first step for attraction of interest of the private sector for more ambitious plans on increase of export, and other projects designed to ensure growth (Kambarata?)

■ **Governance:**

- Participation of the private sector in the energy sector would demonstrate the desire of the Government to oppose interested circles and address issues of governance/corruption in the sector

■ **Provision of main services:**

- Participation of the private sector is necessary for investments, and the investments are needed to improve the quality of services provided to consumers

Principles of the Concession

- The Government grants to the concessionary:
 - An exclusive right to manage and maintain assets for ensuring power supply:
 - To all consumers, private and state owned
 - In the concession territory
 - For a specified period of time
 - However, the right to alienate these assets is not granted, until the Government approves such alienation
- The Concession Agreement stipulates the following:
 - **The Concession territory.** For example, existing territory of Chuisk, Talas oblast, and the city of Bishkek.
 - **Assets transferred to the concessionary** (equipment, mechanisms, spare parts, transport vehicles, technical drawings, studies or reports, etc.)
 - **The period of validity of the Concession.** Usually is from 20 to 25 years

Assets of the Concession

- The concessionary funds at his own expense:
 - Changes, modifications or replacement of existing assets, which he considers necessary or relevant,
 - provided, that does not decrease the value, usefulness or remaining useful life of these assets.
 - And supplement to the existing assets.
- After the concession ends, all these assets are returned or transferred to the Government

Concessionary's Service Obligations

- Safe, adequate and continuous power supply for consumers in the Concession territory
 - Performance indicators are defined the Concession Agreement.
- If the Government finds out that the concessionary fails to comply with the set performance indicators, fines can be imposed
 - Fines are determined in the Concession Agreement. (An example is in the next slide).

Example of Performance Indicators

- Consumer service standards determined in the Concession Agreement:
 - Voltage— \pm [X percent from rated]
 - Frequency— 50 Hz \pm [X percent]
 - Maximal duration of interruptions:
 - [X hours] due to disconnection of a conductor, external obstacle on the line, malfunction of an insulator, breaking or an accident on the pole, blowing of a fuse,
 - [X hours] due to breakdown of a transformer, switcher or substation equipment when spare parts are available in the Concession Agreement territory,
 - [X days]. Due to breakdown of a transformer (35 kV or 10 kV),
 - etc....
- Fines for non-execution of performance indicators are determined in the Concession Agreement:
 - The concessionary has to establish a complaint filing mechanism with respect to the service standards.
 - Fines for each day, in which the number of unsatisfied complaints exceeds the number indicated in the Concession Agreement
 - Fines are applied only when the number of unsatisfied complaints exceeds certain number during a certain month.
- The Concession Agreement envisions revision of performance indicators in several years.

Investment Obligations

- The investment obligations of the concessionary are determined in the Concession Agreement. The concessionary is responsible for preparation of detailed design and estimate documentation, construction, installation, commissioning, operation, technical maintenance and execution of all his investment obligations.
- The concessionary mobilizes financing for investments and serves his debts.

Minimal Investment Obligations of the Concessionary Described in the Concession Agreement

For example:

Capital investments in the concession territory

- Replacement of overhead lines 10 – 6 kV and 0.4 kV
 - Replacement of package substations of city cable networks and lines with voltage 10 kV and lower
 - Replacement of cables and cable coupling sleeves of city cable networks
 - Replacement/repairs of transformers 35 kV
 - Replacement of the distribution device and relevant apparatus for regulation and protection at substations 35 kV
 - Installation of SCADA equipment (information collection and processing system)
 - etc....
- Current assets
 - Technical assistance and help in management

Concession Funding Scheme

- The concessionary funds its investment obligations
 - Capital
 - A private concessionary
 - Attraction of IFC/EBRD, other investors that participate in the capital
 - Debt (borrowed by the concessionary)
 - Attraction of debt from IFC/EBRD without guarantees from the Government
 - The Government should provide support in attraction of multilateral and bilateral financial organizations (direct or re-credited by the Government funding granted to the concessionary)

Financial Aspects

- Tariffs should generate revenues necessary to ensure operation and technical maintenance, serving of the debt, return on equity
 - This commercially necessary tariff in the concession territory is defined for the whole period of validity of the concession in the Concession Agreement.
 - However, due to social reasons the Government and the concessionary may stipulate in the Agreement slow increase of the tariff towards commercially necessary tariff
- The difference between the commercially necessary tariff and the lower average tariff applied by the concessionary due to some social reasons represents the cost of the social protection policy of the Government and is the responsibility of the Government
 - Funded from the budget at the expense (for example):
 - Bilateral organizations (grants)
 - Other mechanisms /measures, such as revenues from re-crediting of financing received from multilateral financial institutions
- The formula for automatic adjustment of tariffs for inflation is indicated in the Concession Agreement

Financial Aspects

- The concessionary is responsible for collection of all payments for electricity consumed in the concession territory. The concessionary has the right to use all collected funds at its discretion after fulfillment of its contract obligations to suppliers (payment for purchase of electricity and transmission charge).
- The concessionary has the right to disconnect from the electricity supply any consumer who failed to pay the electricity bill within [X days] specified in the Agreement;
 - However, exceptions can be envisioned in the Agreement. For example: supply of electricity to buildings where militia or fire brigades, state schools, hospitals, medical clinics and state ministries responsible for national security of the republic are located.

Termination of the Agreement

- The Concession Agreement can be terminated prior to the set date in case of non-compliance with the obligations.
- An example of non-compliance with obligations by the concessionary:
 - Non-execution of investment obligations
 - Violation of any term of the Agreement that negatively affects the investment obligations or assets taken into concession
 - Disregard or unlawful behavior of concessionaries
 - Unauthorized sale or other transfer of rights and assets of the concession.
- An example of non-compliance with obligations by the the Government:
 - Changes in the legislation that cannot be replenished during the period of validity of the concession by means of increasing the tariff.
 - Nationalization or seizure of any material right belonging to the concessionary
 - Political force-majeure event that negatively affected investment obligations or assets given to the concession
 - Violation of the Agreement by the Government that negatively affected investment obligations or assets given to the concession

Consequences of Termination of the Agreement

- Termination in case the Government fails to meet its obligations:
 - The Government is responsible for operating control over assets given to a concession, and pays debts and capital of financing parties within a certain period of time.
- Termination in case the concessionary fails to meet his obligations.
 - The Government has the right to:
 - Levy a fine for non-compliance with performance indicators
 - Collect imposed fines and get compensation for damage caused by non-compliance with the performance standards by the concessionary
 - Address the arbitration in order to get compensation for the damage caused by preliminary termination of the Agreement
 - Take operating control over assets given to the concession after the Government accepts or repays the whole remaining amount of the debt

Dispute resolution

- Disputes have to be settled, if possible, through amicable settlements
- If the parties fail to settle the dispute in such a way, the arbitration mechanism is applied, defined in the Concession Agreement:
 - For example, Arbitration Rules of the International Chamber of Commerce.