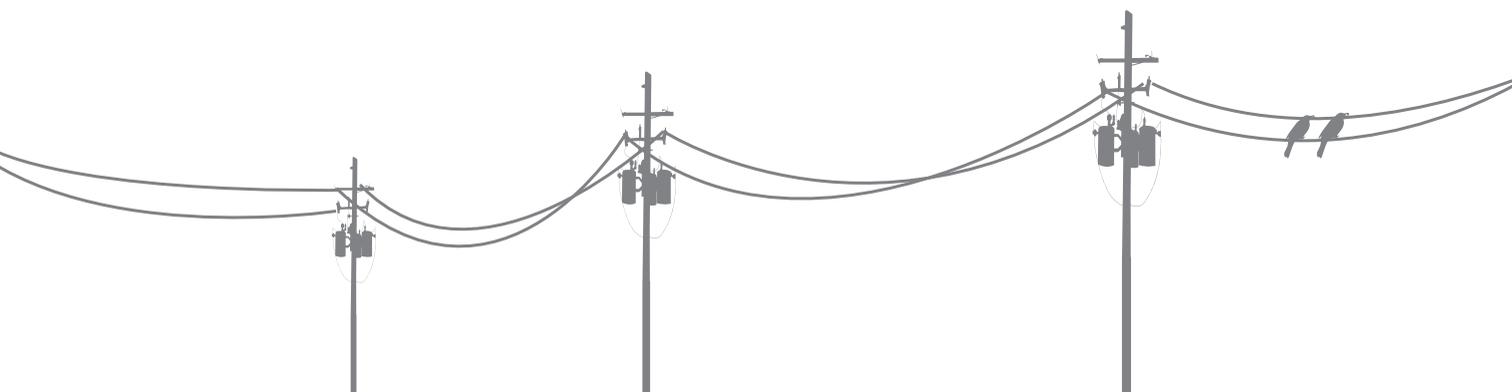
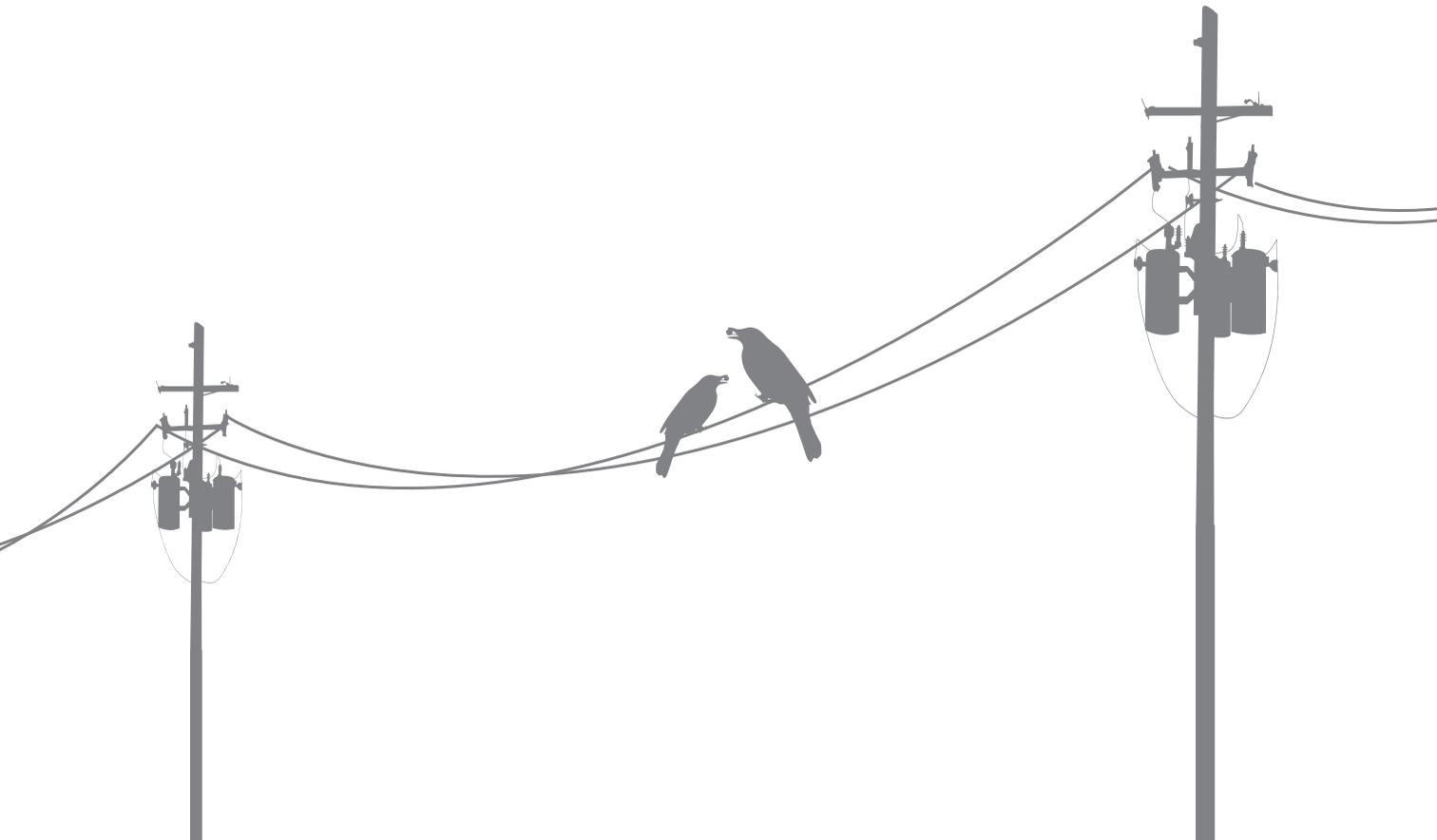


PRIVATISATION IN THE ENERGY SECTOR





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The views expressed in this report are those of the authors and do not necessarily represent those of supporters.

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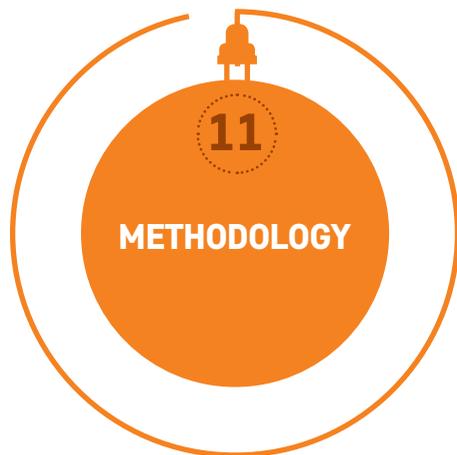
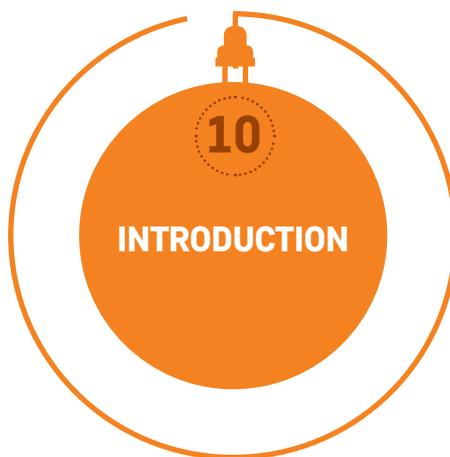
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LIST OF ACRONYMS

EU	→	European Union
CAO	→	Office of the Compliance Advisor Ombudsman (IFC)
IFC	→	International Finance Corporation
KEDS	→	Kosovo Electricity Distribution and Supply Company
KEK	→	Kosovo Energy Corporation
KFOS	→	Kosovo Foundation for Open Society
KOSTT	→	Transmission, system and market operator
GPC	→	Government Privatization Committee
PPRC	→	Public Procurement Regulatory Commission
MED	→	Ministry of Economic Development
POE	→	Publicly Owned Enterprise
PIU	→	Project Implementation Unit
UNMIK	→	United Nation Mission in Kosovo
USAID	→	United States Agency for International Development
ERO	→	Energy Regulatory Office

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EXECUTIVE SUMMARY

The process of including the private sector in the energy sector of Kosovo, particularly the privatisation process of distribution and supply, carried out by Kosovo government in 2013, saw the public polarise on it pro and against. Because this sector has a fundamental importance to the quality of life of Kosovo citizens, the way the privatisation was done and the outcomes of this vital process have justifiably attracted the greatest attention. Given this reality, this report aims at analysing the progress and outcomes of privatisation of distribution and supply sector, so that it can serve as a guideline to similar projects that Kosovo government is supposed to set up and carry out in the coming period, as well as to closing the gaps that can likely be improved in the current project. This report and the platforms via which the report is to be presented intend to ignite a lively debate between the relevant stakeholders, such as the Kosovo parliament, Kosovo government, political parties, civil society, academic circles and the general public.

In spite of the concerns that have constantly been raised, no genuine debate has taken place, which, in the first place would be initiated basically by the public institutions, such as the parliament or government with the other stakeholders included. In fact, the government has given an impression of having attempted to keep this matter inside its close circles. A situation such as this should be overcome by holding wide public debates in the society. Those debates should aim to develop a basic consensus between the key actors and stakeholders in such related processes. Such a thing is a precondition for ensuring the required political backing for such important processes, as well as for eluding any possible political and social tensions that will compromise suchlike projects. Authors of this report believe that introducing the private sector into strategic sectors would be a suitable solution, even though that needs to be based on a proper legal framework, which guarantees adequate policies and procedures; transparency and accountability as well as contributes to a speedy economic growth and sustainable development.

This report identifies significant findings related to the privatisation process in the energy sector. The authors expect that these findings will help in improving the information of important stakeholders in society, in order to encourage growth in the level of accountability, especially to encourage public policies that are anchored in an appropriate legal

framework powerful enough as to ensure a transparent, fair and accountable privatisation.

The main conclusions drawn by this research report are as follows:

- Kosovo government has, in a speedy way, completed the privatization process of energy distribution and supply company amid lack of crucial consensus between the relevant stakeholders in the society in general
- The process as a whole has been characterised by lack of transparency and inclusive debates, amid an impression created that the government was trying to hold this debate merely within its relatively close circles. The process has also been accompanied by a limited access to official documents
- Kosovo Parliament has been avoided holding any privatisation process-related debate in terms of discussing modalities, as well as analysing the costs and benefits. The role of the parliament was merely limited to passing the decision taken by the government, the Government Privatisation Committee (GPC) respectively. Taking into account the fact that Kosovo parliament members are the only representatives elected by the vote of Kosovo citizens, ruling them out from this process practically shuts the door on the voice of the only body that is directly responsible before those who are supposed to benefit from the privatisation of this enterprise; the citizens of Kosovo. What is more, Kosovo parliament passed only in principle the motion on KEDS privatisation, but by imposing a condition on this privatisation depending on the outcomes of feasibility studies which have never been presented
- Despite relying on a basic legal framework, the vulnerability of this legal framework has, however, created an excessive discretion for the government by consequently limiting the observational role of parliament. According to this legal framework, the competences were delegated to the GPC, which is an all-in-one political entity utterly composed of members of government, ministers respectively. That might have well damaged

the process of privatisation of Kosovo Electricity Distribution and Supply Company (KEDS) as well made it vulnerable to the political impact of parties in power and other irregularities in absence of an oversight and report on the parliament

- KEDS has been granted the right to collect a significant amount of financial receivables in the form of initial receivables; an amount which was, reportedly, granted with the aim to ensure proper functioning following the ownership transformation. The transfer of the right to the private investor to collect as initial receivables the amount of over €20M after the privatisation process went in an absolute silence by all the parties involved in the process. Such lack of transparency puts into a new perspective the privatisation of KEDS. In such circumstances, the details of the transfer of the ownership has not presented properly to the citizens.
- KEDS, as a public operator, which provides public services and operates in a regulated market, is obliged to follow the procedures of the public procurement law thoroughly when purchasing goods and services. Nevertheless, it results the KEDS does not follow the law on public procurement. Consequently, there is discrimination on the grounds of treatment against economic operators. Moreover, no proper transparency and competitiveness is ensured in line with the law on public procurement
- The privatisation process has made the investors to significantly reduce trust in investing in Kosovo, given that the process was followed by allegations of corruption and conflict of interest. The lack of law implementation against corruption and the lack of taking measures to clamping down on these phenomena have influenced the process of KEDS privatisation, hence if the situation is to continue with the same pace, it will then have a negative impact on the coming strategic projects in the country.

The main recommendations drawn by this research report are as follows:

- The report suggests Kosovo government and parliament complete the legal framework in order to ensure an efficient, transparent and accountable privatisation in the future via making changes and amendments to the existing laws
- Kosovo government and parliament need to carefully analyse the issue of initial revenues and ensure transparency of the details of the difference between the initial receivables and the obligations that KEDS undertook
- Kosovo government and parliament ought to guarantee an active and comprehensive participation of other stakeholders in the society
- Kosovo parliament should engage more actively in order to strengthen its position in this process, which would ensure the government and other bodies are held accountable and and transparency is ensured so that such similar processes are enabled to succeed in the end. The GPC authorisations should be carefully weighted up and reviewed in this regard. So, this should be made clear through completing the legal framework
- Kosovo government and parliament should carefully analyse the issue of lack of implementation of the public procurement law by the KEDS and take legal steps to improving/punishing the irregularities/violations
- The provisions of law on public procurement should not cover the arrangement of procurement activity of enterprises that provide public services, even though that is likely only when the current legal framework is replaced by a completely new law on public procurement concerning enterprises that offer public services in line with the EU directive (2004/17/EC).

1. INTRODUCTION

The primary goal of this study is to analyse the process of privatisation of Kosovo Electricity Distribution and Supply Company (KEDS), including the institutional and legal framework, as well as procedural aspects followed over the course of this privatisation process. The core theme of the study is related to the significant lack of transparency and accountability during the process of transformation of this company into the private sector, together with contractual obligations designed by Kosovo government as former owner in trust.

The study aims at contributing to the improvement of transparency and accountability of privatisation processes and reconstruction of strategic sectors in Kosovo through these findings and recommendations. The privatisation of electricity distribution and supply serves as a typical example of problems related to a transformation from public sector to private sector in an environment where there is lack of basic social consensus. While attracting the interest of strategic investors is important for any privatisation process, Kosovo government must bear in mind that other audiences are as much, if not more, important.

The audiences include, in the first place, citizens who in the last instance are consumers of the public service. They too, should come to clearly know the benefits and costs of such a process. The government should deal with employees' concerns too, who may be at risk throughout this process. Also, the government needs to undertake significant steps in order to send credible signals to the donors and lenders to indicate that the investments would be profitable.

Furthermore, it is important that the government explains in what period of time the initial costs of such a process would be compensated. From this point of view, Kosovo government has failed in communicating properly and persuading an important part of this audience of profits from this process, as well as of the justification of having chosen suchlike scenario.

Such a consensus and communication can only be reached via a comprehensive dialogue which is anchored to a strong legal and institutional framework that guarantees transparency and accountability. In this case, as this report proves, there has been significant lack of such discussion that would

ensure a wide support from the society. Moreover, the process has been characterised by a compelling lack of transparency followed by a limited access to the data.

The creation of a communication platform is a precondition for succeeding in such processes, particularly in the sector of energy, given that it has rather more complex features than other sectors. Therefore, due to a greater impact that this sector has in a relative point of view on the economy and citizens' well-being, it is necessary that check and balance mechanisms between government and parliament are created, which in this case were very much limited. In the absence of a wide communication and because it is about great economic interests, as well as a strong political lobbying, the dilemma about the progress of such a process is always arisen.

Riinvest Institute has constantly engaged through its research and constructive advocacy in favour of a transparent and accountable process of privatisation in Kosovo. Starting from the research on the privatisation process of socially owned enterprises to addressing the process of privatisation of publicly owned enterprises. These reports have explicated the progress and stagnation in these processes, as well as aimed to encouraging the improvement of transparency and accountability. In this regard, this report, too, deals with the ex-post KEDS privatisation process with the intention to serve as a guideline to similar projects that Kosovo government is supposed to carry out in the coming period, as well as to closing the gaps that can likely be improved in the current project.

This report is organised as follows: the second part presents the research methodology. The third part presents a brief background of energy sector in Kosovo. The fourth part presents a chronology of the process of KEDS privatisation. The fifth part presents the legal and institutional legal framework of privatisation. The sixth part deals with the transparency, social debate and the privatisation process progress, with the seventh part presenting several questionable KEDS privatisation process-related issues.

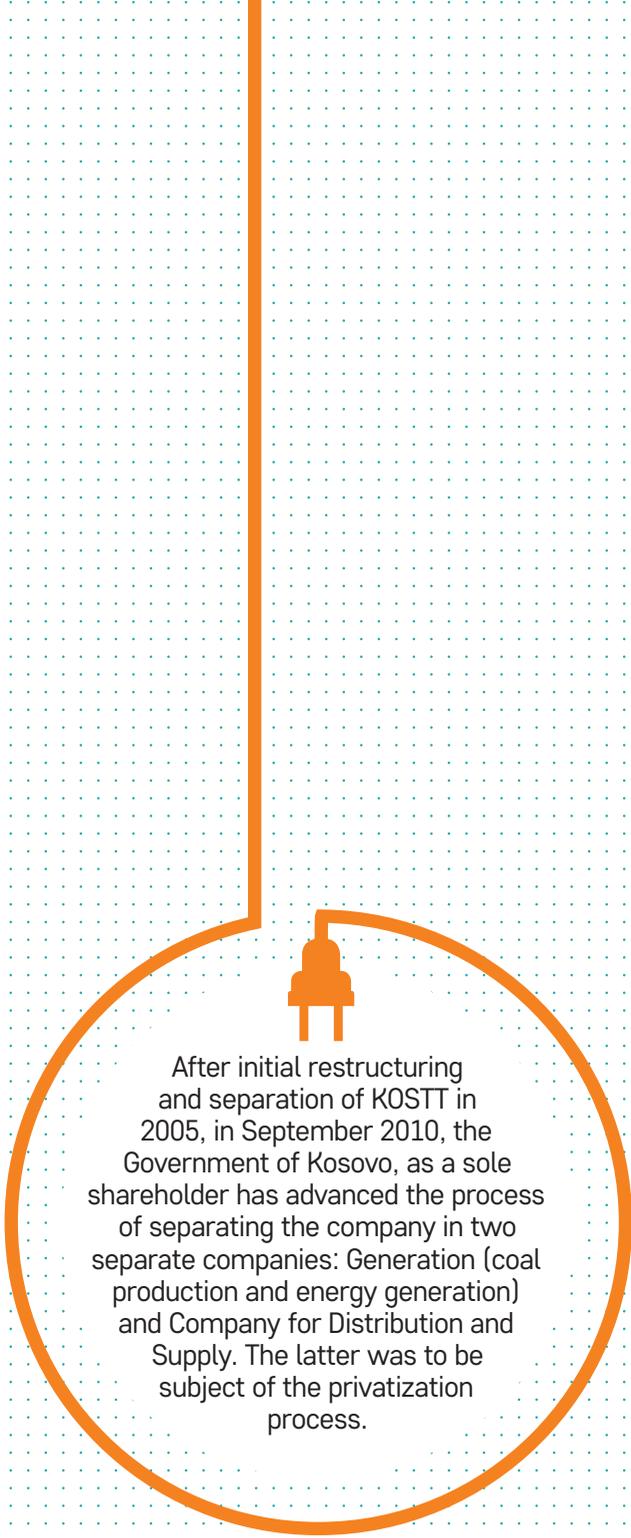
2. METHODOLOGY

This study is based on the primary data collected via interviews, as well as the secondary data carried out via analyses of legal framework and other existing reports. The project team has carried out an in-depth analysis of the existing data on KEDS privatisation. The transactions between the government and private investor and the contracts for collecting the debt arrears between Kosovo Energy Corporation (KEK) have in particular been studied. Several uncertainties were identified in both of these cases, which have then been analysed in details in this study. Other available analyses and reports have also been used. The research in each of the cases has resulted in a series of questions that constitute the basis of a semi-structured questionnaire which was used during the interviews with the stakeholders.

The research team has interviewed Kosovo government officials, parliament officials, KEK representatives, central procurement institutions' representatives, civil society representatives and experts. The findings of the secondary

data and other issues related to the process of ownership transformation and debt collection were on the focus of interviews. The interviews served to validate the research findings. The authors regret that in spite of their numerous efforts over the course of report preparations, they could not come to an understanding about arranging any meetings whatsoever with KEDS and Energy Regulatory Office (ERO) representatives or any other representative authorised by them.

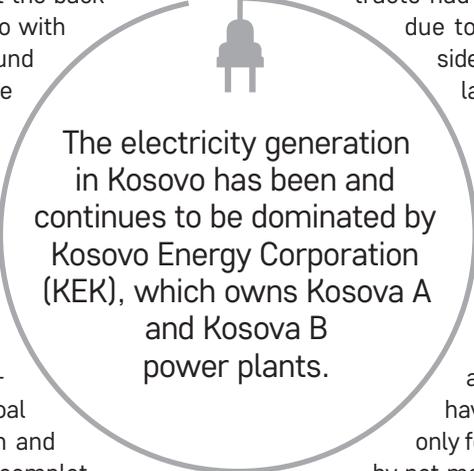
Riinvest would like to thank KFOS for supporting this research and other related-activities, as well as for their continuous collaboration during the time this project was carried out. We would like to kindly thank the interviewees for their cooperation during the interviewing process. Riinvest would like to thank all the parties involved in preparation of this report for their contribution, while it assumes the responsibilities for the report findings and conclusions.



After initial restructuring and separation of KOSTT in 2005, in September 2010, the Government of Kosovo, as a sole shareholder has advanced the process of separating the company in two separate companies: Generation (coal production and energy generation) and Company for Distribution and Supply. The latter was to be subject of the privatization process.

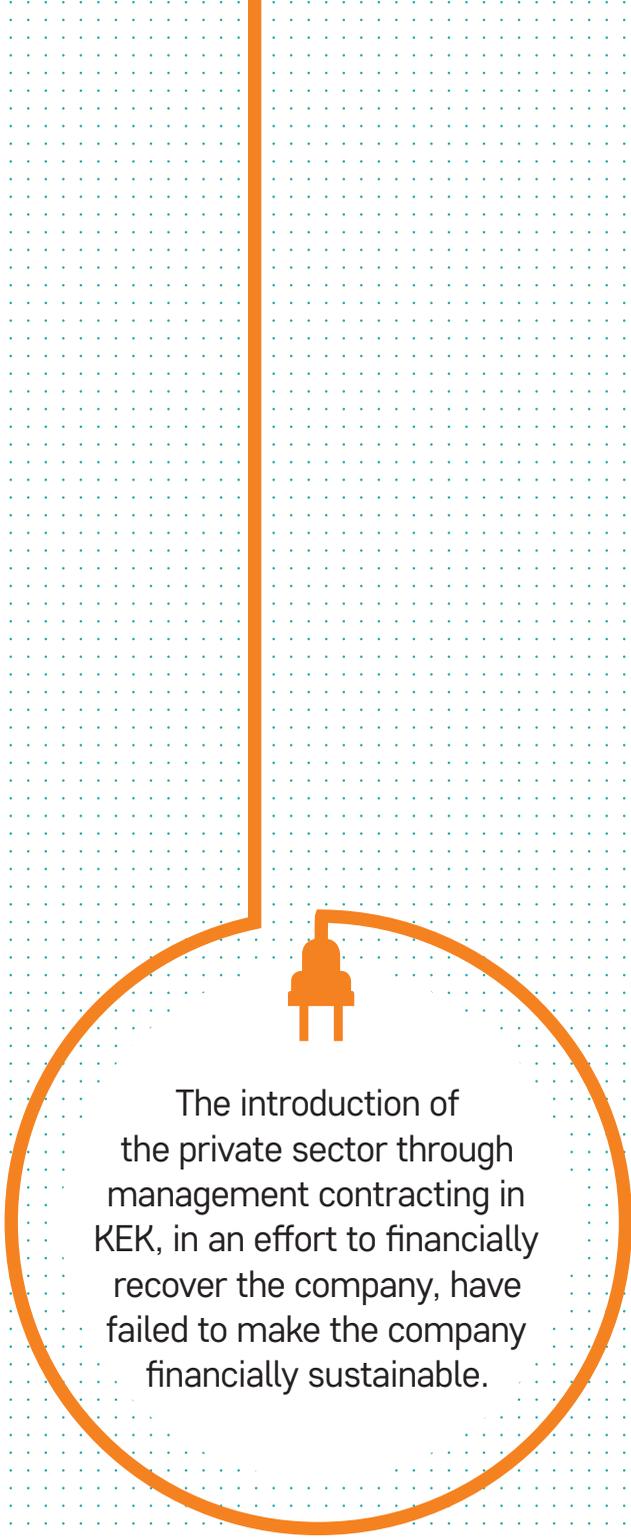
3. A BRIEF BACKGROUND OF ENERGY SECTOR IN KOSOVO

Kosovo predominantly bases the generation of electricity on lignite which constitutes some 97% of overall installed capacities. The remaining part is covered by the capacities of renewable resources. The electricity generation in Kosovo has been and continues to be dominated by Kosovo Energy Corporation (KEK), which owns the Kosova A and Kosova B power plants. The last two represent the backbone of the energy system in Kosovo with a nominal installed capacity of around 1500 MW. KEK as a public enterprise has worked vertically integrated ever since established; nonetheless it has started to unravel since 2002/2003 and onward. The entire sector is monitored by the Energy Regulatory Office (ERO) which was established in 2004. KEK used to be the only electricity distribution and supply company in Kosovo, vertically integrated in four main sectors: Coal production, Generation, Distribution and Supply. A partial restructuring was completed in November 2005 resulting in a separation of The Transmission System Operator (KOSTT), which operates independent of KEK. In September 2010, Kosovo government as the only shareholder pushed forward the process of splitting the company into two companies: The Generation Company (which generates coal and power) and the Distribution and Supply Company. The latter would go on to be a subject of privatisation process.



The electricity generation in Kosovo has been and continues to be dominated by Kosovo Energy Corporation (KEK), which owns Kosova A and Kosova B power plants.

KEK inherited very severe conditions in 1999 following a decade of mismanagement amid lack of investments. After the war, lost of investments were made in KEK mainly from foreign donors. The period when the management contracts were signed saw first steps of private sector involvement. According to the KEK chief executive officer, those contracts had not shown the expected outcomes due to lack of co-ordination between the sides. Hence, that resulted in delays and lack of exact information about investments made by donors. According to the same source, those information were not shared with beneficiary; the KEK in this case. The problems were doubled, with local personnel left aside in most of the cases in the first place and amid lack of establishing the objectives supposed to be achieved. The contracts management have shown low results since they would only focus on the achievement of objectives by not making use of the local expertise. After the country declared its independence in 2008, Kosovo government had quite obviously expressed its commitment to a rather accelerated privatisation process in this sector, which led to a significant disproportion between the level of preparations; creation of a strong legal framework; triggering a necessary political and public support as well as fundamental consensus in the parliament and other key stakeholders in the society.

A thick orange vertical line descends from the top of the page, then curves to the right and down to form a circular callout bubble. Inside the bubble is a small orange icon of a person sitting at a desk with a computer monitor.

The introduction of the private sector through management contracting in KEK, in an effort to financially recover the company, have failed to make the company financially sustainable.

4. CHRONOLOGY OF THE PRIVATISATION PROCESS OF KEDS

The process of unbundling and privatising several parts of the Kosovo Energy Corporation (KEK) begun during early post-war years; at the period when Kosovo was administrated by the UNMIK administration. In 2002 and 2003, the UNMIK in the name of Kosovo signed The Athens Memorandum – 2002¹ and The Athens Memorandum - 2003². Both of these memorandums of understanding aimed to see the application of European Union (EU) norms across Western Balkans countries. The unbundling of vertical enterprises and establishment of independent enterprises for the generation, transmission, distribution and supply of electricity were amongst those norms. Afterwards in 2005, the Athens Treaty³, was signed by which the Energy Community has been established. Kosovo as member of this community undertook mandatory obligations, which amongst other things oblige Kosovo to unbundle its own vertical enterprises in the energy sector. Also, the idea of unbundling and privatising of several KEK parts co-ordinated with UNMIK initiative to commercialise and privatise social enterprises in Kosovo in order to reactivate these enterprises based on free market principles.

KEK organisational structure was inherited from the socialist Yugoslav system, where enterprises used to be organised in a vertical system. An enterprise would be responsible for lignite mines, the generation, transmission, distribution and supply of electricity. In addition to these activities, the KEK also had under its umbrella other non-essential activities, such as gasification of lignite, health services for its own employees, restaurants and public transport. Aside from its very structure, KEK also inherited very old and destroyed assets from the period of 1990-1999, in which investments lacked, and the

enterprise was mismanaged. This fact was one of the key factors as to why KEK had poor financial performance between 1999 and 2008. From 1999 until 2002, KEK was managed by the UNMIK administration, while from 2002 until late 2007 by foreign companies in collaboration with local staff. Nevertheless, all the efforts into a financial recovery failed and thus the KEK could not become financially sustainable.⁴

One of the key triggers of financial problems at the KEK was the immense losses in the distribution network. The average loss in the distribution network between 2000 and 2009 was estimated to be about 45% of the entire energy injected into the distribution network. This figure goes on to reach the maximal point of losses over the course of 2005 and 2007, with a 49.2% loss. Out of these losses, about 18% were technical losses, whereas the other part commercial ones. Although there is a trend of declines in losses, the technical and commercial losses continue to be one of the main problems in the energy system in Kosovo to this day, with an estimated 35.54% of losses marked in 2013 (see Figure no. 1).

The other essential problem was the electricity bill collection. During 2000, only 37.7% of the billed electricity was collected. However, as the efficiency of KEK management grew and with the formation of state institutions, the percentage rose to 58.8% in 2001 and gradually to 79.7% in 2009 before reaching its highest point in 2011, when the level of collection was estimated at 90% (see Figure no.2).

Large electricity losses not only caused financial problems to KEK, but to the consolidated Kosovo budget as well, which was obliged to subsidise the electricity system in order not to put it at the risk of a total failure. Over the period between 2000 and 2007 alone, some €273M were allocated on subsidy by Kosovo's consolidated budget to

1 Memorandum of Understanding on the Regional Electricity Market in South East Europe and its Integration into the European Union Internal Electricity Market <http://www.energy-community.org/pls/portal/docs/36296.PDF>

2 Memorandum of Understanding on the Regional Energy Market in South East Europe and its Integration into the European Community Internal Energy Market The Athens Memorandum 2003 <http://www.stabilitypact.org/energy/031208-mou.pdf>

3 Treaty establishing the Energy Community http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Legal/Treaty

4 Energy Strategy of the Republic of Kosovo 2009-2019. http://mzhe.rks-gov.net/repository/docs/STRATEGJIA_E_ENERGJISE_E_REPUBLIKES_SE_KOSOVES_2009-2018.pdf

FIG. 01 TECHNICAL AND COMMERCIAL LOSSES

Source: ERO Annual Report 2014

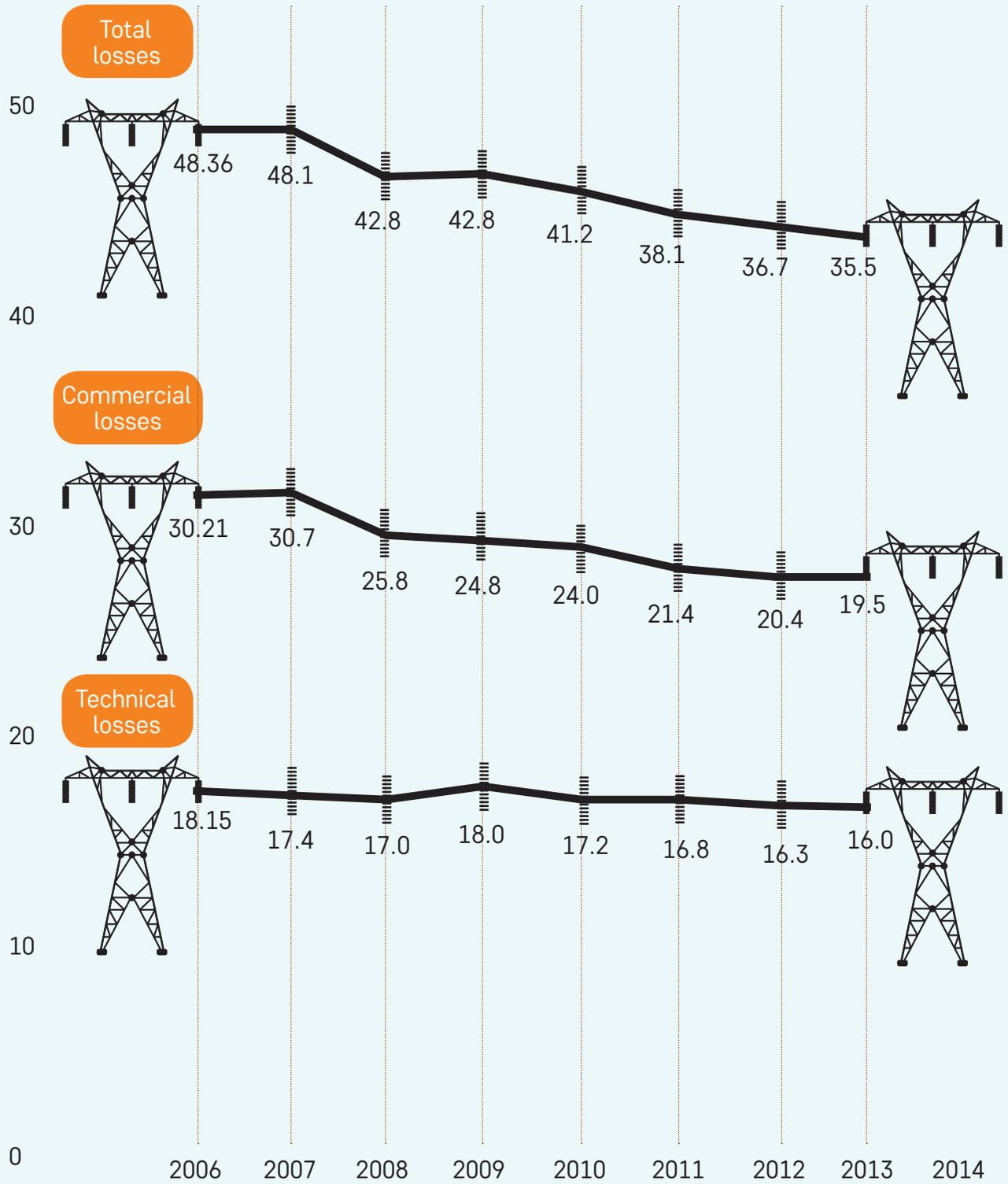
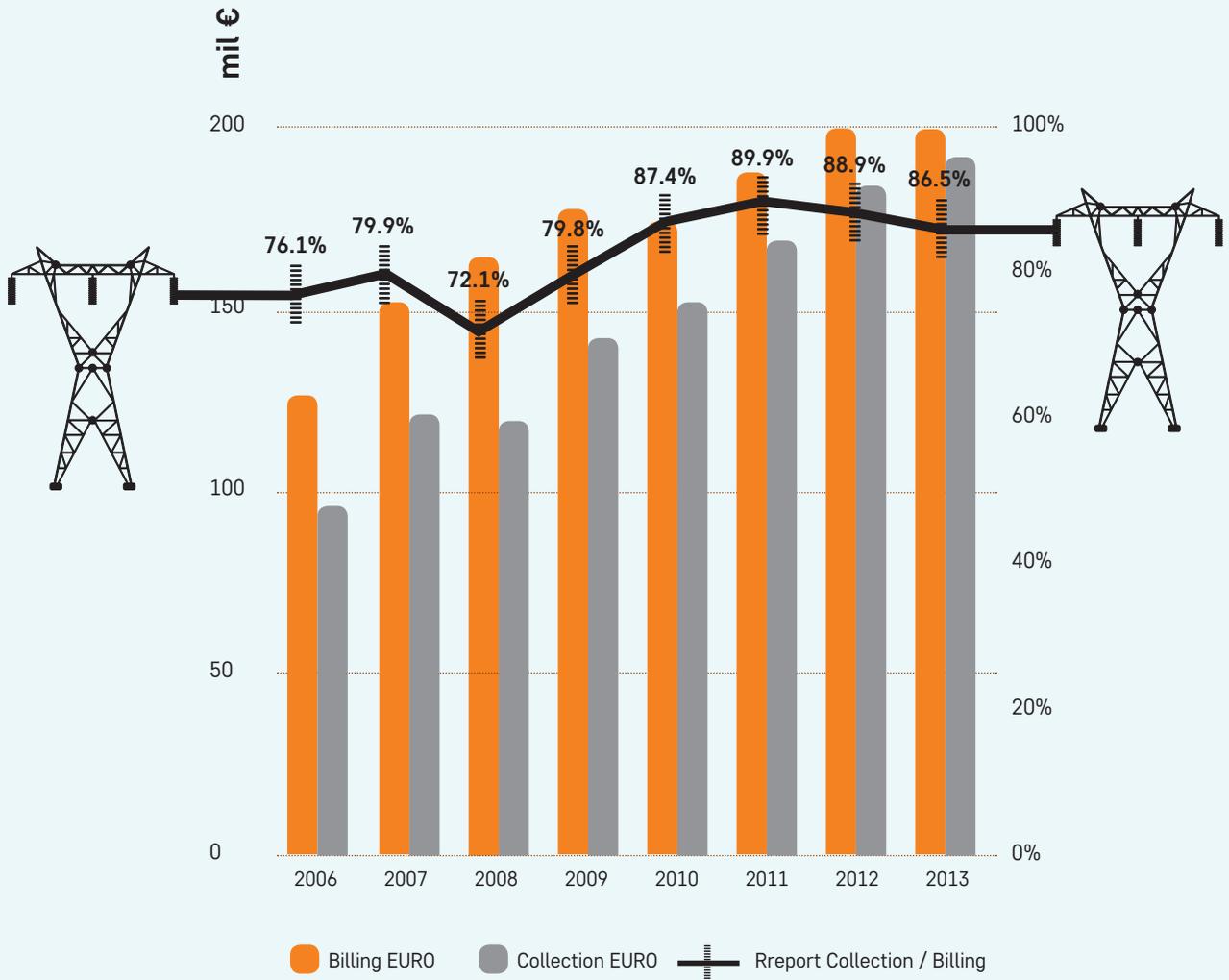


FIG. 02 TECHNICAL AND COMMERCIAL LOSSES

Source: ERO Annual Report 2014



KEK, and this is a figure which constituted some 85% of the overall amount of subsidies allocated to the public enterprises during that period.⁵ In addition to many subsidies, the Kosovo energy sector was also a target of lots of foreign donations. During 1999 and 2007 alone, some €400M were granted by the EU to different energy projects, whereas the overall amount the KEK received between 1999 and 2008 is estimated to be around €1,052M.⁶ Despite the continual increase of collections and cuts in technical and commercial losses, the poor financial performance of KEK was a heavy burden on the Consolidated Budget of Kosovo.

In 2005, the first country's energy strategy was drafted and approved; Kosovo Energy Strategy 2005-2015. Given the significant electricity losses, the heavy budget burden of KEK on Kosovo and the international obligations for unbundling the energy enterprises, this strategy foresaw the restructuring of energy sector and incorporation of KEK as means of addressing these problems. It was then planned that until 2009, the Kosovo energy system constituted of independent actors of mines, generation, transmission, distribution and supply. Meanwhile, until 2009, Kosovo government would aim to give under concession or completely privatise mines, generation and supply, while the transmission would remain a publicly-owned-property.⁷ Regarding that the distribution, the strategy anticipated the distribution unit "could be thought to be privatised in order to attract private investments". The objective that was supposed to be achieved through the unbundling and privatisation of energy sector was "to increase the competitiveness by ensuring complete bill collection until 2009" and "to cutting the technical losses to the levels of international standards until 2010-2012."

The process of privatisation of distribution and supply unit got underway with the adoption of Energy Strategy 2005-2015. While 2006 was a busy year with the establishment of the Transmission and System Operator KOSTT, the decision on

commencing the procedure for privatisation of distribution and supply unit was not taken until late 2008. On 17 September 2008, upon the decision Nr. 04/36⁸, Kosovo government approved the further unbundling of KEK in line with the Energy Strategy 2005-2015. Fifteen days later, on 2nd October, Kosovo government took the decision Nr. 03/38⁹, via which adopted the establishment of Kosovo Electricity Distribution and Supply Company as a company with joint investments. Meanwhile, six days later, it was also decided that an intergovernmental working group is formed for the privatisation of distribution and supply unit of KEK through the government decision Nr. 08/39. The Minister of Trade and Industry, the Minister of Energy and Mining, the Minister of Labour and Social Welfare, the Minister of Environment and Spatial Planning were nominated to the intergovernmental working group, with the Minister of Economy and Finance as group chairperson.



Alongside the losses in the distribution system, a core problem remained the collection of billed energy. During 2000, only 37.7 percent of the billed energy was collected.

It is worth mentioning the fact that during this period a lack of clarity is noticed in the privatisation of distribution and supply unit. In the decision Nr. 03/38 is determined the establishment of a company for distribution and supply, which gives a broad hint that both of the divisions will be privatised into one single company. While in the decision Nr. 08/39, the inter-ministerial working group is assigned to recommend to Kosovo government on which divisions in the KEK framework should be privatised, meaning the privatisation modality was not determined yet, nor whether both divisions would be privatised. That is

also confirmed by the decision Nr. 03-V-074 of Kosovo parliament, which adopted in principle the privatisation but by imposing a condition on this privatisation of units depending on the outcomes of feasibility studies of each and every unit.¹⁰ Also, the Energy Strategy 2005-2015, on which the privatisation of distribution and supply unit was based, does not clarify it whether the distribution should be privatised.

The technical preparation, such as the set up of Kosovo Electricity Distribution and Supply (KEDS) on 11 Septem-

5 The Treasury Department, MEM - Costs of Kosovo Consolidated Budget for social enterprises between 1999 and 2007. Quoted from: Dilemmas and Backwards in a Fast Track privatization of POEs in Kosovo. Riinvest Institute. 2009.

6 Energy Strategy 2009-2019. http://mzhe.rks-gov.net/repository/docs/STRATEG-JIA_E_ENERGJISE_E_REPUBLIKES_SE_KOSOVES_2009-2018.pdf

7 Energy Strategy 2005-2015. Ministry of Energy and Mining

8 Government Decision No. 04/36 http://www.kryeministri-ks.net/repository/docs/Vendimet_e_Mbledhjes_se_36-te_te_Qeverise_2008.pdf

9 Government Decision No. 03/38 http://www.kryeministri-ks.net/repository/docs/Vendimet_e_Mbledhjes_se_38-te_te_Qeverise_2008.pdf

10 Decision of the Kosova Assembly http://www.kuvendikosoves.org/common/docs/proc/proc_s_2008_12_11_10_al.pdf

ber 2009 for commencing the privatisation process lasted from 2009 until 2011. During June 2010, the application for prequalification from the interested investors in purchasing KEDS was announced. On 6 April 2011, out of the total of five companies that had applied, four passed the prequalification threshold: Limak, a company registered in Turkey; Calik also registered in Turkey; TAIB Bank BSC registered in Turkey and Bahrain; and ElsewedyElectric registered in Egypt.¹¹ Following the prequalification, the interested companies were offered access to the “Dataroom”, in which there were data on the distribution and supply sector. Those data would serve to the companies for studies aimed to preparing their bids. On 27 March 2012, the Government Privatisation Committee on the privatisation of KEDS, following the request made by the prequalified companies, decided to postpone the date on bids submission. Further, Government Privatisation Committee on the privatisation of KEDS decided to allow the prequalified companies to form consortia between one another with the intention to encourage rather more qualitative bids.¹² Thus, the Limak-Calik consortium was formed, with the ElsewedyElectric company remaining only in the process after the TAIB Bank BSC company withdrew its bid for privatising KEDS. On 8 June 2012, Government Privatisation Committee announces the best offer, which was made by the Limak-Calik consortium at the value of €26.3M, as opposed to an €22.8M offer made by ElsewedyElectric company.

During the presentation of company structure and profile, as well as plans for investments a month after the winner was announced, the Limak-Calik consortium had vowed €300M investments in the next fifteen years. At the same meeting, several other details on the sale were made public as well, such as ensuring KEDS employees have their jobs guaranteed for three years after privatisation; leaving out the sale of 110kV level, and the old debts to remain with KEK. On 17 October 2012, the agreement between Kosovo government and the Limak-Calik consortium was signed. This agreement turned the promise of €300M investments into an obligation for the consortium, but “under the condition the Energy Regulatory Office of Kosovo (ERO) always gives the approval and adopts the involvement of the influence of these investments in the relevant KEDS tariffs.”¹³ In

a regulated market, it is illogical not to account the impact of investment on tariffs, hence the obligation for a €300M investment is more of an obligation falling on the field of relations with the public than it was an additional obligation for the winning company. The first of May 2013 was set as the date for KEDS transformation. In the meanwhile, KEK would continue to operate the business of distribution and supply. On 1st March 2013, ERO transformed the distribution and supply licence from the KEK to the KEDS¹⁴, and on 2 May the ERK approved the changes to the control of the licensee to distribute and supply from Kosovo government to Kosova Calik Limak Energy company. As of this date, the distribution and supply operate as privatised and the privatisation process was considered closed.

The illustration below shows graphically the KEDS privatisation chronology.

11 Four companies in the race for the privatization of KEDS. <http://mzhe.rks-gov.net/?page=1,42,285>

12 GPC: the deadline for bid submission for privatization of KEDS was extended' <http://mzhe.rks-gov.net/?page=1,42,464>

13 Article 4.14, Implementation Agreement http://mzhe.rksgov.net/repository/docs/MARREVESHJE_IMPLMENTIMI_-_KKDFE.pdf

14 ERO Decision_502_2013 dhe V_503_2013.; http://ero-ks.org/Vendimet/Shqip/2013/V_503_2013.pdf

PRIVATIZING ELECTRICAL ENERGY DISTRIBUTION AND SUPPLY

October 8, 2008
Government decision
for forming an
intergovernmental group
for privatizing KEK's
distribution and supply



October 2, 2008
Government decision
for forming a
company for
the supply and
distribution of
electrical energy



2005

Energy Strategy
2005-2015 foresees
privatizing energy supply
and the opportunity for
privatizing distribution



2008



Government decision
for continuation of
KEK unbundling

2008



2011

Four pre-qualified
companies are
announced

June 9, 2012

Consortium Limak-Çalik is announced as the winner with the highest offer

**€26.3
milion**



October 17, 2012

Contract between Kosovo's government and consortium Limak-Çalik is signed

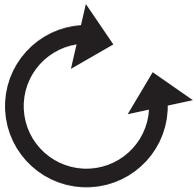


2013

2012

March 27, 2012

Consortiums are allowed to be formed among pre-qualified companies

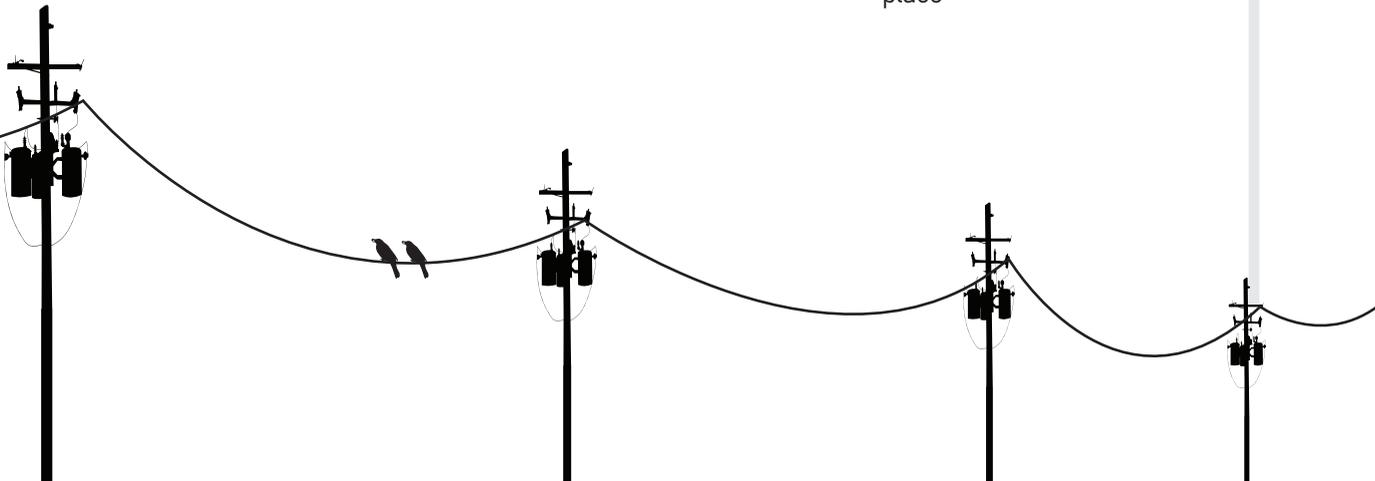
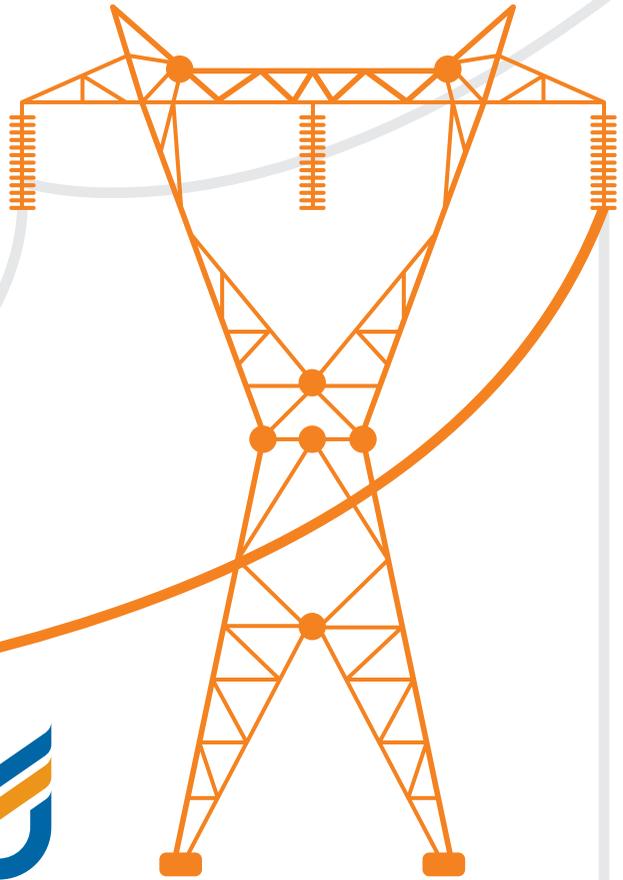


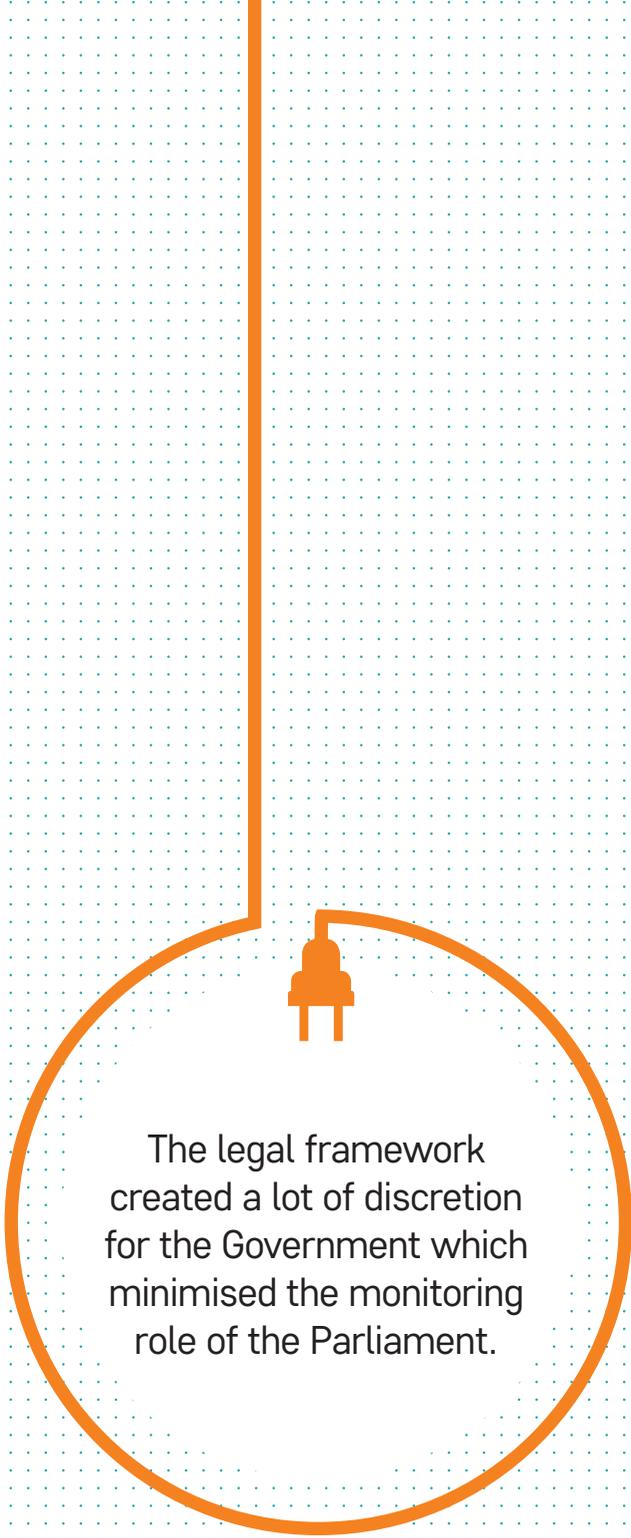
March 1, 2013

ERO-s decision for transferring the license for supply and distribution from KEK to KKDFE takes place

May 2, 2013

ERO-s decision for changing the control of KKDFE from Kosovo's government to Limak-Çalik takes place





The legal framework created a lot of discretion for the Government which minimised the monitoring role of the Parliament.

5. THE LEGAL AND INSTITUTIONAL FRAMEWORK OF PRIVATISATION

The privatisation of distribution and supply of KEK was in line with the Energy Strategy, as well as was based on the Law on Public Enterprises No. 03/L-087¹⁵, and Law on the Concession Award Procedure No. 02/L-44.¹⁶ According to the law on public enterprises, in order to sell the shares, a decision by the government and approval by the Kosovo parliament with a simple majority is required.

Following the approval, the Government Privatisation Committee composed of five relevant ministers is authorised to carry out the tendering procedures in line with the Law on Public Procurement. Moreover, the law on public enterprises also foresaw the formation of a secretariat, or a group of experts, who would assist over the course of privatisation process through preparing the technical procedures and giving advises. Also, the law on public enterprises foresaw further procedures of privatisation were to proceed in accordance with the law on the procedure for the award of concessions.

Those decisions were also approved in principle by a simple majority of Kosovo parliament, which paved the way for further procedures. Following the creation of government committee on privatisation, the Project Implementation Unit (PIU) was also established. The PIU was a technical office responsible for managing privatisation projects. To

advising this office, the Deloitte Consulting LLP was officially contracted to give energy advises. This company was contracted by the USAID and the International Financial Corporation (IFC), which is to part of the World Bank for advice on the transaction. The purpose of engaging the IFC was to “carry through a transparent and competitive process in order to attract private investors”.¹⁷

During the privatisation process, the IFC in the framework of PIU, was engaged in redesigning the methodology for tariff setting, in defining the criteria that the purchaser was supposed to meet, as well as in managing the tendering process for selecting the winner and finalising the contract.

The existing legal framework gave the right to the government to decide on commencing the process of KEDS transformation into a private ownership.

Under the condition that it would be implemented in an adequate way, a legal framework as such had the potential to successfully conclude the process. However, the deficiencies of this legal framework created an excessive discretion for the government which led to the limitation of monitoring role of the parliament. According to this legal framework, the competences were delegated to the GPC, which is an all-in-one political entity completely composed of members of government, ministers respectively. That might have well damaged the process of privatisation of KEDS as well as make this process vulnerable to the political impact and irregularities.



The law did not contain any guideline as to what should contain the proposal made by the government for the privatisation of KEDS, which was then sent to the parliament for voting. Also, there was no guideline as to what decision should the parliament take to merely ensure a ‘yes’ or ‘no’, or to dig deeper to analyse the issues related to the privatisation of KEDS, such as the the privatization strategy and the effects of such a process.

¹⁵ Law on Public Enterprises No. 03/L-087. Official Gazette http://www.gazetazrytare.com/e-gov/index.php?option=com_content&task=view&id=164&Itemid=56&lang=sq

¹⁶ Law on the Concession Award Procedure No. 02/L-44. Gazeta Zyrtare. http://www.gazetazrytare.com/e-gov/index.php?option=com_content&task=view&id=246&Itemid=28&lang=sq

¹⁷ Public-Private Partnership Stories: Kosovo: Electricity Distribution. IFC. 2013. http://www.ifc.org/wps/wcm/connect/e00cbd004e4dc988f0caf7a9dd66321/PPPStories_Kosovo_ElectricityDistribution.pdf?MOD=AJPERES

Actually, the process was mainly left in the hands of the government, apart from the legal obligation for a prior approval of the decision on whether the KEDS privatisation should commence or not, with a simple majority in Kosovo parliament but without any monitoring of the process onward. What is more, the law did not contain any guidelines as to what should contain the proposal made by the government for the privatisation of KEDS, which was then sent to the parliament for voting. There is no guideline as to what decision should the parliament take to merely ensure a 'yes' or 'no', or to dig deeper to analyse the issues related to the privatisation of KEDS, such as the strategies and policies for the privatisation of KEDS.

Consequently, Kosovo parliament has been avoided holding any privatisation process-related debate in terms of discussing modalities, as well as analysing the costs and

benefits of the process. The role of the parliament was merely limited to passing the decision taken by the government, the Government Privatisation Committee (GPC) respectively. Taking into account the fact that Kosovo parliament members are the only representatives elected by the vote of Kosovo citizens, ruling them out from this process practically shuts the door on the voice of the only body that is directly responsible before those who are supposed to benefit from the privatisation of this enterprise; the citizens of Kosovo. In such circumstances, the parliament was not able to properly observe the process of privatisation of KEDS. Such an observation should have been ensured through a improved legal framework, which would ensure that the government's proposals are debated not only within parliament, but beyond with the society, professionals, academic circles, researchers and the media.

6. TRANSPARENCY, SOCIAL DEBATE AND THE PROGRESS OF PRIVATISATION PROCESS

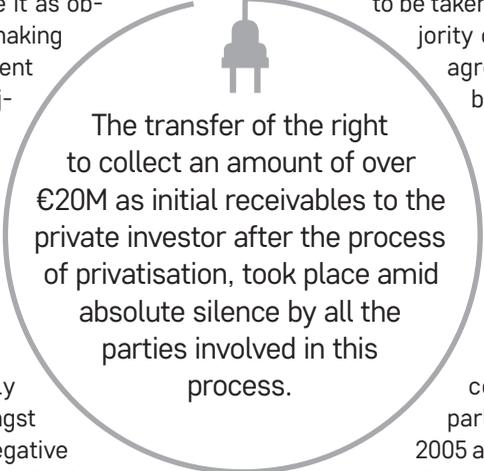
The whole process of privatisation of distribution and supply of KEK has been characterised by the lack of transparency and inclusive debates, amid an impression created that the government was trying to hold this debate merely within its relatively close circles. Many civil society organisations demanded access to the public documents, but had seen their demands rejected. Meanwhile, the lack of public debates and the participation of civil society organisations in decision-making, be it as observers, has resulted in a decision-making behind closed doors by the Government Committee on privatisation and Project Implementation Unit. The lack of the transparency throughout the entire process has aroused suspicions about the progress and mismanagement of KEDS privatisation process. But above all, the lack of transparency and the social debate on the modality of the privatisation system of distribution and supply aroused concerns and distrust amongst citizens which might well have a negative impact on the further function of the privatised company and reduce the trust in governmental actions and policies in this regard.

The lack of transparency has been identified also by a considerable number of requests made by civil society organisations which faced rejection or limitation to official documents.¹⁸ In their justification, the officials of Kosovo Ministry of Economic Development claimed the documents the civil society organisations had asked to have access to “had not yet been in their final form (only in the draft form)” and as such were “not yet public documents”, or that the

18 For further about these requirements, please see the file of refusals of applications published by GAP Institute in the following link: http://www.institutigap.org/documents/31883_Pergjigjet_refuzuese.pdf

information the civil society organisations had asked to have access to were “confidential documents of economic operation” and that such information would “seriously violate” the economic interests of the company.¹⁹

There has been also lack of wider debate in the society during the privatisation process²⁰, coupled with lack of transparency, made the decisions on KEDS privatisation to be taken from top to bottom. As the vast majority of policymakers and relevant actors agree that the supply unit should have been privatised, or that the private sector should have been involved in it in other ways²¹, which would make the process of privatisation of supply not at all controversial, not everyone shares the same position that distribution unit should have been privatised or that both of the units should have been sold to one single company. Kosovo government and parliament did not agree on that during 2005 and 2008 as aforesaid. But the decision on privatisation of both of the units (distribution and supply) and selling them to one single company came without genuine social and institutional debate. Kosovo parliament itself never approved the privatisation of KEDS in this way. As aforementioned, the decision No. 03-V-074 of Kosovo parliament gives the approval in principle under the condition that the final decision is taken after the outcome of feasibility study of each unit. This decision of Kosovo



The transfer of the right to collect an amount of over €20M as initial receivables to the private investor after the process of privatisation, took place amid absolute silence by all the parties involved in this process.

19 The IFC also was accused of lack of transparency and limitation/rejection to official documents, in which case the Office of the Compliance Advisor/ Ombudsman of the IFC (CAO) had launched an investigation. Scroll down to read the details: Kosovo KEK Case Summary (Updated April 2013). CAO. http://www.cao-ombudsman.org/documents/Kosovo_webtext_English_April2013.pdf

20 The privatization of Distribution and Supply. Riinvest Institute. December 2011.

21 Dilemas and Backwards in a Fast Track privatization of POEs in Kosovo. Riinvest Institute. 2009

parliament was, however, taken as a final approval of privatisation of KEDS, even though the other points had not been addressed, such as the conclusion of feasibility studies which were never presented before the Kosovo parliament.

More to the point, other options of privatisation or unbundling were never taken into consideration, despite the presentation of lots of options by institutes and civil society organisations. Amongst other presented options, the option to privatise the supply unit, but not the distribution unit; opening the market for third parties at the supply level; the privatisation of both of the units but to different companies rather than one single company; non-privatisation of both of the units but strengthening of courts and law enforcement officials to reduce commercial losses and billing problems were also put on the table.

Following the conclusion of privatisation process, the IFC presented the challenges for attracting investors to the privatisation process of KEDS, in a brochure about the KEDS privatisation project. Out of five challenges identified, two of them are related to the work of Kosovo government, two related to the market and its regulation, and the last one to the international market. Those challenges were (i) lack of the interest shown from strategic investors as a result of economic and debt crisis in Europe, (ii) small market in Kosovo, (iii) regulated tariffs and the methodology of determining them, (iv) high level of commercial losses and low confidence in law enforcement, and (v) government's expectations related to the agreements with the winning company. Furthermore, these challenges have had an impact on KEDS sale price to be low, though according to the Medium Term Expenditure Framework 2009-2011 a 30-50 million euros in revenue were planned to be generated with KEDS privatisation.²² Also, the winning company was obliged to invest €300M in the next fifteen years aimed to reducing losses by 3% per year.²³ Although this figure is welcomed given the severe situation in Kosovo, this agreement fades as opposed to the very same agreement in Albania, a country which also faces problems in immense commercial, technical and billing losses. Albania signed an agreement with the World Bank on a \$150M funding in energy sector, which aimed to reduce the overall losses currently standing at 40% to 17% until 2019, and to increase the billing which

currently stands at 84% to 93% by 2019²⁴. So, had there been wider social debate and had other perspectives been taken into consideration, perhaps as a result of the debate, a much more profitable alternative and affective for the energy system in Kosovo would have emerged.

22 Quoted from: Dilemas and Backwards in a Fast Track privatization of POEs in Kosovo. Riinvest Institute. 2009

23 Calik & Limak promises 300 million euro investment. MED. <http://mzhe.rks-gov.net/?page=1,42,521>

24 Financing Agreement of \$ 150 million signed with the World Bank for the recovery of the energy sector. Ministry of Energy and Industry of Albania. <http://www.energija.gov.al/al/njoftime/lajme/nenshkruhet-marreshja-e-financimit-150-milion-dollare-me-banken-boterore-per-rimekembjen-e-sektorit-energjetik>

7. QUESTIONABLE ISSUES RELATED TO THE KEDS PRIVATISATION PROCESS

The issues treated in the two subsections below were identified following the analysing of KEDS privatisation process; legal framework and contracts, as well as interviewing of different parties. As discussed below, these findings identify serious problems related to the privatisation of this enterprise, the designing of obligations and contractual benefits and monitoring of KEDS ex-post operation after ownership transformation.

7.1 Initial receivables after the transfer of right to operate

The research in official document, and particularly in the debt collection agreement between Kosovo Energy Corporation (KEK) and KEDS, shows that KEDS has been granted the right to collect a significant amount of financial receivables in the form of initial receivables. Based on talks with Kosovo Ministry of Economic Development (MZHE) and KEK officials, the KEDS had demanded to have in its disposal an initial capital in order to ensure proper functioning upon ownership transformation. KEK, according to its officials, had not agreed on such request. However, in order to accommodate the demand of the private investor, KEK advisers proposed an alternative solution.

The proposed solution foresaw that the private investor was granted the right to collect the unpaid electricity bills issued over the past two months before the date of ownership transformation (the ownership transformation date, referred to as the effective date in the debt collection agreement is 3rd of May 2013). Based on the debt collection agreement, article 4, point 4.2, those receivables would be collected by counting the overall amount of electricity bills issued in the last two months and by deducting from this amount the level of collection that the KEK had made during that period. Effectively, that meant that KEDS would inherit all the uncollected debts during February (the electricity bill for February was issued on 5th of March) and March (the electricity bill for March was issued on 5th of April). Meanwhile, the electricity bill for April (issued on 4th of May, meaning after the effective date), was transferred completely to KEDS (for

the last part, refer to Page 1 of Attachment B of the Debt Collection Agreement).

According to the ERO's annual report for 2013, KEK had managed to collect 79% of the energy billed in February and 77% of energy billed in March (Table 1). Although deductions cannot be calculated directly on the grounds that consumers can pay the old bills, however, it gives us a rough indication of the level of collection. Based on the data of ERO, it roughly seems that KEDS has been granted the right to collect an amount of €24.5M as initial receivables (a €4.77M difference between billing and collection in February; a €5.07M difference in March; and the complete bill for April at the value of €14.68M). KEDS has assumed some obligations that KEK should pay for this period, however, their level and therefore the difference between the initial revenue and obligations has been impossible to be determined due to a lack of willingness by KEDS -it to meet the project team.

The transfer of the right to the private investor to collect as initial receivables the amount of over €20M after the privatisation process went in an absolute silence by all the parties involved in the process. Such lack of transparency puts into a new perspective the privatisation of KEDS. In such circumstances, the details of the transfer of the ownership has not presented properly to the citizens. Therefore, Kosovo government and parliament need to carefully analyse the issue of initial revenues and ensure transparency of the details of the difference between the initial receivables and the obligations that KEDS undertook.

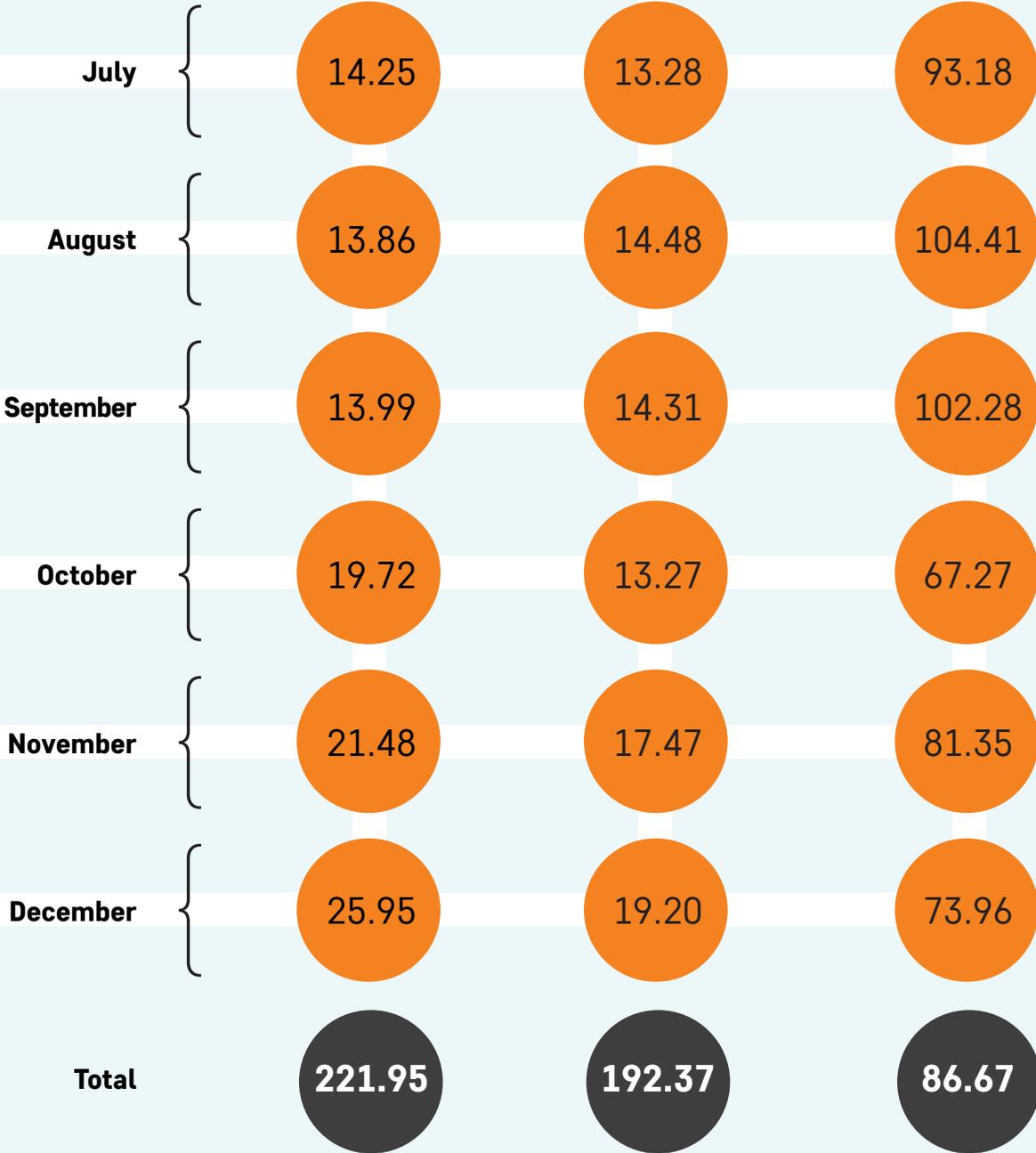
7.2 Application of law on procurement by the new private investor

Based on talks with KEK officials, representatives of private sector as well as representatives of Public Procurement Regulatory Commission (PPRC), it results that KEDS applies the commercial and independent manner when purchasing goods and services. Consequently, KEDS does not implement the law on public procurement in Kosovo when conducting its procurement activities. Although the lack of implementation

TABLE 1. THE LEVEL OF BILLING AND COLLECTION 2013

	Billing	Collection	Billing/Collection
January {	26.10	19.49	74.68
February {	23.05	18.28	79.30
March {	22.25	17.18	77.18
April {	14.68	17.23	117.3
May {	13.34	13.99	104.87
June {	13.26	14.20	107.08

Source: ERO Annual Report 2014



of the law on public procurement has not been confirmed by KEDS or ERO officials, due to their hesitation to communicate with the project team, it is however confirmed by the aforementioned sources. Moreover, the KEDS cannot be found in the list of contracting authorities on the official website of Public Procurement Regulatory Commission. All the contracting authorities that implement the law on public procurement during the conduction of their procurement activities are in this list.

Having said that, it was of a significant importance for the authors of the report to treat the legal framework which obliges KEDS, though a private sector company, to comply with public procurement law, due to its virtue of being a public provider. The question whether or not KEDS is obliged to implement the law on public procurement in Kosovo has several times been raised over the course of interviews. Moreover, according to the government officials, this matter has to be dealt with by central procurement institutions. However, in consultation with legal experts it was concluded that KEDS as a service provider is obliged to comply with the law on public procurement, as KEDS is a *public operator* engaged in *offering public service* based on the licence issued by ERO.

Under the transaction contract between Kosovo government and the private investor, point 4.9 of article 4 specifies that KEDS has the right to conducting activities of public procurement on the commercial basis and independently. The contract, however, does not presume the provisions of law on public procurement or of other laws in effect. More to the point, the KEDS transaction contract specifies that the agreement as a whole must be governed and designed fully in line with the applicable laws in Kosovo. In this context, the lack of implementation on public procurement by KEDS is a violation of legal provisions that regulate this field.

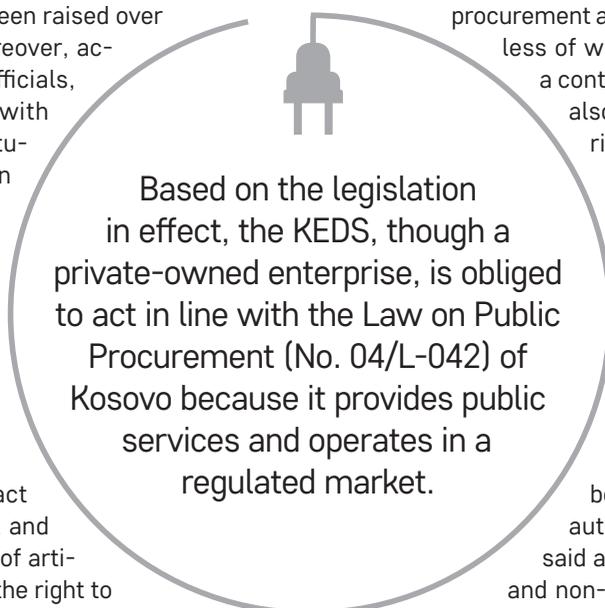
Although the lack of application of the law on public procurement might have resulted in savings during purchasing goods and services, , but this does not grant amnesty to the KEDS for not implementing this law. As indicated,

the provisions of law on public procurement should not cover the arrangement of procurement activity of enterprises that offer public services, even though that is likely only when the current legal framework is replaced by a completely new law on public procurement concerning enterprises that offer public services in line with the EU directives (2004/17/EC).

The principle of transparency and accountability is promoted through the provisions of law on public procurement. The law foresees that the process of public procurement in Kosovo, in all of its stages, should be accessible for all the stakeholders. More to the point, according to article 10, paragraph 1 of law on public procurement “a contracting authority shall maintain a well-ordered and comprehensive set of records for each procurement activity that it conducts, regardless of whether such activity results in a contract or design award”. The law also foresees and guarantees the right for all the stakeholders to have access to the specified data. Upon the request of any person, a contracting authority is obliged to provide such person prompt and reasonable access to the records described, other than confidential business information, relating to any procurement activity that has been concluded. The contracting authority is to provide the afore-said access in a routine, uneventful, and non-obstructive manner. The contracting authority may, however, provide for

the supervision of such access or take other reasonable measures to ensure that the integrity of the records is maintained. Based on article 7, paragraph 1, the law also states that a contracting authority shall treat economic operators equally and non-discriminatorily and is also obliged to act in a transparent way.

In absence of implementation of law on public procurement, it is impossible to ensure such a level of transparency and accountability. As long as the KEDS operates as a public operator in a regulated market, it is vital to ensure the implementation of such a standard of transparency that originates in the legal provisions and not to voluntary opening enterprise. For



Based on the legislation in effect, the KEDS, though a private-owned enterprise, is obliged to act in line with the Law on Public Procurement (No. 04/L-042) of Kosovo because it provides public services and operates in a regulated market.

this, it is important to have the law on public procurement implemented as a provisional means until after the same is replaced by a whole new law on public procurement regulating this field for the enterprises that provide public services in line with the European Union directive (2004/17/EC). The latter provides flexibility for the enterprises that provide public services so that they can react with more ease against the changes in market conditions, while guaranteeing competitiveness on the basis of the principle of transparency and non-discrimination. Due to the nature of services that such enterprises provide, it is of fundamental importance to apply such standards that guarantee sustainability in the sector and transparency for the wide public as the final user of regulated services. Given the current situation of non-compliance with the public procurement law, a quick response by the policy-makers should be a key priority. Moreover the lack of such a reaction thus far remains inexplicable for the authors of this report, who insist that it should be urgently treated by the Kosovo government and parliament.

