

The World Bank

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Report No: PAD1031

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED LOAN

IN THE AMOUNT OF EUR 112.1 MILLION  
(US\$ 150 MILLION EQUIVALENT)

TO THE

REPUBLIC OF ALBANIA

FOR A

POWER RECOVERY PROJECT

September 8, 2014

Energy and Extractives Global Practice  
South East Europe Country Unit  
Europe and Central Asia Region

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## CURRENCY EQUIVALENTS

(Exchange Rate Effective – December 12, 2013)

Currency Unit = Euro  
 Albanian Lek 1 = US\$0.01  
 US\$1 = Albanian Lek 103.84

## FISCAL YEAR

January 1 – December 31

## ABBREVIATIONS AND ACRONYMS

CEZ	<i>České Energetické Závody</i> (Czech Power Company)	LSMS	Living Standards Measurement Study
CEZ Sh	<i>CEZ Shperndarje</i> – Albanian Distribution Company	LV	Low Voltage
CIT	Corporate Income Tax	MoEI	Ministry of Energy and Industry
CPS	Country Partnership Strategy	MV	Medium Voltage
DFB	Department of Finance and Budget	MWh	Megawatt hours
DPO	Development Policy Operations	NPV	Net Present Value`
EBRD	European Banks for Reconstruction and Development	OSSh	<i>Operatori i Sistemit të Shpërndarjes (Distribution System Operator)</i>
EIA	Environmental Impact Assessment	OShEE	<i>Operatori i Shperndarjes se Energjise Elektrike (Power Distribution Operator)</i>
EIRR	Internal Rate of Return	OST	<i>Operatori i Sistemit të Transmetimit (Transmission System Operator)</i>
ERE	Energy Regulatory Authority	PIU	Project Implementation Unit
ESMF	Environmental and Social Management Framework	PMU	Project Management Unit
GDP	Gross Domestic Product	POM	Project Operations Manual
GOA	Government of Albania	PPAs	Power Purchase Agreements
GWh	Gigawatt hours	RPF	Resettlement Policy Framework
HPP	Hydro Power Plant	SPA	Share purchase agreement
HV	High Voltage	TPP	Thermal Power Plant
IPP	Independent Power Producer	TSO	Transmission System Operator
IFI	International Financial Insituation	TWh	Terawatt hour
KESh	<i>Korporata Elektroenergjetike Shqiptare</i> (Albanian Power Corporation)	VAT	Value Added Tax
LEGEN	Environmentally and Socially Sustainable Development and International Law Unit	WPS	Wholesale Power Supplier

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Country Director:	Ellen A. Goldstein
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REPUBLIC OF ALBANIA  
Power Recovery Project

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## PAD DATA SHEET

*Albania*

*Power Recovery Project (P144029)*

### PROJECT APPRAISAL DOCUMENT

*EUROPE AND CENTRAL ASIA*

*GEEDR*

Report No.: PAD1031

Basic Information			
Project ID: P144029	EA Category B - Partial Assessment	Team Leader Arturo S. Rivera	
Lending Instrument Investment Project Financing	Fragile and/or Capacity Constraints		
	Financial Intermediaries		
	Series of Projects		
Project Implementation Start Date 15-Aug-2014	Project Implementation End Date 30-Nov-2019		
Expected Effectiveness Date 30-Nov-2014	Expected Closing Date 30-Nov-2019		
Joint IFC No			
Practice Manager/Manager	Senior Global Practice Director	Country Director	Regional Vice President
Ranjit J. Lamech	Anita Marangoly George	Ellen A. Goldstein	Laura Tuck
Borrower: Republic of Albania			
Contact: General Directorate of Public Debt Management Telephone No.: +355 42281018		Title: Director Email: apaloka@minfin.gov.al	
Responsible Agency: Ministry of Energy and Industry			
Contact: Telephone No.:	Mr. Damian Gjikhuri +355 42227617	Title: Email:	Minister

Project Financing Data(in USD Million)							
<input checked="" type="checkbox"/> Loan	<input type="checkbox"/> Grant	<input type="checkbox"/> Guarantee					
<input type="checkbox"/> Credit	<input type="checkbox"/> IDA Grant	<input type="checkbox"/> Other					
Total Project Cost:	201.30			Total Bank Financing:	150.00		
Financing Gap:	0.00						
Financing Source				Amount			
BORROWER/RECIPIENT				51.30			
International Bank for Reconstruction and Development (IBRD)				150.00			
Total				201.30			
Expected Disbursements (in USD Million)							
Fiscal Year	2015	2016	2017	2018	2019	2020	
Annual	20.00	30.00	40.00	40.00	20.00	0.00	
Cumulative	20.00	50.00	90.00	130.00	150.00	150.00	
Proposed Development Objective(s)							
The project development objective is to improve reliability of power supply and financial viability of the power sector.							
Components							
Component Name						Cost (USD Millions)	
Short Term Complementary Power Import Support						30.00	
Upgrading Distribution Infrastructure						93.00	
Transmission Meter/Data Center Upgrade						20.00	
Supporting Power Sector Reforms and Project Implementation						7.00	
Institutional Data							
Practice Area / Cross Cutting Solution Area							
Energy & Extractives							
Cross Cutting Areas							
<input type="checkbox"/> Climate Change							
<input type="checkbox"/> Fragile, Conflict & Violence							
<input type="checkbox"/> Gender							
<input type="checkbox"/> Jobs							
<input type="checkbox"/> Public Private Partnership							
Sectors / Climate Change							
Sector (Maximum 5 and total % must equal 100)							
Major Sector	Sector			%	Adaptation Co-	Mitigation Co-	

			benefits %	benefits %
Energy & Extractives	General energy sector	100		100
Total		100		
<input type="checkbox"/> I certify that there is no Adaptation and Mitigation Climate Change Co-benefits information applicable to this project.				
<b>Themes</b>				
Theme (Maximum 5 and total % must equal 100)				
Major theme	Theme	%		
Environment and natural resources Management	Climate change	40		
Social protection and risk management	Social risk mitigation	30		
Economic management	Other economic management	30		
Total		100		
<b>Compliance</b>				
<b>Policy</b>				
Does the project depart from the CAS in content or in other significant respects?			Yes [ ]	No [ X ]
Does the project require any waivers of Bank policies?			Yes [ ]	No [ X ]
Have these been approved by Bank management?			Yes [ ]	No [ X ]
Is approval for any policy waiver sought from the Board?			Yes [ ]	No [ X ]
Does the project meet the Regional criteria for readiness for implementation?			Yes [ X ]	No [ ]
<b>Safeguard Policies Triggered by the Project</b>		<b>Yes</b>	<b>No</b>	
Environmental Assessment OP/BP 4.01		X		
Natural Habitats OP/BP 4.04			X	
Forests OP/BP 4.36			X	
Pest Management OP 4.09			X	
Physical Cultural Resources OP/BP 4.11			X	
Indigenous Peoples OP/BP 4.10			X	
Involuntary Resettlement OP/BP 4.12		X		
Safety of Dams OP/BP 4.37			X	
Projects on International Waterways OP/BP 7.50			X	
Projects in Disputed Areas OP/BP 7.60			X	
<b>Legal Covenants</b>				
<b>Name</b>	<b>Recurrent</b>	<b>Due Date</b>	<b>Frequency</b>	
Debt Service Coverage Ratio	X		Yearly	
<b>Description of Covenant</b>				

The Borrower shall take all the necessary steps to ensure:

- (i) that OST and KESh shall not incur any debt unless a reasonable forecast of the revenues and expenditures of OST and KESh shows that the estimated net revenues of OST and KESh for each fiscal year during the term of the debt to be incurred shall be at least one (1.0 ) for the first thirty six (36) months and thereafter one and six tenths (1.6) times the estimated debt service requirements of the relevant Project Implementing Entity in such year on all debt of the OST and KESh, including the debt to be incurred.
- (ii) that a reasonable forecast of OShEE's net revenues and expenditures demonstrates that the ratio of estimated net revenue to debt service requirements is as follows:
  1. within thirty-six (36) months of the Effective Date, six tenths (0.6);
  2. within the subsequent thirty-six (36) months, one (1.0); and
  3. thereafter, one and six tenths (1.6).

Name	Recurrent	Due Date	Frequency
Debt to Equity Ratio	X		Yearly

**Description of Covenant**

KESh and OST will not incur any debt if, after the incurrence of such debt, the ratio of debt to equity shall be greater than sixty (60) to forty (40);

Name	Recurrent	Due Date	Frequency
Establishment of Revenue Escrow Account with Commercial Bank at OShEE to cover payment schedule to KESh and OST.		31-Dec-2014	

**Description of Covenant**

The Borrower shall not later than **December 31, 2014**, cause OShEE to open a Revenue Escrow Account in a financial institution satisfactory to the Bank and deposit its monthly revenues to pay for the energy purchase and transmission costs in accordance with the following schedule: (i) pay 85% of the monthly energy purchase invoice to KESh and 85% of the monthly transmission fees invoice to OST for the first twelve (12) months; (ii) pay 95% of the monthly energy purchase invoice to KESh and 95% of the monthly transmission fees invoice to OST for the next subsequent twenty four (24) months; (iii) pay 100% of the monthly energy purchase invoice to KESh and 100% of the monthly transmission fees invoice to OST for the next subsequent thirty-six (36) months; and (iv) pay 105% of the monthly energy purchase invoice to KESh and 105% of the monthly transmission fees invoice to OST until such time as the revenue arrears of each Project Implementing Entity are fully amortized. The Borrower shall: ensure that any of OShEE's residual funds remaining after paying KESh and OST are transferred to OShEE on a monthly basis; and cause OShEE to subject the Revenue Escrow Account to an annual audit satisfactory to the Bank.

Name	Recurrent	Due Date	Frequency
Power Service Contracts between: KESh/ OShEE (or successor); KESh/OST; OShEE/OST		31-Oct-2014	

**Description of Covenant**

Power Service Contracts are established among KESh, OShEE, OST as per market rules, to enforce, among others: (i) daily scheduling, deviations and accounting; (ii) monthly energy balance; (iii) monthly energy and financial settlement based on methodology monitored and established by market operator, OST; and (iv) monthly payments and guarantees through commercial banks.



Name	Recurrent	Due Date	Frequency
Five year Business Plan by KESh, OST and OShEE		31-Dec-2014	Yearly
<b>Description of Covenant</b>			
The Borrower shall cause each Project Implementing Entity to prepare and submit to the Bank and the Borrower no later than December 31 of each year a five-year business plan including associated financial projections in form and substance satisfactory to the Bank.			
Name	Recurrent	Due Date	Frequency
OShEE to provide 10% of the financing for all contracts value in Component 2	X		
<b>Description of Covenant</b>			
Counterpart funds as joint co-financing of 10% to be provided from OShEE on all contracts under Component 2.			
Name	Recurrent	Due Date	Frequency
OST to provide 20% financing for all contracts in Component 3 of the project	X		
<b>Description of Covenant</b>			
Counterpart funds as joint co-financing of 20% to be provided from OST on all contracts under Component 3.			
<b>Conditions Effectiveness</b>			
Source of Fund	Name	Type	
IBRD	Effectiveness	Effectiveness	
<b>Description of Condition</b>			
<ul style="list-style-type: none"> <li>(i) The Borrower, through Ministry of Energy and Industry, has prepared and adopted a Project Operations Manual satisfactory to the Bank.</li> <li>(ii) The Borrower, through the Ministry of Energy and Industry, has: (i) established a PMU and caused the Project Implementing Entities to each establish PIUs and, (ii) and caused the Project Implementing Entities to recruit for the PIUs, staff with qualifications, experience and resources satisfactory to the Bank.</li> <li>(iii) The Subsidiary Loan Agreements have been executed on behalf of the Borrower and the Project Implementing Entities.</li> <li>(iv) The Additional Legal Matter consist of the following, namely, the Subsidiary Agreements have been duly authorized or ratified by the Borrower and each respective Project Implementing Entity and each Subsidiary Agreement is legally binding upon the Borrower and each respective Project Implementing Entity in accordance with its terms.</li> <li>(v) Power Sector Financial Recovery Plan The Borrower shall no later than <b>October 30, 2014</b> submit to the Bank a Power Sector Financial Recovery Plan satisfactory to the Bank on sector's financial and operational performance and based on it an action plan, including but not limited to sources of funding for: (a) power imports not financed by the Project; (b) retail power subsidies; (c) payments made to private power producers; and, (d) projected financial deficits for the power sector.</li> </ul>			
<b>Team Composition</b>			

<b>Bank Staff</b>			
<b>Name</b>	<b>Title</b>	<b>Specialization</b>	<b>Unit</b>
Esra Arikan	Environmental Specialist	Safeguards	GENDR
Rhedon Begolli	E T Consultant	Energy	GEEDR
Gazmend Daci	Energy Specialist	Energy	GEEDR
Elda Hafizi	Program Assistant	Operations Support	ECCAL
Bekim Imeri	Social Scientist	Safeguards	GURDR
Jose C. Janeiro	Senior Finance Officer	Disbursement	CTRLA
Maiada Mahmoud Abdel Fattah Kassem	Finance Officer	Disbursement	CTRLA
Dung Kim Le	Program Assistant	Operations Support	GEEDR
Arben Maho	Procurement Specialist	Procurement	GGODR
Jasna Mestnik	Finance Officer	Disbursement	CTRLA
Jonida Myftiu	Financial Management Specialist	Financial Management	GGODR
Arturo S. Rivera	Lead Energy Specialist	Energy	GEEDR
Nightingale Rukuba-Ngaiza	Senior Counsel	Legal	LEGLE
Rozena Serrano	Program Assistant	Operations Support	GEEDR
<b>Non Bank Staff</b>			
<b>Name</b>	<b>Title</b>	<b>Office Phone</b>	<b>City</b>
Charles Husband	Consultant/Financial Specialist		
Surekha Jaddoo	Consultant/Operations Officer		

## **I. STRATEGIC CONTEXT**

### **A. Country Context**

1. Albania has made significant progress in poverty reduction. The country was propelled from being one of the poorest countries in Europe in the 1990s to middle income status in 2008. Between 2002 and 2008 alone, Albania's poverty was halved, falling from 25.4 percent in 2002 to 12.8 percent in 2008. Since 2008 poverty has, however, been on the rise. Results from the 2012 Living Standards Measurement Study (LSMS) data show an increase in poverty to 14.3 percent (28,900 people). Extreme poverty decreased from about 5 percent in 2002 to 1.2 percent in 2008, but increased to 2.2 percent in 2012. Similarly, shared prosperity - consumption growth of the bottom 40 percent - improved between 2005 and 2008 but has deteriorated between 2008 and 2012 with consumption declining for all economic groups (1.3%), including those at the bottom 40 percent.

2. The global financial crisis in 2008 and the subsequent Eurozone crisis led to a significant slow-down in Albania's growth. In the years preceding the global crisis, 2005-08, the economy grew at an average annual rate of 6.2 percent enabling an increase in household expenditures of the bottom 40 percent by 2.6 percent per year. Albania was able to avoid a recession but GDP growth slowed to less than 3 percent on average between 2009 and 2012 as exports, remittances and inflows suffered, in particular from Albania's close ties to the Greek and Italian economies.

3. Albania's fiscal deficit widened significantly in 2013 to 6.2 percent. Its fiscal deficit averaged 3.4 percent between 2005 and 2012, except in 2008 and 2009, when it deteriorated sharply. Fiscal pressures rose further during the energy shortage in 2012 as the government provided support to the power generation company KESh in the form of guarantees for power imports.

4. The government accumulated significant budgetary arrears. In addition to arrears related to public works, there were budgetary arrears related to health (mostly drugs), education, water, VAT refunds, corporate income tax (CIT) repayments, electricity bills and social benefits. The stock of payment arrears was estimated at about Lek 72.5 billion (USD \$710 million) or 5.3 percent of GDP. To address these issues, the World Bank prepared a Fiscal Development Policy Operations to: (i) strengthen public financial management and arrears clearance; and (ii) improve fiscal sustainability through tax, pension and energy sector reform.

5. The power sector poses significant fiscal risks and requires serious reforms. Recurrent power shortages due to fluctuations in rainfall in a power system depending exclusively on hydro generation, coupled with persistently high distribution losses (about 43 percent in 2013), low collection rates and regulated tariffs below energy costs, have resulted in sustained fiscal support from government over the last decade, in the form of guarantees and liquidity injections, to the power generation company KESh. Today, the commercial overdraft of KESh is about US\$ 340 million (about 2.5 percent of GDP). The private distribution company, previously under interim administration, CEZ Shperndarje (now called OSHEE) faces an unfunded deficit of over US\$ 550 million which, in the absence of an aggressive loss reduction program would reach about US\$ 800 million by 2018.

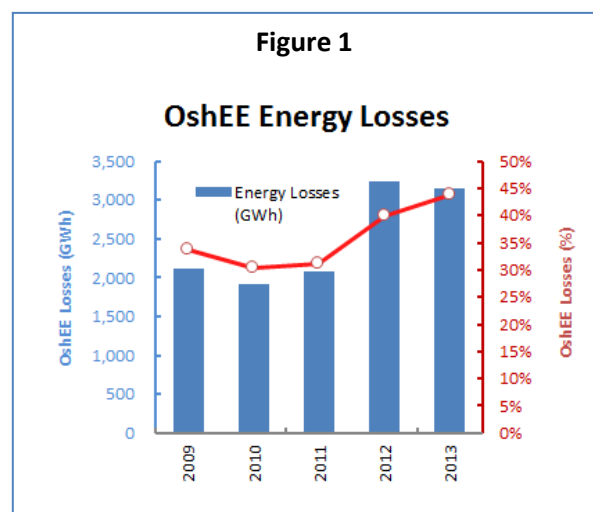
## B. Sectorial and Institutional Context

6. Albania's power sector is operated by the Albania Power Corporation, KESh (generation), Transmission System Operator, OST (transmission) and OShEE (distribution). The sector is regulated by the Energy Regulatory Authority (ERE). Both KESh and OST are publicly owned while 76 percent of OShEE was owned by a Czech public company, CEZ a.s. until June 2014, when it returned the ownership to the Government as part of a settlement agreement. In August 2004, all non-household customers were granted the right to become eligible consumers and choose their own suppliers. Albania has six high voltage (HV) eligible customers with annual consumption of 600 GWh per year (14 percent of all electricity sales), thus removing KESh from the obligation of supplying them under a regulated tariff.

7. KESh is responsible for the overall power supply of the regulated market in Albania. KESh operates as a power generation company, as well as a Wholesale Public Supplier (WPS). KESh/WPS buys the electricity produced by KESh Gen at a regulated price, as well as electricity produced by Independent Power Producers (IPPs) to serve tariff customers (MV and LV commercial customers and households), at a higher price agreed in Power Purchase Agreements (PPAs). KESh Gen may sell any electricity not taken by the WPS in the open market. According to the Energy Law, KESh/WPS is also the "supplier of the last resort", thus, WPS has to buy additional electricity on the market to meet the demand of regulated customers. After it purchases all the power generated by KESh Gen, KESh/WPS is obligated to purchase all the power from IPPs before purchasing imports of electricity to meet the needs of tariff customers in the regulated market.

8. In 2009 the distribution company was privatized in order to secure investment, improve operational efficiency, reduce power losses, and improve revenue collections. With support from government it was envisaged that this would overcome mounting losses and lead to lower, more affordable and competitive retail power tariffs over the medium-term. From the outset, however, challenges began to emerge between the new owners and government regarding bad debt provisions, the rate of loss reduction and annual tariff filings. The distribution license was revoked by the Albanian Energy Regulatory Authority (ERE) in 2013 when the distribution company failed to meet the conditions of its license. Given its integrated nature, this failure cascaded throughout the sector.

9. *An Unfinished Distribution System Reform.* The sector started to deteriorate when the privatization of the distribution company did not play out as anticipated. The expectation was that OShEE was going to reduce losses to 17 % by 2014 and invest around \$150 million over five years in the distribution system. The new management of the company did not succeed in reducing distribution losses or completing the necessary investments as planned. Agreements on the baseline for the level of losses and bad debts were completed later than originally expected, while the Energy Regulator did not adjust the retail tariffs in a timely manner. In addition, bill collections from budgetary and non-budgetary institutions did not improve and the distribution company, managed by CEZ Sh, was

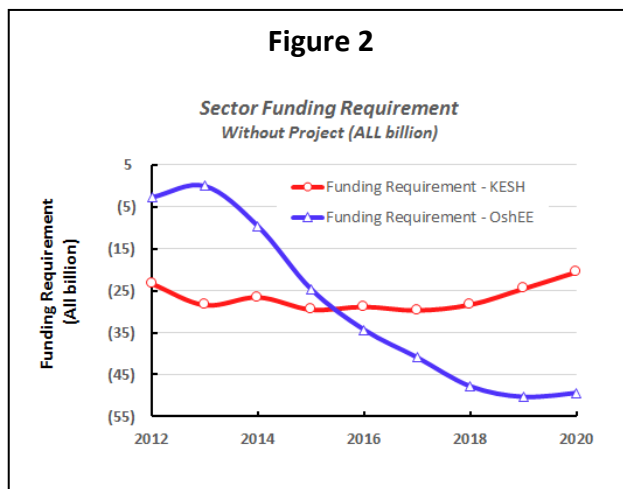


unable to effectively reduce technical and non-technical losses.

10. Power losses increased from 33.7 in 2009 to 51.1 percent by the end of 2012, while cash collection decreased from 85 percent in 2008 to 73 percent in 2011 and down further to 64 percent in 2012. The distribution company is required under the Regulatory Statement to compensate for technical losses and theft of power by importing power as required by the privatization Share Purchase Agreement. Hence, in the fall of 2012, CEZ Sh had exhausted its resources and stopped electricity imports to cover its net losses, while KESh, as the supplier of last resort, used its hydro reservoirs to cover demand and ensure security of supply. On January 21, 2013, ERE revoked CEZ Sh’s license due to noncompliance of its obligations under the license and appointed a temporary state administrator to run the distribution system. By taking over the management of the distribution company, ERE also assumed responsibility—and inherently the fiscal risk—for the power imports necessary to compensate for energy losses and rising consumer demand. In May 2013, CEZ a.s. initiated international investment arbitration against the Government of Albania seeking compensation for damages incurred due to its non-protected investment in the power distribution company.

11. After a suspension of actions in 2013 due to general elections, the Government resumed discussions with CEZ a.s. in January 2014. On June 23<sup>rd</sup>, 2014, GoA and CEZ a.s. agreed to terminate arbitration proceedings and entered into an amicable agreement. As a result of this settlement CEZ a.s. has returned the complete ownership of the distribution company back to GoA. The government announced its commitment to reduce the high level of losses and improve collection. Thus, the Government requested World Bank support to develop an investment project that will improve the performance of the distribution company, reduce inter-company arrears, and turn the sector around. With the support of its partners, the Government managed to achieve a settlement agreement with CEZ a.s., which has opened the way for investments in OSHeE (formerly CEZ Sh) to turn around the company towards improved performance.

12. *Inadequate Power Market Reforms and Weak Corporate Governance.* The power sector has also suffered from incomplete reforms and weak governance. Resolution of the sector’s issues has also been thwarted by: i) weak enforcement of market rules; ii) lack of payment discipline; iii) poor collection rates; iv) inadequate cost reflective tariff levels and fragile independence of the regulator; and v) periodic impasses in decision making due to elections. Given these conditions, the sector has been continually run in emergency mode, and unable to transition to sustainable operations. To address this issue, the government is in the process of updating its power market model, including: (i) enforcing bilateral contracts and payments among KESH, OST, OSHeE (formerly CEZ Sh) and IPPs according to market rules; (ii) preparation of a new tariff methodology for regulated consumers; (iii) gradual opening of the power market for medium voltage (MV) commercial customers; and (iv) moving towards a more competitive and sustainable renewable energy market, in line with trends in the European Union and the rest of the world.



13. *Leading to a Financial Crisis.* The combination of poor performance by the distribution company and weak sector reforms have led to a major financial crisis: a projected combined deficit of about US\$ 550 million in 2015, growing to over US\$ 800 million in 2018. OShEE (formerly CEZ Sh) is insolvent and the entire sector has been negatively impacted and continues to sustain high energy losses and poor collections; KESh and OST, while solvent, in part due to a revaluation of the assets, remain highly illiquid due to the lack of consistent payments by OShEE. The Government is taking steps to put in place a comprehensive program divided in short and medium term measures, as outlined above, to develop a power market operated on commercial principles. This proposed project is an element of that program.

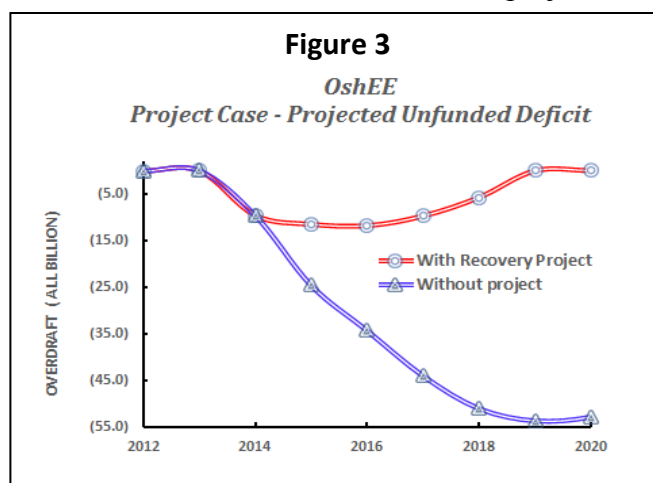
14. *Vulnerability to Climatic Volatility.* Albania’s struggle to secure reliable power supplies is also affected by volatile regional and climatic dimensions, and the interplay between them. Albania’s power supply challenge is further affected by the region’s constrained transmission capacity and the tight supply for trade from neighboring countries. In 2002, 2008 and 2011, severe drought not only diminished domestic generation, but also that of its neighbors, thus decreasing the availability of power imports and effectively pushing the country to the brink of a possible emergency and load shedding.

15. To address this recurrent issue in a more systematic way, the Bank and GoA have agreed to: a) carry out analytical work to lay out a robust and sustainable “Risk Management Strategy” to manage weather volatility and its impact in the power sector; and b) in the interim, and as a first step, the project will support up to US\$ 30 million facility to cover gaps in KESh’s obligations to supply the regulated market due to lower than expected rainfall and/or maintenance of water levels at KESh’s HPPs on the Drin Cascade over the life of the project.

16. *The Way forward and Expected Results.* The project will support the implementation of Government's Power Sector Recovery Plan, which is anchored around four main components comprising: i) enhancing security of supply through diversification of generation sources and strengthening regional integration; ii) improving system efficiency in the distribution sector by reducing losses and improving cash collection; iii) supporting improvements of the electricity market under commercial basis; and iv) introducing power reforms in the power sector to create a competitive market that will attract private investment while reducing fiscal risks for the government.

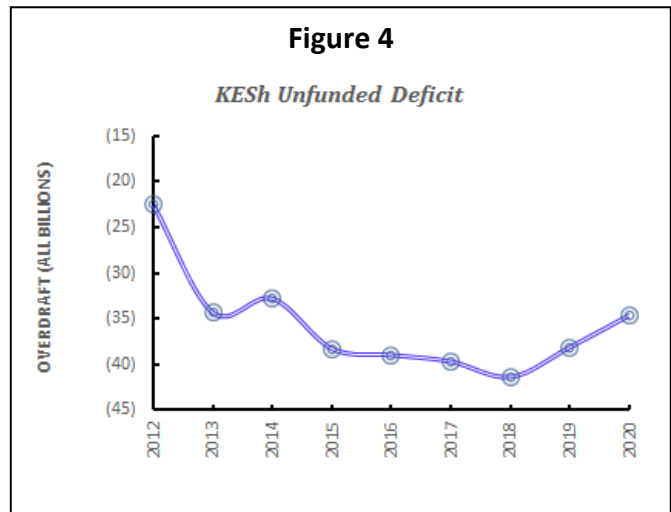
17. The financial results expected for each of the beneficiaries under the project are summarized in Annex 6 (ci)-(ciii). These projections show that with focused investment, cost reflective tariffs and good management, the sector’s decline can be halted and the companies returned to health within reasonable period of time. Based on realistic assumptions these projections suggest that:

- Distribution. Even with an adjustment in tariff of 15-20 percent to reflect more fully the prevailing cost structure, it will take OShEE a long



time to recover. The project investment is only a first but important step in its recovery. The company can become profitable by 2016, but will still require an additional cash infusion of US\$ 112 million over the period 2014-2019, from IFIs or Government, to further lower losses, reduce arrears and import energy to compensate for technical and non-technical losses as indicated in Fig. 3 above. It will be seen, ceteris paribus, that OShEE will be able to repay this gap over the next five years while extending its arrears to KESH and OST, who will bear the financing burden before beginning to liquidate its short-term liabilities by 2018 (Fig. 4).

- **Transmission.** Despite remaining profitable throughout the collapse of OShEE (formerly CEZ Sh.), OST has also been impacted by mounting arrears from the distribution company. It is, however, better placed than KESH to adapt to the situation by curtailing investments. However, if ignored, this will begin to affect the transmission network, create bottlenecks in the system and delay the benefits of regional integration.
- **Generation.** After a proposed increase in wholesale prices in 2015, KESH will be able to reestablish and maintain profitability thereafter. Liquidity remains a challenge with overdraft facilities reaching just under US\$ 350 million by end 2013 as shown in Fig. 4. Mandatory minimum payments by OShEE to liquidate its arrears to KESH and as its position improves will enable KESH to reduce its short-term liabilities at a reasonable pace from 2018 as also indicated in Fig. 4. Despite this, KESH and its future outlook remain highly vulnerable to extreme climatic conditions. There is, as mentioned earlier, an urgent need to put in place an appropriate risk management mechanism to place a floor under the impact of below average rain fall patterns to protect the viability of the company and its fragile recovery.



18. The proposed project focuses on urgent areas and priority sector reforms, and is complemented by the DPL series and the process of clearance of arrears under the IMF program. Further, it is planned that a second Sector project will be needed in FY 16 to complete the financial restructuring of the sector, further reduce power losses at reasonable levels and anchor the sector reforms to a greater extent. The World Bank is uniquely placed to coordinate the international community and mobilize the resources needed to turn the sector around within a reasonable period of time and place it on a more sustainable footing to ensure security of supply.

### C. Higher Level Objectives to which the Project Contributes

19. As highlighted in the CPS, the unreliability and poor quality of electricity supply has regularly been cited by Albanian firms of all sizes as being among the most critical constraints they face. The proposed operation would directly address this issue, and support both the 2010 CPS and the 2012 progress report recognizing the energy sector as one of the pillars of the joint GoA/WB group strategy.

## **II. PROJECT DEVELOPMENT OBJECTIVES**

### **A. PDO**

20. The project development objective is to improve reliability of power supply and financial viability of the power sector.

### **B. Project Beneficiaries**

21. Expected beneficiaries of the project would include:

- Ministry of Energy and Industry (MoEI): The proposed project will support the Ministry's efforts to improve its monitoring capacity and strengthen its capacity to lead the recovery program in the sector.
- Ministry of Finance (MOF): As a result of gradual and predictable reduction of government guarantees to cover power imports for losses.
- Distribution Company OShEE: The key beneficiary of the project will be the Distribution Company, which will benefit from the reduction of losses and improved billing and collection rates.
- KESh: Albania's main generation company KESh will benefit from an improved financial sustainability and capacity to supply at least the regulated market.
- OST: OST will benefit from the enhancement of the installation of new meters to facilitate the market restructuring that would require medium voltage consumers to be removed from the regulated consumer group.
- Electricity customers: As a result of improvements in the supply and distribution efficiency, electricity customers in Albania will benefit from improved service quality and reliability.

### **C. PDO Level Results Indicators**

22. Key PDO level indicators will include:

- (i) Total electricity losses per year in the project area
- (ii) Collection rate of distribution company
- (iii) Reliability of MV level at Tirana area
- (iv) KESh/OST arrears in number of days sales equivalent.



### III. PROJECT DESCRIPTION

#### A. Project Components

23. This proposed project consists of four components: i) short-term complementary power import support; ii) upgrading distribution infrastructure, iii) transmission meter/data center upgrade; and iv) supporting power sector reforms and project implementation.

#### **Component 1 – Short Term Complementary Power Import Support (IBRD - US\$30.0 million)**

24. This component will: support KESh/WPS with up to US\$ 30 million to purchase short term complementary power imports to meet KESh/WPS' power supply obligations.

25. The main outcome of this support would be: in the short term, to secure adequate reservoir levels at the Drin cascade over the period of the project. In the medium-term, this component will be complemented by analytical work under component 4 to develop a robust risk management strategy to mitigate weather related volatility.

#### **Component 2 – Upgrading Distribution Infrastructure (IBRD - US\$93.0 million)**

26. This component will support GoA's and Distribution Company's plan to reduce distribution losses, improve cash collection and reliability of power supply. The distribution company has finalized a study, conducted by international consultants, assessing the areas of high losses and low collections. The report also includes a proposed action plan to reduce losses over the next six years. The investments are estimated at \$35 million for each year or about \$275 million over the next six years (2015-2020). This project component will focus on those priority investments during the first 4 years.

27. The investments will be focused on: i) supply and installation of transformers and ancillary equipment at selected substations in Tirana; ii) providing targeted investments in the medium voltage grid including cable line; concrete poles, metal clad switchgears, power distribution cabins and associated metering equipment; iii) supplying and installing power meters to cater for customers who have no or damaged meters; and iv) upgrading the billing and collection system to implement OShEE's Performance Management Program, including among others, loss reduction and collection increase.

28. Four proposed subcomponents will include:

- a) *Upgrading the sub-transmission distribution system*: Investments in the sub-transmission level are required to upgrade system reliability in Tirana area by reinforcing two existing 35/MV substations (SSs) to 110/MV SSs with new 110 kV lines.
- b) *Targeted investments in the medium voltage grid (6-20kV)*: The proposed investment will include MV cable lines, LV ABC lines, LV concentric cable and concrete poles, MV metal clad switchgears, and MV/LV distribution cabins with associated LV metering facilities.

- c) *Metering systems in the LV network*: Recent OShEE's reports show that approximately 250,000 customers have damaged meters or do not have meters at all. Under this subcomponent the project will provide financing for the purchase and installation of: (i) approximately 230,000 single and three-phase meters; (ii) low voltage coaxial cables; (iii) ABC cables and accessories; and (iv) three-phase regular conductor cables.
- d) *Upgrading billing and collection system*: upgrading the billing and collection system and providing any necessary training for its implementation.

### **Component 3 – Transmission Meter/Data Center Upgrade (IBRD - US\$20.0 million)**

29. In 2011, GoA moved high voltage industrial customers to the deregulated market, which effectively reduced GoA's obligations, through KESh/WPS, to provide guarantees of about US\$ 50 million per year to KESh/WPS. This modification put Albania at the forefront of market reforms required by EU directives. The next step in the market reform is to open the market for medium voltage commercial customers, which will further reduce the public obligation to guarantee supply for regulated tariff customers. In order to facilitate this process, the project will support OST to: i) providing power meters and upgrading a data center; and, ii) supplying and installing an IT system for the data center and providing technical assistance for developing procedures for the establishment of a market platform for independent power producers and some eligible customers, among others.

30. Two subcomponents will include:

- a) *OST investments in meters for MV customers, MV feeders, IPPs and data center*: The project will finance power meters and upgrade a data center at OST.
- b) *IT systems and rules*: Under this subcomponent, the project will finance supplying and installing an IT system for the data center and providing technical assistance for developing procedures for the establishment of a market platform for IPP's and eligible customers, among others.

### **Component 4 – Supporting Power Sector Reforms and Project Implementation (IBRD - US\$7.0 million)**

31. This component will support priority power sector reforms to facilitate the recovery of the power sector and improve the performance of the distribution company through provision of management and technical advisory services.

32. Four subcomponents will include :

- a) *Priority power sector reforms*: Sector reform areas will include: i) revising the power market model to introduce more competition in the sector and reduce the Borrower's power supply obligation as per the relevant EU directives; ii) revising the renewable energy law to ensure sustainability of independent power producers; iii) introducing a new cost-recovery tariff methodology to reflect updates in the power market model; iv) updating the Borrower's current energy strategy; and (v) designing implementation and monitoring of social outreach programs targeting electricity consumers and key stakeholders.

b) *Project implementation support*: This subcomponent will support the establishment of a Project Management Unit, within the MoEI through recruitment of relevant staff and provision of goods, Operating Costs and technical advisory services.

c) *Management advisory services*: Recruiting specialized advisory services to support the implementation and monitoring of OShEE’s Performance Management Program, including among others, loss reduction and collections increase, for the period of the project.

d) *Risk management mechanism for weather volatility*: This subcomponent will support the carrying out of a risk management study to mitigate the impact of weather volatility in the power sector.

## B. Project Financing

33. The project will be financed by a US\$150 million IBRD loan extended to the Republic of Albania. The Ministry of Finance will on-lend the funds to the respective public enterprises OShEE, KESh and OST.

**Table 1: Project Cost and Financing, including contingencies and duties (US\$ million)**

	The Project			Source of Funding				Total	VAT
	Foreign Costs	Local Costs	Total Costs	IBRD	Counterpart				
				Project Contracts		Works /Instal	Duties		
	US\$ million	US\$ million	US\$ million	US\$ million	US\$ million	US\$ million	US\$ million		
Component 1 (Supply - Import)	30.0	0.0	30.0	30.0	0.0	0.0	0.0	30.0	6.0
Component 2 (Distribution)	103.30	35.0	138.3	93.0	10.3	30.0	5.0	138.3	27.7
Component 3 (Transmission)	25.0	1.0	26.0	20.0	5.0	0.0	1.0	26.0	5.2
Component 4 (Sector Reform)	7.0	0.0	7.0	6.625	0.0	0.0	0.0	6.625	1.3
Front-end Fee				0.375	0.0	0.0	0.0	0.375	0.0
<b>TOTAL</b>	<b>165.3</b>	<b>36.0</b>	<b>201.3</b>	<b>150.0</b>	<b>15.3</b>	<b>30.0</b>	<b>6.0</b>	<b>201.3</b>	<b>40.2</b>

## C. Lessons Learned and Reflected in the Project Design

34. The Project draws extensively upon the lessons learned from similar World Bank engagements worldwide and in Albania. A number of projects, and regional experiences, have been considered to identify the key lessons learned relevant to this operation, including: i) Dominican Republic Electricity Rehabilitation Distribution Project, ii) Power Loss Reduction Project, Power Transmission and Distribution project, Power Sector Rehabilitation Project in

Albania; and iii) Distribution Privatization project in Albania.

35. The following key lessons have been reflected in the project design; (i) the need for upfront political commitment, and will, in enforcing payment discipline and penalization, under the existing judicial framework, of electricity theft; (ii) complementing project design and monitoring around higher policy actions through the DPL series, focusing on structural changes in the sector; (ii) designing implementation and monitoring of social outreach programs targeting electricity consumers and key stakeholders; (iii) coordination with inter-ministerial task forces responsible for supporting the loss reduction program and ongoing IFIs/donor support programs; and (iv) strong analytical diagnosis underpinning the operation. Still, heavy upfront implementation preparation and supervision of this operation will be required, together with periodic interaction with donors and IFIs involved in the sector.

## **IV. IMPLEMENTATION**

### **A. Institutional and Implementation Arrangements**

36. The project implementation arrangements are designed to have a proper oversight and accountability by a Project Management Unit, established in the MoEI, with three technical PIUs, in each of the power utilities, responsible for delivering the first three components. Additional details on the project implementation arrangements and procedures are provided in Annex 3.

37. The PMU in the MoEI will have the responsibility for overall project coordination of implementation progress. Day-to-day project implementation for the first three components will be conducted by PIUs established in the three power utilities KESh, OShEE and OST, while the PMU (MoEI) will implement component 4. Core staff of the PMU will be appointed based on terms of references approved by the Bank. Throughout the implementation of the project, the PMU will also draw on relevant experts of the Ministry, power utilities and international specialists as needed.

38. The project will be overseen by MoEI, through the Project Management Unit, which will be established by the order of the MoEI, and will be managed by a Project Coordinator hired by the MoEI. The PMU has overall oversight for project, including the following additional responsibilities: i) preparing the Project Operations Manual, together with PIUs, to be approved by the Minister of Energy and Industry, and satisfactory to the Bank ii) assisting PIUs in developing bidding documents, iii) assisting the Borrower, through the MoEI, in the establishment of Bid Evaluation Committees, comprising of staff from PMU and PIUs, as appropriate, according to the Project Operations Manual iv) supporting coordination in the design and monitoring of social outreach programs; (v) carrying out implementation oversight including supervision, as appropriate, and providing periodic monitoring of project implementation and evaluation of the project.

### **B. Results Monitoring and Evaluation**

39. The PMU will be responsible for results monitoring and evaluation (M&E) activities, including the submission of semi-annual implementation progress reports to the World Bank. A simple management information system for M&E will be developed by the PMU to measure progress towards achievement of the PDOs. The key results indicators are specified in Annex 1.

40. For most of the indicators, the PMU will have to create a system for measuring, evaluating and reporting technical and commercial indicators. In addition, each PIU in every of the three power utilities will use its own existing company systems for the indicators. More detailed information on M&E is provided in Annex 3.

41. Overall, technical experts in the PMU will have capacity to collect and process data required for the M&E system. In addition, the World Bank team will supervise implementation progress at least twice a year, including results indicators defined in Annex 1 as well as additional financial management and procurement aspects of project implementation. A comprehensive evaluation of project results will be conducted during the project’s mid-term review and at completion.

### C. Sustainability

42. GoA is committed to resolve these pressing issues in the sector, but it has also stated its commitment to structural reforms to enable a sustainable power sector. All components, excluding power imports provide vital power sector reform initiatives that will improve the reliability of the sector and reduce government’s fiscal liabilities.

43. Further expansion of a competitive and open market combined with improvements in market operations will significantly reduce the risks of increased losses in the system. Improvements in the market operations will be achieved through the adoption of necessary power sector legislation, market rules and procedures, standard contracts and PPAs.

## V. KEY RISKS AND MITIGATION MEASURES

### A. Risk Ratings Summary Table 2

<b>Risk Category</b>	<b>Rating</b>
<b>Stakeholder Risk</b>	High
<b>Implementing Agency Risk</b>	
– Capacity	High
– Governance	Substantial
<b>Project Risk</b>	
– Design	High
– Social and Environmental	Moderate
– Program and Donor	Low
– Delivery Monitoring and Sustainability	Moderate
<b>Overall Implementation Risk</b>	High

### B. Overall Risk Rating Explanation

44. Overall preparation risk is rated "*High*" as the key risks relate to the uncertain legal situation of CEZ Sh (now renamed to OShEE), substantial staff turnaround, especially at the

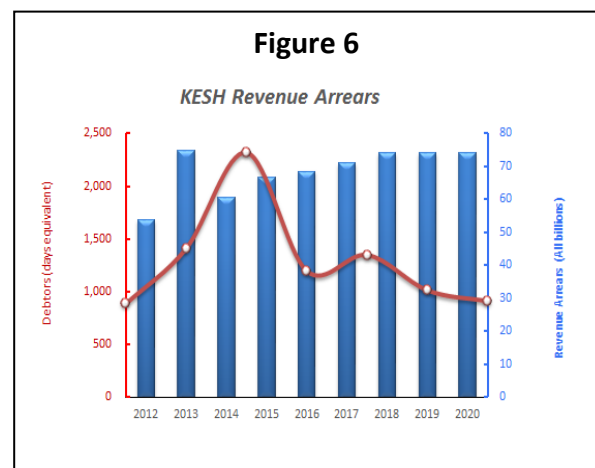
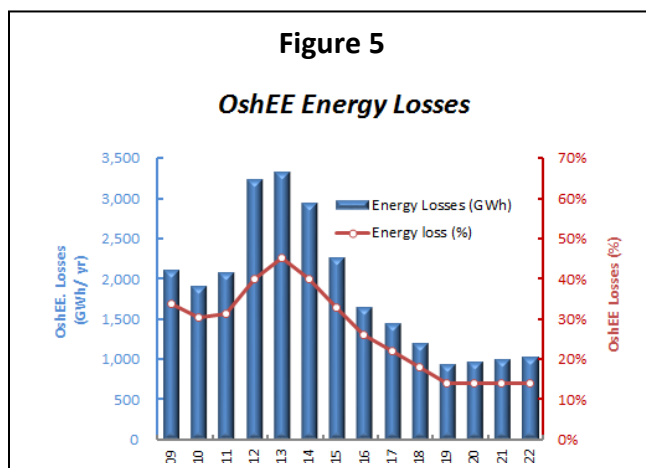
management level, number of project beneficiaries under one operation, and lack of detailed design documentation. The risk is further amplified by a tight schedule to deliver a highly complex project under an uncertain legal and financial situation created by the rapid deterioration in the sector over the last four years. The option of inaction, however, is not viable for the sector and the economy as the sector suffers monthly losses of about euro 10-15 million and piles up additional arrears.

45. While the legal dispute with CEZ a.s. has been resolved and the risk is partially mitigated, however significant financial risk remains. This risk will be mitigated through the strong analytical background underpinning this operation, the close cooperation with the Ministry of Energy and Industry, which has established an inter-Ministerial task force to ensure proper implementation of the power sector recovery and reform program and a close coordination with other partners, IFIs and donors, confirmed at the April 8, 2014, donors’ meeting. Overall implementation risk is rated "High" due to significant risks associated with the need for tariff adjustments, penalization of electricity theft, and gradual opening of the power market. The government is committed to enforce payment discipline among budgetary and non-budgetary institutions, and to address the necessary community and stakeholder outreach.

## VI. APPRAISAL SUMMARY

### A. Economic and Financial Analysis

46. *Financial Status of the sector:* The cash flows of the sector have in the past been volatile and generally inadequate, leading to accumulation of intercompany arrears and depletion of OShEE’s resources and asset base. Going forward, however, and provided a competent management team with adequate technical support and experience in turnaround of distribution companies is in place at the distribution company, its cash flows and inter-company arrears should improve, as shown in the Figs. 5 and 6 below, due to reduced losses, increased billed sales and better revenue collections. In turn this should improve the financial viability of all companies in the sector, including profitability, liquidity and solvency as summarized in the financial projections set out in Annex 6(c) - (ciii).



47. *Economic analysis:* The energy sector is highly inter-dependent, and any change in the system cascades quickly from one company to the next. Accordingly, the project analysis is based on the consolidated results of the sector and total project investment. The economic benefits of the

project have been limited to significant quantifiable benefits that include the reduction of technical losses, savings of reduced consumption due to reduction of non-technical losses and reduction of energy not served due to poor reliability of power supply. Consequently the resulting economic net present value (NPV) and the economic internal rate of return (EIRR) should be seen a lower bound relative to the actual economic benefits derived from the project. The economic valuation of the project adjusted for taxes, interest and other transfers, is set out in detail in Annex 6 (b) and summarized in Table 10 below. The economic analysis, based only on technical losses, avoided costs due to reduced consumption and improved reliability of supply, yields an economic NPV of US\$ 15.7 million and EIRR of 12.1 percent.

48. The main quantifiable economic benefits of the project include the annual reduction of technical losses, reduction of energy not served due to improved reliability of power supply, and savings of reduced consumption due to reduction of non-technical losses. The economic costs of the project include aggregate investment costs, and incremental operation and maintenance (O&M) costs associated with the investments.

49. The key parameters, which may significantly affect the economic viability of the project, are the estimated reduction in technical losses and the investment costs. To assess the degree to which the project is sensitive to changes in these key parameters, the switching value of each was determined (see below).

50. *Financial Analysis:* Project returns based on incremental cash flows derived from the financial projections and are set out in detail at the end of this annex and summarized in the table below. Based on conservative assumptions, the analysis demonstrates that the project is robust and show net present value at an 8% rate of discount of US\$67.2 million and financial rate of return of 19.6 percent.

**Table 3: Incremental Financial and Economic Project Returns**

	<b>Economic Evaluation</b>	<b>Financial Evaluation</b>
Net Present Value <sup>1</sup>	US \$15.7 million	US \$67.2 million
FIRR	12.1%	19.6%

<sup>1</sup> Discounted at the social discount rate of 8%

51. The main financial benefits of the project for sector are the savings from lower power purchase costs as a result of loss reduction and additional sales from the portion of non-technical losses that will be converted to additional billing. The main financial costs of the project are the capital investment costs and incremental O&M costs, inclusive of Income Tax, and VAT.

52. *Sensitivity Analysis - Switching Values.* Switching values represent the percentage change in the respective variables required to reduce the economic internal rate of return of the projects to the minimum required rate of return of 8%. From this analysis set out in the table below, it is apparent that the project and its components are financially robust over a wide range of assumptions. The project is economically justified but susceptible to small changes in the key variables, which is not unusual for projects of this kind.

**Table 4: Switching Values**

	Switching Values (%)	
	Economic	Financial
Energy Losses	n/a	-25
Capital expenditure	12	34
O&M	60	296
System Reliability	-34	n/a
Cost of Standby Generation	-22	n/a

53. *Proposed Financial Covenants.* Covenants to ensure prudent financial structures, creditworthiness, sector liquidity and market operation on commercial basis will include:

- (a) *Debt Equity Ratio.* KESh and OST will not incur any debt if, after the incurrence of such debt, the ratio of debt to equity shall be greater than sixty (60) to forty (40).;
- (b) *Debt Service Coverage.* The Borrower shall take all the necessary steps to ensure that OST and KESh shall not incur any debt unless a reasonable forecast of the revenues and expenditures of OST and KESh shows that the estimated net revenues of OST and KESh for each fiscal year during the term of the debt to be incurred shall be at least one (1.0 ) for the first thirty six (36) months and thereafter one and six tenths (1.6) times the estimated debt service requirements of the relevant Project Implementing Entity in such year on all debt of the OST and KESh, including the debt to be incurred.
- (c) that a reasonable forecast of OShEE’s net revenues and expenditures demonstrates that the ratio of estimated net revenue to debt service requirements is as follows:
  - i. within thirty-six (36) months of the Effective Date, six tenths (0.6);
  - ii. within the subsequent thirty-six (36) months, one (1.0); and
  - iii. thereafter, one and six tenths (1.6).

54. Given the scope of additional funds required by the distribution it is important to ensure an adequate Flow of Funds throughout the energy sector. Therefore the Borrower shall not later than December 31, 2014, cause OShEE to open a Revenue Escrow Account in a financial institution/s satisfactory to the Bank and deposit its monthly revenues to pay for the energy purchase and transmission costs in accordance with the following schedule:

- i. 85% of the monthly energy purchase invoice from KESh and 85% of the monthly transmission fees invoice from OST for each of the first twelve (12) months;
- ii. 95% of the monthly energy purchase invoice from KESh and 95% of the monthly transmission fees invoice from OST for each of the subsequent twenty four (24) months;
- iii. 100% of the monthly energy purchase invoice from KESh and 100% of the monthly transmission fees invoice from OST for each of the next subsequent thirty-six (36) months;
- iv. 105% of the monthly energy purchase invoice from KESh and 105% of the monthly transmission fees invoice from OST until such time as the revenue arrears of each Project Implementing Entity are fully amortize and ;



- v. Transfer any residual funds remaining after paying KESh and OST to OShEE on a monthly basis.

55. The OShEE revenue escrow account will be subjected to an annual audit and submitted to the Bank for review.

56. Each of the companies will be required to produce five year business plans and financial projections on an annual basis for submission to the Bank for review. As is usual for revenue producing entities, annual financial audits will also be required.

57. In order to consolidate the sector's finances, monitor performance and ensure proper financing of the sector, the Government will be required to formulate a Power Sector Financial Recovery Plan satisfactory to the Bank on sector's financial and operational performance and based on it an action plan, including but not limited to sources of funding for: (a) power imports not financed by the Project; (b) retail power subsidies; (c) payments made to private power producers; and, (d) projected financial deficits for the power sector.

## **B. Technical**

58. During project preparation, KESh provided an assessment of worst-case scenario for imports needed to cover the regulated market in 2014, estimated at that time at 1,200 GWh equivalent to about US\$ 100 million. This situation has now changed as precipitation has increased and power imports needed to supply the regulated market have been reduced. The project will provide financial support to compensate for lower than expected rainfall during the year(s) and/or lack of generation at Komani HPP. KESh has experience in scheduling and procuring power imports.

59. During project preparation, power utilities commissioned a number of studies and assessments with the support of the Bank in order to ensure sound technical solutions for the proposed project. Specifically, the investments to strengthen the distribution infrastructure under Component 2 rely on OShEE's investment plan prepared by a qualified international consultant, which includes urgent investment needs of the company for the upcoming next six years. This is based on the distribution company's potential for loss reduction, supply reliability improvement and service quality.

60. The equipment and technologies for implementation and operation of the Component 2 of the project are commercially proven, have been widely used by utilities in developed and developing countries worldwide, and will be implemented according to internationally accepted technical standards and practices.

61. The commercial billing system financed under Component 2 will support a more efficient development of the core business functions of OShEE's commercial management, corporate management, network planning and operations. The technical and functional specifications of the system will be defined based on ongoing assessments conducted by qualified international consultants.

62. The metering system for MV customers, MV feeders, IPPs and data metering establishment, and market functioning financed under Component 3 will support the efficient

development of a deregulated market for eligible customers<sup>1</sup> and IPPs. The equipment and technologies for implementation and operation of this part of the project have been widely used by the utilities in developed countries. OST has more than 10 years of experience operating a small data center for metering systems installed at transmission borders between generation and distribution as well as six existing eligible customers.

63. There are, however, overall implementation risks related to lack of capacity and inadequacy of business processes, which will be mitigated through business process reengineering and provision of substantial technical assistance and training to local staff to properly implement the project. In addition, qualified international consultants will be recruited to assist power utilities (OST and OShEE) in supervising implementation of investments under Component 2 and Component 3.

64. This project will also include detailed reviews of existing power sector legal framework and sector strategies. It will also provide recommendations for changes in the sector structure and legislation moving towards a deregulated market and improvement of sector's efficiency.

### **C. Financial Management**

65. A financial management (FM) assessment was carried out to determine FM implementation risk and help establish adequate FM arrangements for the proposed operation. The review included MoEI, KESh, OST and OShEE, including company systems such as: staffing, internal controls, project accounting and financial reporting for project purposes, planning and budgeting, disbursements and auditing. Each implementing agency will be responsible for the FM activities of the respective component, as described further in Annex 3. Areas that require further strengthening were discussed, and recommendations and complementary actions were provided to ensure that project is implemented within a sound fiduciary environment and meet the minimum requirements under OP 10.00. These are summarized in the following paragraphs.

66. The Department of Finance and Budgeting (DFB) in MOEI will be supported by a qualified financial management specialist (FMS) that will be hired. Since KESh and OST have previous experience with Bank financed projects, these entities will assign one qualified and experienced financial management specialist from their existing staff, respectively, who has previously worked with World Bank financed projects, in charge of FM and disbursement arrangements for their respective components. The FM responsibilities in OShEE will remain with their Chief Financial Officer (CFO). The establishment of the PMU in MoEI and PIUs in the three power entities, including fiduciary staff, will be a condition of effectiveness.

67. Periodic and on job-training on World Bank FM and disbursement policies and procedures will be provided to the FM staff engaged in the project. Policies and procedures for implementation of the project will be documented in the project operations manual (POM). The POM will include the FM disbursement and internal controls policies and procedures, and is intended to guide staff and minimize the risk of errors and omissions, as well as delays in recording and reporting. The adoption of POM will be a Project effectiveness condition. An acceptable accounting and reporting software for the project will be installed for project use in MoEI, while OST, KESh and OShEE will use their existing accounting software. Until the software in MoEI is fully operational, spreadsheet based project accounting and recording will be

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<sup>1</sup> Active customers that are supplied under market conditions.

used. Quarterly IFRs will be prepared separately by each implementing agency with respect to project activities they will implement. The IFRs will be submitted for Bank's review within 45 from the end of the quarter.

68. The approved procurement plan and project implementation plan (updated periodically) will be the basis for the preparation of the project investment forecasts and budgets (medium term, annual and quarterly). The project budgeting process will be integrated with the implementing entity planning and budgeting process.

69. The operation will utilize the regular Project investment financing disbursement mechanism, including DA, special commitments and direct payment. Each implementing agency will be responsible for its own Designated Account, therefore four segregated Designated Accounts will be opened in total, one for each implementing agency. Disbursements will be based on statements of expenditures and records submitted by each implementing agency. Counterpart funds financed from the own funding in the case of the companies and national budgets in case of MoEI, allocated to finance project expenditures related to applicable taxes, would be secured through preparation of annual budget of the implementing agency, channeled through the treasury account in the case of MoEI.

70. Independent financial audits of the use of project funds from each implementing agency will be conducted on an annual basis, by independent auditors and based on audit terms of reference (TOR), both acceptable to the Bank. Each implementing agency will produce a separate set of financial statements/ reports for the project activities they will implement. In addition, the companies will be required to submit audit reports of their IFRS financial statements to the Bank within 6 months after the end of the fiscal year. The audited Project financial statements will be submitted and made publicly available in a timely fashion and in a manner acceptable to the Bank. More detailed FM arrangements are discussed in Annex 3.

#### **D. Procurement**

71. A procurement risk assessment was conducted to assess the procurement risk and to establish procurement arrangements for the project. This large scale operation, which involves separate components for each of three utility companies, will be coordinated and monitored by the PMU at MOEI. To carry out its function, the PMU and PIUs will be supported by a consulting firm, or individual, with experience on project implementation and management. OShEE, who will carry out the largest project component under this operation, does not have experience with World Bank procurement procedures. Therefore OShEE will hire a qualified procurement specialist experienced in World Bank procurement. A procurement plan covering the first 18 months of the project is prepared and agreed with the MET and three utility companies during project preparation. The PIUs, to be established respectively within KESh, OST and OShEE will be responsible for implementation of their respective project components, including procurement activities.

72. The procurement for the project will be carried out in accordance with the World Bank's "Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits and Grants by World Bank Borrowers" dated January 2011, (Procurement Guidelines), "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits and Grants by World Bank Borrowers" dated January 2011 (Consultant Guidelines) and

the provisions stipulated in the Loan Agreement. The World Bank Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credit and Grants dated October 15, 2006 and revised on January 2011, will also apply. More detailed procurement arrangements, including procurement plan, can be found in Annex 3.

#### **E. Social (including Safeguards)**

73. Given that this project will support the improved reliability of the energy sector, it is also of high interest not only for the Government of Albania but also other stakeholders around the energy sector such as the private sector, energy consumers interested in reliable and affordable supply, as well as producers who are interested in more efficient markets.

74. Social issues in the project would have two dimensions: (i) project level dimension and/or (ii) sub-project level dimension. Social accountability mechanism would be established on the project level to secure transparency and channel dialogue between stakeholders, and thus, would secure broad public support for the reforms undertaken by the Government of Albania. At the project level, the social accountability mechanism would facilitate dialogue for the activities supporting regulatory reforms, between producers and large consumers, and other interested parties. In addition, the project aims to reduce losses both technical and improve collection rates. Other aspects at the project level social accountability dimension would include building trust and strengthening cooperation with the wider public, which would result in further increased billing and collection rates for electric consumption and more reliable supply. Government efforts to increase collection rates have already provided results; however, increased collection should also result in improvement of service and trust toward the distribution operator. Thus, the social accountability mechanism at the project level will support public relations and communication activities with consumers to improve public support and trust for the distribution company.

75. At the sub-project level, this operation will invest in improving efficiency of distribution such as meters, underground cables and sub-stations. Given that investments will be in neighborhoods, the project will establish communication channels, such as publicly available contacts and open offices, where the local population will be informed and consulted about the ongoing works. The communication mechanism at sub-project level will be temporary during the preparation phase for the works and implementation of works. The mechanism will take into consideration grievances related to the works. The type of communication with the surrounding population will also be used as a feedback mechanism, where the feedback will take into consideration potential differences based on gender. If there is a distinguishing pattern of feedback based on the gender, than follow up actions will be undertaken taking into consideration this gender based feedback. Monitoring and Evaluation system will have data disaggregated by gender, where applicable; and specific sections such as beneficiaries will have disaggregated indicators based on gender.

76. From the Social Safeguards point of view, the project investments could potentially impact private land or land in use. These impacts could be caused through investments in new sub-stations and/or laying down underground cables. Since the impact could not be determined in advance, the counterpart agency prepared a Resettlement Policy Framework (RPF) to manage potential impacts on private land or land use. The RPF will provide guidance on how the land acquisition or right of way will be secured if needed. The RPF was disclosed on April 24, 2014.

## **F. Environment (including Safeguards)**

77. In accordance with World Bank environmental policies and procedures (OP/BP/GP 4.01) the project has been assigned “Category B”, as the types of potential impacts are limited with the footprints of the investments and should be relatively easy to assess and mitigate through careful selection of sites and good construction practices.

78. For the distribution network component of the project, an environmental and social management framework (ESMF) has been prepared by OShEE since the exact footprints of the activities are not determined yet. The ESMF was designed to provide guidance for screening, assessing, conducting, consultations, reporting and monitoring practices for the sub-project investments under the management of OShEE. It is expected that all distribution investments will be conducted in the urban areas and since the Natural Habitats and Physical/Cultural Properties policies have not been triggered, the ESMF makes it clear that in case a project may have effects on protected sites and/or culturally important sites, it will not be eligible for financing under this project. The ESMF has been consulted with key stakeholders on April 14, 2014, and the final framework document has been disclosed on OShEE website on April 24, 2014 and on Bank’s Infoshop on April 25, 2014.

79. For the transmission network, the project will finance new metering devices and hardware/software purchase for OST. Since these investments will not have adverse impacts on environment, a separate environmental documentation has not been prepared. OST provided explanation about the disposal methods of the old meters, which was found to be suitable according to bank procedures.

## **G. Other Safeguards Policies Triggered**

80. The project will not have any impacts on the flow scheme of the Drin basin. The sub-component for optimization of the dam cascade would not involve any physical works or changes in the operating regimes of the dams, but only financing the import of electricity to meet seasonal gaps in power production.

## **H. Impact on Greenhouse Gas (GHG) Emissions**

81. The global environmental impact of the Project was assessed using the GHG accounting method. GHG emissions were estimated for the Power Recovery Project (PRP). The World Bank Guidelines for GHG emission of T&D projects were used to determine the net emissions of all Project investments. GHG accounting was carried out by considering emissions linked with: (i) the requirement for equipment that uses sulfur hexafluoride (SF6) and (ii) the electricity losses in the project area.

82. The Component 2 and Component 3 are considered. The project consists of rehabilitating and strengthening (i) the substations (110 kV) and distribution network (MV and LV), (ii) the metering system in MV level and to customers, and (iii) data and information management systems. Both components represent the bulk of the project investment and help reduce technical losses, reduce service interruptions, and improve the ability of the distribution company to manage effectively the business (including reducing nontechnical losses and increasing the collections).

83. It was directly estimated net emission reductions, because the main objective as a part of

results framework is reduction of losses, which have a significant impact on reduction of electricity demand. The GHG emissions reduction associated with the lower demand for power generation was estimated based on yearly reduction of technical and non-technical losses in distribution system. The reduction of technical losses was estimated at 140 GWh over the next 10 year (2015-2024). The global and regional experience of power sector reforms indicates that about one third of commercial loss reduction becomes reduced power demand. With this assumption, during the project evaluation period the reduction of non-technical losses was translated to cumulative reduction of power generation by 994 GWh over the next 10 years. The GHG emissions reduction was calculated assuming that the emission factor in national grid of Albania was estimated at 11 kgCO<sub>2</sub> per MWh. To estimate the SF<sub>6</sub> fugitive emission only number and type of equipment was known and the calculation was done based on that assumption and over the 10 years period.

84. The table below summarizes the emission reduction linked with PRP expressed in terms of ton per CO<sub>2</sub>.

**Table 5: Total Emissions Reduction with PRP (tCO<sub>2</sub>)**

	<b>Baseline</b>	<b>Project</b>	<b>Net</b>
SF <sub>6</sub> fugitive emission	0	6214	6214
Generation emissions from losses in the project	12476	0	-12476
<b>Total Emission</b>	<b>12476</b>	<b>6214</b>	<b>-6262</b>

**Annex 1: Results Framework and Monitoring**  
**Country: Republic of Albania**  
**Project Name: Power Recovery Project (P144029)**

**Results Framework**

<b>Project Development Objectives</b>												
PDO Statement												
The project development objective is to improve reliability of power supply and financial viability of the power sector.												
<b>These results are at</b>		Project Level										
<b>Project Development Objective Indicators</b>												
Indicator Name	Core	Unit of Measure	Baseline 2013	Cumulative Target Values						Frequency	Data Source/ Methodology	Responsibility for Data Collection
				YR1	YR2	YR3	YR4	YR5	2019			
Electricity losses per year in the project area	☒	Percentage	45	40	33	26	22	18	14	Semi-annually	OShEE	PMU/OShEE
Total net injected power (Megawatt hour (MWh) - Sub-Type: Supplemental) - (Core)		MWh	7,145,000	7,250,000	7,360,000	7,470,000	7,590,000	7,720,000	7,850,000	Semi-annually	OShEE	PMU/OShEE
Electricity losses per year in the project area- Technical (Percentage - Sub-Type: Supplemental) - (Core)		Percentage	15.30	14.90	14.50	14.20	13.70	13.30	12.60	Semi-annually	OShEE	PMU/OShEE

Electricity losses per year in the project area- Non-Technical (Percentage - Sub-Type: Supplemental) - (Core)		Percentage	29.80	25.10	18.50	11.80	8.30	4.70	1.40	Semi-annually	OShEE	PMU/OShEE
Collection rate of distribution company	<input type="checkbox"/>	Percentage	78.0	85.0	88.0	90.0	91.0	92	93.0	Semi-annually	OShEE	PMU/OShEE
Reliability of MV level at Tirana area	<input type="checkbox"/>	Percentage	100	110	120	70	70	70	70	Semi-annually	OShEE	PMU/OShEE
Total amount of intercompany arrears	<input type="checkbox"/>	Number of days	1,200	800	775	750	650	600	550	Semi-annually	PMU/MEI	PMU/MEI

### Intermediate Results Indicators

Indicator Name	Core	Unit of Measure	Baseline 2013	Cumulative Target Values						Frequency	Data Source/ Methodology	Responsibility for Data Collection
				YR1	YR2	YR3	YR4	YR5	2019			
Number of medium voltage customers in deregulated market	<input type="checkbox"/>	Number	0.00	0.00	100	500	2000	4000	5000	Baseline, interim and completion	OShEE	PMU/OShEE
Power sector reforms implemented	<input type="checkbox"/>	Text	No	Updated market model / Revision of renewable energy	New market rules in place / Cost recovery tariff						Ministry of Energy and Industry	PMU



				law	methodology approved								
Implementation of a new billing and collection management system	<input type="checkbox"/>	Text	No			New billing and collection system in place						OShEE	PMU
Implemented Risk management mechanism for weather related power imports	<input type="checkbox"/>	Text	No	No	Risk Mechanism designed	Risk Mechanism implemented	Risk Mechanism implemented		Risk Mechanism implemented			Ministry of Energy and Industry	PMU
Share of meters installed by OST	<input type="checkbox"/>	Percentage	0.00	10.00	60.00	85.00	100.00	100.00	100.00	Semi-annually		OST	PMU/OST
Debt-to-Capitalization Ratio of OShEE, KESh and OST	<input type="checkbox"/>	Percentage							60	Semi-annually		KESh, OST	PMU
Debt to Equity Ratio of OShEE, KESh and OST	<input type="checkbox"/>	Number							1.6	Semi-annually		KESh, OST	PMU
OShEE monthly revenues used to pay for energy purchases to KESh and transmission fees to OST	<input type="checkbox"/>	Percentage	40%	50%	85%	95%	95%	100%	100%	Semi-annually		KESh, OST	PMU
Direct project beneficiaries	<input checked="" type="checkbox"/>	Number	0.00	0.00	50,000	100,000	150,000	200,000	200,000	Semi-annually		OShEE	PMU/OShEE
Female beneficiaries	<input checked="" type="checkbox"/>	Percentage Sub-Type/Sup	0.00	0.00	52.00	52.00	52.00	52.00	52.00	Semi-annually		OShEE	PMU/OShEE

## Annex 1: Results Framework and Monitoring

Country: Republic of Albania

Project Name: Power Recovery Project (P144029)

### Results Framework

<b>Project Development Objective Indicators</b>	
Indicator Name	Description (indicator definition etc.)
Total electricity losses per year in the project area	This indicator is calculated by dividing total electricity losses (i.e. the sum of technical and non-technical losses) by the total net injected generation in the project area. The baseline is the actual electricity losses in the distribution grid at the beginning of the project.
Collection rate of distribution company	This indicator is calculated by dividing the amount collected with the amount billed from the distribution company. Increased collection rate improves the financial viability of the whole sector.
Reliability of MV level at Tirana area	Sub-Transmission transformation capacity in Tirana area (MVA)
KESh/OST arrears in number of sales days equivalent	This indicator is calculated by expressing the total amount of KESh and OST receivables from OShEE divided by annual sales to OShEE times 365.
<b>Intermediate Results Indicators</b>	
Indicator Name	Description (indicator definition etc.)
Number of medium voltage customers in regulated market	This indicator measures the number of medium voltage customers that have been removed from the regulated market.
Power sector reforms implemented	This indicator measures progress towards improving the electricity market through market reforms, which will include the adoption of new market rules, new tariff methodology, updated market model and revision of renewable energy law.
Implementation of a new billing and collection management system	This indicator assesses the implementation of a new billing and collection management system, which will support the improvement in billing and collection of the DSO.
Implemented Risk management mechanism for weather	This indicator assesses the establishment of a risk management mechanism for weather

related power imports	related power imports, which would hedge risks of price volatility related to weather conditions.
Share of meters installed by OST	This indicator measures progress in installing meters financed under Component 3. The indicator is expressed in percentage of installed meter, i.e. based on the allocated value for metering.
Debt-to-Equity Ratio of OShEE, KESh and OST	This indicator measures the financial leverage of the power companies (OShEE, KESh and OST), calculated by dividing their debt by the amount of capital available, converted as a percentage.
Debt Service Coverage Ratio of OShEE, KESh and OST	This indicator measures the companies' level of indebtedness relative to their income, calculated by dividing the total annual debt payments by annual income.
OShEE monthly revenues used to pay for energy purchases to KESh and transmission fees to OST	This indicator measures the level of payments made by OShEE to KESh for energy purchases and to OST for transmission fees, expressed as a percentage of energy sales by KESh and transmission fees invoiced by OST to the distribution company respectively.
Direct project beneficiaries	Direct beneficiaries are people or groups who directly derive benefits from an intervention (i.e., children who benefit from an immunization program; families that have a new piped water connection). Please note that this indicator requires supplemental information. Supplemental Value: Female beneficiaries (percentage). Based on the assessment and definition of direct project beneficiaries, specify what proportion of the direct project beneficiaries are female. This indicator is calculated as a percentage.
Female beneficiaries	Based on the assessment and definition of direct project beneficiaries, specify what percentage of the beneficiaries are female.

**Annex 2: Detailed Project Description**  
**REPUBLIC OF ALBANIA: Power Recovery Project (P144029)**

1. Albania's power sector is operated by the Albania Power Corporation, KESh (generation), Transmission System Operator, OST (transmission) and OShEE (distribution). The sector is regulated by the Energy Regulatory Authority (ERE). Both KESh and OST are publicly owned while 76 percent of OShEE was owned by a Czech public company, CEZ a.s. until June 2014, when it returned the ownership to GoA as part of a settlement agreement. In August 2004, all non-household customers were granted the right to become eligible consumers and choose their own suppliers. By the end of 2012, Albania had 7 eligible customers with annual consumption of 600 GWh per year (14 percent of all electricity sales).

2. KESh is responsible for supplying the regulated power market in Albania. KESh operates as a power generation company as well as a Wholesale Public Supplier (WPS). The KESh/WPS buys the electricity produced by KESh Gen at a regulated price, as well as electricity produced by Independent Power Producers (IPPs) to serve tariff customers (MV and LV commercial customers and households), at a higher prices agreed in Power Purchase Agreements (PPAs). KESh Gen may sell any electricity not taken by the WPS in the open market. According to the Energy Law, KESh/WPS is also the "supplier of the last resort", thus, WPS has to buy additional electricity on the market to meet the demand of regulated customers. After it purchases all the power generated by KESh Gen, WPS is obligated to purchase all the power from IPPs before purchasing imports of electricity to meet the needs of tariff customers in the regulated market.

3. At the time of the privatization the expectation was that CEZ Sh's was going to reduce losses to 17 % by 2014 and invest around \$ 150 million over five years in the distribution system. The privatization did not work out as expected. Acceptance of the level of losses and bad debts happened later than expected. Retail tariffs were not timely adjusted. Bill collections from budgetary and non-budgetary institutions did not improve and the private sector distribution company was unable to deal effectively in reducing technical and non-technical losses. Power losses increased to 51.1 percent by the end of 2012; collection rates decreased from 85 percent in 2008 to 73 percent in 2011 and to 64 percent in 2012. In the fall of 2012, CEZ Sh had exhausted its resources, and without the support of its holding company, stopped electricity imports to cover its net losses. KESh, as the supplier of last resort, overused its hydro reservoirs to cover demand. On January 21, 2013, ERE revoked CEZ Sh's license due to noncompliance of its obligations under the license and appointed a temporary state administrator to run the distribution system. In doing so, it also assumed responsibility—and thus the fiscal risk—for the power imports necessary to compensate for energy losses and rising consumer demand.

4. Albania faces significant fiscal risks related to the energy sector. Albania's energy generation relies almost entirely on hydropower, making it highly vulnerable to weather patterns and requiring emergency power imports during dry seasons which are financed through government guarantees. The sector also suffers from persistently high distribution losses, significantly increased after the failed privatization of the distribution company, and regulated tariffs that are below energy costs. The government can mitigate energy sector related fiscal risks by diversifying generation sources, reducing distribution losses, improving the energy market

model and implementing an appropriate power sector reform. A Socialist-led coalition government with a stronger than usual majority assumed office in September 2013, which has signaled a strong commitment to reforms. It has shown willingness to address long-standing structural challenges in energy sector.

5. The proposed operation will support the implementation of the Government's Power Sector Recovery Plan, which is centered around four main pillars: i) enhancing security of supply through diversification of generation sources and strengthening regional integration; ii) improving system efficiency in the distribution sector by reducing losses and improving cash collection; c) supporting improvements of the electricity market and d) introducing priority power reforms in the power sector to create a competitive market that will attract private investment while reducing fiscal risks for the government.

6. The project consists of four components: i) short-term power import support, ii) upgrading distribution infrastructure, iii) transmission meter/data center; upgrade and iv) supporting power sector reforms and project implementation. Details are provided below.

#### **Component 1 – Short Term Complementary Power Import Support (IBRD - US\$30.0 million)**

7. Albania lacks firm generation capacity to manage weather volatility, furthermore, the Komani HPP on the Drin cascade—a peaking plant-- is under maintenance, which will create a capacity gap of about 150 MW /yr over a three year period. To address the lack of diversified generation supply, KESH has committed its own financing funds to prepare a feasibility and tender design documents for the reinstatement of the seawater cooling system for the Vlore TPP. In the short-term, and as part of an overall Risk Management Strategy to be developed over the next year, this component will provide up to \$30 million to compensate for the reduced generation by HPP Komani's rehabilitation as well as under the event of unfavorable weather conditions to supply the regulated market. The main outcome of this support would be to secure adequate reservoir management levels at the Drin cascade.

#### **Component 2 – Upgrading Distribution Infrastructure (IBRD - US\$93.0 million)**

8. This component will support GoA's and Distribution Company's plan to reduce distribution losses, improve cash collection and reliability of power supply. The distribution company has finalized a study, conducted by international consultants, assessing the areas of high losses and low collections. The report also includes a proposed action plan to reduce losses over the next six years. The investments are estimated at \$35 million for each year or about \$275 million over the next six years (2015-2020). This project component will focus on those priority investments during the first 4 years.

9. The investments will be focused on: i) supply and installation of transformers and ancillary equipment at selected substations in Tirana; ii) providing targeted investments in the medium and low voltage grid including cable line; concrete poles, metal clad switchgears, power distribution cabins and associated metering equipment; iii ) supplying and installing power meters to cater for customers who have no or damaged meters; and iv) upgrading the billing and collection system to implement OShEE performance management program, including among

others, loss reduction and collection increase plan.

10. Four proposed subcomponents will include:

- a) *Upgrading the sub-transmission distribution system*: Investments in the sub-transmission level are required to upgrade system reliability in Tirana area by reinforcing two existing 35/MV to 110/MV systems with new 110 kV lines.
- b) *Targeted investments in the medium voltage grid (6-20kV)*: The proposed investment will include MV cable lines, LV ABC lines, LV concentric cable and concrete poles, MV metal clad switchgears, and MV/LV distribution cabins with associated LV metering facilities.
- c) *Metering system investments in the low voltage network*: Recent OShEE reports show that approximately 250,000 customers have damaged meters or do not have meters at all. Under this subcomponent the project will provide financing for the purchase and installation of: (i) approximately 230,000 single and three-phase meters; (ii) low voltage coaxial cables; (iii) ABC cables; and (iv) three-phase regular conductor cables.
- d) *Upgrading billing and collection system*: The investments under this component will be focused on the installation of an IT system for metering, billing and collection. Investing in these systems is crucial for implementing a sound loss reduction plan. IT system investments will include (i) updating or replacing the customer database to reduce errors; (ii) installation of a modern system to strengthen the control and monitoring of staff and assets; and (iii) investments associated with asset management and control.

### **Component 3 – Transmission Meter/Data Center Upgrade (IBRD - US\$20.0 million)**

11. In 2011, GoA moved high voltage industrial customers to the deregulated market, which effectively reduced GoA's obligation, through KESh/WPS, to provide guarantees of about US\$ 50 million/yr to KESh/WSP. This modification put Albania at the forefront of market reforms required by EU directives. The next step in the market reform is to open the market for medium voltage commercial customers, which will further reduce the public obligation to guarantee supply for regulated tariff customers.

12. In order to facilitate this process, the project will support OST to: i) providing power meters and upgrading a data center; and, ii) supplying and installing an IT system for the data center and providing technical assistance for developing procedures for the establishment of a market platform for independent power producers and eligible customers, among others.

13. Two subcomponents will include:

- a) *OST investments in meters for MV customers, MV feeders, IPPs and data center*: The project will finance power meters, IPPs, MV feeders and upgrade of a data center for the market operator OST.

- b) *IT systems and rules:* Under this subcomponent, the project will finance supplying and installing an IT system for the data center and providing technical assistance for developing procedures required for the establishment of a market platform, among others, for IPP's and eligible customers.

**Component 4 – Supporting Power Sector Reforms and Project Implementation (IBRD - US\$7.0 million)**

14. GoA recognizes that investments alone will not be sufficient to turn the sector around without priority power sector reforms that will address structural, institutional and operational issues of the sector. Power sector reforms will (i) increase market competition by deregulating specific customer groups, thus reducing government's supply obligations; (ii) ensure sustainability of private sector investments and (iii) improve financial viability of the sector. In addition to project implementation support, this component will finance technical assistance required to initiate priority reforms to enable the recovery of the power sector and improving the management of the distribution company.

15. This component will support priority power sector reforms to facilitate the recovery of the power sector and improve the performance of the distribution company through provision of management and technical advisory services.

16. Four subcomponents will include :

*a) Priority power sector reforms:* Sector reform areas will include: i) revising the power market model to introduce more competition in the sector and reduce the Borrower's power supply obligation as per the relevant EU directives; ii) revising the renewable energy law to ensure sustainability of independent power producers; iii) introducing a new cost-recovery tariff methodology to reflect updates in the power market model; iv) updating the Borrower's current energy strategy; and (v) designing implementation and monitoring of social outreach programs targeting electricity consumers and key stakeholders.

*b) Project implementation support:* This subcomponent will support the establishment of a Project Management Unit, within the MoEI through recruitment of relevant staff and provision of goods, Operating Costs and technical advisory services.

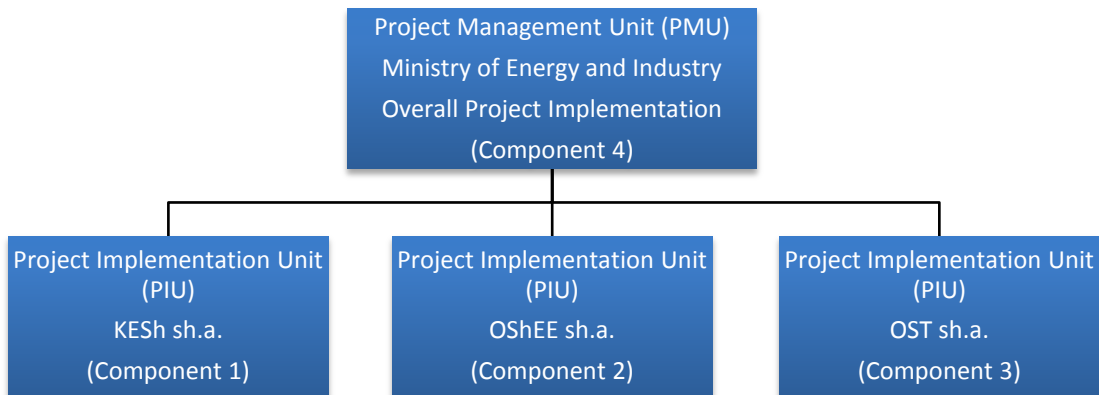
*c) Management advisory services:* Recruiting specialized advisory services to support the implementation and monitoring of OShEE's Performance Management Program, including among others, loss reduction and collections increase plan).

*d) Risk management mechanism for weather volatility:* This subcomponent will support the carrying out of a risk management study to mitigate the impact of weather volatility in the power sector.

**Annex 3: Implementation Arrangements**  
**REPUBLIC OF ALBANIA: Power Recovery Project (P144029)**

**Project Administration and Mechanisms**

1. The project implementation arrangements are designed to have a proper oversight and accountability by a Project Management Unit with three other PIU responsible for delivering each component. The Project Management Unit, located in the MoEI, will be responsible for the overall project implementation. Each component will be delivered by a separate PIU as follows: i) KESh will have a PIU responsible for implementing the first component, ii) OShEE will have a PIU responsible for implementing the second components, iii) OST will have a PIU responsible for the third component, and iv) the PMU in the Ministry of Energy and Industry will directly implement the fourth component, its staffing composition will be reflected and agreed in the PMO.



2. Day-to-day project implementation will be conducted by PIUs established in three power utilities KESh, OShEE and OST for the first three components, and the PMU for the fourth component. Core staff of the PMU will be appointed based on terms of references prepared by MOEI and approved by the Bank. Throughout the implementation of the project, the PMU will also draw on relevant experts of the Ministry as well as the three power utilities.

3. The project will be overseen by MoEI, through a Project Management Unit, to be established by the order of the MoEI, and will be managed by a Project Coordinator hired by the MoEI. The PMU has overall oversight for the project, including the following additional responsibilities: i) preparing the Project Operations Manual, together with PIUs, to be approved by the the Minister of Energy and Industry, and satisfactory to the Bank ii) assisting PIUs in developing bidding documents, iii) assisting the Borrower, through the MoEI, in the establishment of Bid Evaluation Committees, comprising of staff from PMU and PIUs, as appropriate, according to the Project Operations Manual iv) supporting coordination in the design and monitoring of social outreach programs; (v) carrying out implementation oversight including supervision, as appropriate, and providing periodic monitoring of project implementation and evaluation of the project.



## **Financial Management**

4. Albania has participated in a number of detailed reviews of its public financial management (PFM), among them two Public Expenditure and Financial Accountability (PEFA) assessments (2006 and 2011), a Public Expenditure Review (2006), a Public Finance Review (2013), annual EU-SIGMA reviews, and other analysis by the World Bank, the IMF, the EC, and other organizations. The various reviews have plotted the significant progress Albania has made in improving PFM. The last PEFA assessment for Albania from 2011 concluded that Albania has an adequately functioning fiscal and budget management system, in the sense that the system has enabled the government to finance and execute a budget that delivers public services to the general population. Albania scores relatively well on comprehensiveness and classification of the budget, basic treasury operations (including budget, and payroll controls), financial reporting/transparency and public access to government budget and financial information. Lagging areas, as identified in the 2011 PEFA assessment include: (i) multi-year perspective in fiscal planning and policy formulation; (ii) internal audit; (iii) implementation of the integrated planning system (FMIS); and (iv) scope and nature of the external audit function.

## **Staffing**

5. The MoEI, Department of Finance and Budgeting (DFB) does not have experience in implementing large scale donor funded projects. For the implementation of the project, DFB will be supported by a full time qualified financial management specialist (FMS) that will be hired and will report to the head of DFB and project management.

6. As KESh and OST have experience with Bank financed projects, these entities will assign one qualified and experienced financial management specialist from their existing staff, respectively, who has previously worked in such projects, in charge for financial management and disbursement activities for their respective components. The FMSs will report to entity Chief Finance Officer (CFO) and Head of PIU's for the respective component.

7. The economic department within *OShEE* will be responsible for implementing a sound FM environment with respect to project activities. The CFO of the entity will be responsible for segregating duties with respect to project FM and disbursement within her team.

8. The establishment of the PMU in MoEI and PIUs in the three power entities, including fiduciary staff, will be a condition of effectiveness. Periodic and on job-training on World Bank FM and disbursement policies and procedures will be provided to the FM staff engaged in the project. Details on Project institutional and implementation arrangements, including roles and responsibilities of staff in each implementing agency will be defined in a Project Operations Manual (POM), the preparation of which will be a condition of effectiveness.

## **Internal Controls**

9. The implementing agencies will maintain an effective internal control system to ensure that project expenditures are properly verified and authorized; supporting documents are maintained; accounts are reconciled periodically; and project assets, including cash, are safeguarded. The POM will elaborate disbursement arrangements, funds flow and internal

controls policies and procedures (FM, procurement, and contract management), and is intended to guide staff and minimize the risk of errors and omissions, as well as delays in recording and reporting. The FM sections will provide detailed description of processes (budgeting, execution of expenditure, recording, reporting, auditing) and will depict the key controls activities including verifications, authorizations, segregation of duties and reconciliations in each implementing agency. These sections will also clarify responsibilities of staff, including level of authority, clarify controls over funds and assets, and steps to ensure timely and accurate financial reporting. The adoption of POM will be a Project effectiveness condition.

### **Planning and Budgeting**

10. While MoEI is a budgetary institution, the other implementing agencies are state owned entities, and consequently different policies guide the respective planning and budgeting process.

11. *MoEI*: The project budget and planning process, with respect to the project component 4, will be aligned with the ministry budgeting process, and the project information will be integrated within MoEI budgeting process but identified separately. The approved procurement plan and project implementation plan (updated periodically) will be the basis for the preparation of the project investment forecasts (medium term, annual and quarterly). The project budgeting process will be coordinated by MoEI DFB and supervised by the head of PMU (project director). The budgets and forecasts will reflect technical inputs from the PMU procurement specialist and technical units, if needed, within MoEI. The project annual budgets will be approved by the project director and by MoEI Secretary General. The process will be finalized before the start of each budget year. Finally, the project investment forecasts should be adequately reflected in the Medium Term Budget Plan and Budget for 2014 and onward

12. *KESh, OST, OShEE*: The approved procurement plan and project implementation plan (updated periodically) for each respective component will be the basis for the preparation of the project investment forecasts and budgets (medium term, annual and quarterly). The budgets and forecasts will be prepared by the head of the PIU with inputs from the procurement specialist, FM specialist and technical departments as applicable. The project budgets and forecast will be reviewed by CFO, and subsequent to CEO authorization will be submitted for final approval in the entity supervisory board/ board of directors. The annual budget process will be finalized before the start of each budget year.

13. The budgeting process, budget monitoring and budget revision mechanism will be described in the project Operations Manual. The project budgets and forecasts will include all sources of financing including counterpart funds for applicable taxes on project expenditure, parallel financing and joint financing of activities. Counterpart funds, provided in the companies and MoEI budget, would be made available as expenditures are incurred.

### **Accounting System**

14. *MoEI*: An acceptable project automated accounting and reporting software will be purchased for project use and installed; the project funds and expenditures will be accounted separately; project chart of accounts will be defined based on project activities for the respective component and IFRs format will be described in the POM. The accounting software should

identify committed amounts for each consultant/ supplier and the respective liability, as well as support transactions in currencies other than the functional currency (ALL) and reporting currency (EUR). Until the software is fully operational, spreadsheet based accounting and recording will be used.

15. Since one single disbursement is expected under component 1, KESh will use its existing accounting software for the accounting and reporting of the respective component financial transactions, which is considered adequate.

16. *OST and OShEE* are using Oracle and SAP, respectively, for company accounting and financial reporting purposes. The project transactions for the respective components will be recorded in the accounting system and will be captured under a specific cost center assigned for the project, sub cost centers will be used to group transactions by subcomponent. The accounting systems support multi-currency recording and reporting. The chart of accounts will be defined based on project activities for the respective components and respective IFRs format will be described in the POM.

### **Financial reporting**

17. Quarterly IFRs will be prepared by each implementing agency for their respective component and submitted for Bank's review within 45 days from the end of reporting period. The implementing agencies will prepare financial reports on cash basis presented in EUR. The IFRs will contain (i) statement of sources and uses of funds (with expenditure classified by component and disbursement category), (ii) contract management report and (iii) designated account reconciliation. The annual project financial statements will be prepared in accordance with IPSAS cash basis. *OST* and *OShEE* will provide also balance sheets statement showing accumulated funds of the project, bank balances, other assets of the project, and liabilities. The IFRs and annual financial statements will include all sources of funding and project expenditure, including counterpart financing.

### **Annual Audit**

18. The entity financial statements of KESh, *OShEE*, and *OST* and project financial statements (separate for each component) will be audited annually by independent auditors acceptable to the Bank. As of the date of negotiations, there is one overdue audit of the KESh financial statements and respective management recommendation letter for the year ended December 31, 2013. The audit of the Dam Safety project for the year then ended was submitted with minor delay. The audit will be conducted based on terms of reference acceptable to the Bank. The entity audit reports are required for the purposes of the analysis of financial performance of the entities. The audited financial statements will be made publicly available within 2 months from the date of receipt of the audit report from the auditors. The implementing entities and MoEI will publish the annual project audit reports in their respective websites. The following table indicates the audit reports that will need to be submitted by the implementing entities and the due dates for their submission.

<b>Audit report</b>	<b>Due date</b>
KESh financial statements prepared in accordance with IFRS	Within six months from the end of each fiscal year and also at the closing of the project
Project financial statements for the Part A/ Component 1 implemented by KESh sh.a.	Within six months from the end of each fiscal year and also at the closing of the project
<i>OShEE</i> financial statements prepared in accordance with IFRS	Within six months from the end of each fiscal year and also at the closing of the project
Project financial statements for the Part B/ Component 2 implemented by <i>OShEE</i> sh.a.	Within six months from the end of each fiscal year and also at the closing of the project
OST financial statements prepared in accordance with IFRS	Within six months from the end of each fiscal year and also at the closing of the project
Project financial statements for the Part C/ Component 3 implemented by OST sh.a.	Within six months from the end of each fiscal year and also at the closing of the project
Project financial statements for the Part D/ Component 4 implemented by MOEI	Within six months from the end of each fiscal year and also at the closing of the project

### **Funds Flow and Disbursement Arrangements**

19. The operation will utilize the regular project investment financing disbursement mechanism. Available disbursement method include: (a) Reimbursement to the Borrower for expenditures eligible for financing that the Borrower has pre-financed from its own resources; (b) Advance of Loan proceeds into a Designated Account of the Borrower opened in a bank acceptable to the World Bank to finance eligible expenditures as they are incurred and for which supporting documents will be provided at a later date when requesting replenishment of the Designated Account; (c) Direct Payment to third parties (i.e. supplier, consultant, contractor) for eligible expenditures at the request of the Borrower; and (d) Special Commitment to pay a third party for eligible expenditures under special commitments entered into, in writing, at the Borrower's request and on terms and conditions agreed between the Bank and the Borrower. Disbursements from the loan will flow to the Designated Accounts, (see below) maintained in the Bank of Albania (the Central Bank) and will be based on statements of expenditures and records submitted by each implementing agency. The Loan financing will finance eligible expenditures exclusive of taxes. This will be subject to review by project auditors (TORS will reflect that) as well as the regular SOEs reviews conducted by Bank staff during regular supervision missions.

20. The implementing agency will then request the Treasury Department at MOF to make transfers from the Designated Accounts to the respective bank accounts that will be opened in commercial banks, the bank accounts in [Euro and local currency] will be used to make project expenditure payments to third parties i.e. consultants, contractors and suppliers.

21. Designated accounts that will be opened in Bank of Albania for each implementing agency:

<b>Implementing agency source of financing</b>	<b>IBRD</b>
MoEI	X (EUR)
KESh sh.a.	X (EUR)
OST sh.a.	X (EUR)
OShEE sh.a.	X (EUR)

### **Expenditure category**

<b>Category</b>	<b>Amount of the Loan Allocated (expressed in Euros)</b>	<b>Percentage of Expenditures to be financed (exclusive of Taxes)</b>
(1) Short Term Power Purchases under Part 1 of the Project	22,419,750	100%
(2) Goods, Consulting services, non-consulting services, and Training under Part 2 of the Project	69,500,000	90%
(3) Goods, Consulting services, and non-consulting services under Part 3 of the Project	14,950,000	80%
(4) Goods, consulting services, non-consulting services, Training, and Operating Costs under Part 4 of the Project	4,950,000	100%
(5) Front-end Fee	280,250	Amount payable pursuant to Section 2.03 of this Agreement in accordance with Section 2.07 (b) of the General Conditions
<b>TOTAL AMOUNT</b>	<b>112,100,000</b>	

22. **Counterpart funding.** The borrower has committed to finance all applicable taxes on project expenditure. In addition, counterpart funds from OShEE and OST will be provided in the form of joint co-financing for the activities included under component 2 and 3, respectively category 2 and 3, at the rate of 10% and 20% respectively. Joint co-financing of activities means that all contracts on goods, non-consulting and consulting services and training foreseen under these components will be financed jointly by loan proceeds and counterpart funds at the determined rate. These contracts will be procured in accordance with the requirements set forth in the Bank Procurement Guidelines. Counterpart funds financed from the own budget of the implementing agencies, allocated to finance project expenditures and applicable taxes, would be

secured through preparation of annual budget of the respective implementing agency. In the case of MoEI, counterpart funds for applicable taxes will be channeled through the treasury account.

23. **Retroactive Financing.** To facilitate prompt execution of project preparation, retroactive financing of up to Euro 100 thousand will be provided to finance agreed upon eligible project expenditures incurred within 12 months prior to proposed project signing date up to proposed project effectiveness date and will follow the World Bank procurement guidelines. These pre-financed funds will be provided by the Borrower from its own resources and reimbursed to the Borrower after project becomes effective. Retroactive financing will finance category 4 expenditure related to PMU staff salaries, operating costs and FM software license for the PMU (see implementation arrangements).

## **Procurement**

24. The key issues and risks concerning procurement within the new operation have been identified based on Bank project experience and include: (i) the delays in ECSEE APL 2, a project implemented by KESh and OST; and (ii) delays in the evaluation of bids in the current Dam Safety Project managed by KESh; (iii) lack of experience/knowledge on Bank's operation and procurement from OShEE, which will carry out the largest component under the proposed project.

25. The corrective measures which have been agreed are: (i) the PIUs to be established in KESh, OST and OShEE will be staffed with qualified staff, including project coordinators, procurement specialists, FM specialist and other technical staff; (ii) The PMU to be established in the Ministry of Energy and Industry will monitor and coordinate the implementation of all three components; the PMU will be assisted in carrying out its function by a consulting firm with experience in project implementation and management. The first project component will be implemented by a PIU, which will be established within KESh's WPS department. The PIU staff shall have experience in Bank's procurement procedures. The second project component will be implemented by the PIU established within OShEE. Its core staff shall include a PIU coordinator, a procurement specialist, and an FM specialist experienced with Bank's procedures. The third project component will be implemented by the PIU within OST. It will include a PIU coordinator, a procurement specialist, an FM specialist and a contract administrator. Forth project component will be implemented by PMU of the MOEI.

26. **Guidelines.** Procurement for the proposed Project would be carried out in accordance with the World Bank's "Guidelines: Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants" dated January 2011; and "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers" dated January 2011; and Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits & Grants, and the provisions stipulated in the Legal Agreement.

27. **Risk Rating.** In December 2013, the above mentioned implementing agencies were assessed for their capacity to implement procurement actions. The procurement risk is assessed as High before mitigations. The following measures were agreed to mitigate the risks and maintain the implementing team's capacity.

**Table 6: Summary Risk Assessment**

<b>Risk</b>	<b>Rate</b>	<b>Mitigation</b>	<b>Rate</b>
<ul style="list-style-type: none"> <li>Unsatisfactory quality of technical specifications or designs may lead to delays in contract implementation and contract amendments</li> </ul>	S	<ul style="list-style-type: none"> <li>Hiring of qualified consultants for the preparation of feasibility studies and technical designs;</li> <li>Close involvement of Bank technical expert in the review of the TOR for hiring such consultants, and the review of the TS and designs.</li> </ul>	M
<ul style="list-style-type: none"> <li>Potential delays in overall project implementation due to management of project by three separate PIUs/institutions for such scale project and operation.</li> </ul>	H	<ul style="list-style-type: none"> <li>A PMU will closely coordinate and monitor the implementation of all three components, including PIUs activities.</li> <li>A Project Operation Manual will be prepared, including detailed roles of the PMU, and all three PIU's and their operating staff.</li> </ul>	S
<ul style="list-style-type: none"> <li>Delays in bidding process and bid evaluation may result on substantial delays in contract and or project implementation.</li> </ul>	H	<ul style="list-style-type: none"> <li>Hiring consultant with international technical experience contract management knowledge.</li> </ul>	S
<ul style="list-style-type: none"> <li>Insufficient knowledge of the Bank's procurement procedures, including latest Procurement and Consultants Guidelines (January 2011) applicable for the Project, especially for the OShEE PIU in charge with implementation of the largest project component</li> </ul>	H	<ul style="list-style-type: none"> <li>OShEE will hire procurement specialist with experience/qualification in Bank's procurement. All three PIUs staff will attend the Bank's procurement training to get latest updates on applicable guidelines.</li> </ul>	S
<b>Average</b>	H		S

Risk Ratings: H: High; S: Substantial; M: Moderate and L: Low

### **The Procurement Plan**

28. The Borrower, at appraisal, developed a Procurement Plan (PP) for project implementation, which provides the basis for procurement methods. It includes the Bank review requirements and thresholds. It is available as a separate project document. The PP will be reviewed and agreed between the Borrower and the Bank during negotiations. It will be available at the offices of the PIUs for each component, and on the Bank's external website. The Procurement Plan shall be updated in agreement with the Bank annually or as required to reflect the actual project implementation needs.

### **Procurement Arrangements**

29. The following methods may be used for procurement of goods, works and non-consulting services as agreed in the procurement plan: International Competitive Bidding (ICB), National Competitive Bidding (NCB), Shopping (S), and Direct Contracting (DC).

## Procurement of Goods

30. Goods contracts under the project include procurement of meters, cables, sub-stations, power imports, IT systems, etc. Procurement for all ICB procedures will be done using the Bank's Standard Bidding Documents (SBD). Smaller value contracts as needed will be procured using harmonized NCB documents for Goods or shopping using ITQ (June 2011), depending on the cost estimate for the package. The procurement of power imports will be conducted in accordance with provisions under clause 2.68 (procurement of commodities) of procurement guidelines following procedures that are satisfactory to the Bank

## Selection of Consultants

31. Consultant services under this project would include: (i) Technical assistance for project management and implementation, and (ii) technical assistance for power sector market model and reform, and (iii) management of distribution system operation activities including capacity building. The World Bank's Standard Request for Proposals will be used. The applicable selection methods will be as follows: *Quality and Cost Based Selection (QCBS)* method will be the preferred method for a majority of consulting assignments depending on the size and complexity of the assignments. Other procurement methods may be used as follows: Quality Based Selection (QBS) method will be used for specialized assignment, where cost considerations are of less importance and costs are also not expected to differ substantially between the consulting firms; Selection based on Consultants Qualifications (CQ) may be used for contracts estimated to cost less than US\$300,000 equivalent; Single Source Selection (SS) may be used in exceptional cases as per provisions of the Guidelines and with prior Bank approval. Contracts with individual consultants (IC) may be used for services where teams of personnel are not required and where the qualification and experience of the individual consultant are the paramount requirements. ,

## Summary of Procurement Plan

**Table 7: Procurement Arrangements and Schedule for Goods and consultants**

Ref Nr	Contract (Description)	Procurement Method	P-Q	Review by the Bank (prior/post)	Expected bid opening date	Comment
<b>I</b>	<b>Component 1. Short term complementary power import support</b>					
1	Power Imports (turbine maintenance, once a year, for three years)	Commodities		Prior	TBD	
<b>II</b>	<b>Component 2. Upgrading distribution infrastructure</b>					
1	<i>Substations</i>					
	(1) Tirana 110/20 kV NST-1 substation (GIS with 2x40 MVA) (including 110 kV 5 km Cable Line and 110 kV Line Bay extension at Tirana 1 substation). (2) Tirana 110/20 kV KOMBINAT substation (outdoor with 2x40 MVA including 110 kV 3 km OHTL)	ICB		Prior	30 Mar 2015	Supply and Installation



Ref Nr	Contract (Description)	Procurement Method	P-Q	Review by the Bank (prior/post)	Expected bid opening date	Comment
2	<i>Electricity Meters</i>					
	(1) Three phase Meters including CTs and accessories (12,000 pcs for existing MV/LV Cabins); (2) Integrated Single Phase Meters with Plastic Box and Limiters (MCB) (30,000 pcs); (3) Three phase Meters (for non-household LV consumers and for existing metallic collective boxes) (50,000 pcs); (4) Single phase Meters (for existing metallic collective boxes) (200,000 pcs).	ICB		Prior	15 Jan 2015	Goods
3	<i>Medium and Low Voltage Cables</i>					
	(1) 20 kV Cable Line (XLPE AL 3x1x185mm <sup>2</sup> /240mm <sup>2</sup> single phase cable twisted for three phase) and accessories (300 km) (2) LV ABC Line (with three phase four conductors cables and accessories) (1250 km); (3) LV Concentric single phase cables (2x 6 mm <sup>2</sup> ) and accessories (750 km); (4) LV PVC three phase four conductors (4x95 mm <sup>2</sup> and 3x120+95 mm <sup>2</sup> ) and accessories (300 km).	ICB		Prior	28 Jan2015	Goods
4	<i>Metal Clads and Transformation Points</i>					
	(1) 20 kV Metal Clad Switchgears for substations (20 pcs) (2) 20/0.4 kV Transformation Points (cabins) with 400 kVA transformer (500 pcs)	ICB		Prior	15 Mar 2015	Goods
5	Concrete poles for LV lines (10,000 pcs)	ICB		Prior	30 Jan 2015	Goods
6	Investment in Billing System (Customer data base, billing, customers care and modern commercial system)	ICB		Prior	30 Mar 2015	Goods and Services
<b>II</b>	<b>Component 3. Transmission meter/data center upgrade</b>					
1	<i>MV Metering and Data Center Facilities</i>					
	(1) Three phase meters (for all MV feeders and Independent Power Producers); (2) Three phase meters (for all MV customers in distribution network including Ct & VT); (3) Establishing Data Center (hardware's, software's, furniture's, IT and metering staff training, etc)	ICB		Prior	30 Mar 2015	Supply and Installation  US\$ 4million will be covered by OST
2	<i>Establishing Market Place</i>					

Ref Nr	Contract (Description)		Procurement Method	P-Q	Review by the Bank (prior/post)	Expected bid opening date	Comment
	Establishing Market Place (hardware, software, furniture's, data acquisition, web platform, furniture's, rules and procedures for benchmark market, clearing house, IT and operation staff training, operation practices and guidelines, etc.)		ICB		Prior	30 Mar 2015	Goods and Services
<b>IV</b>	<b>Component 4. Supporting power sector reforms and project implementation</b>						
1	TA for Project Management and implementation		QCBS		Prior	4 Dec 2014	
2	TA for Power Sector Strategy and Reform		QCBS		Prior	30 Oct 2014	
3	Management of Distribution System Operation Activities and Capacity Building		QCBS		Prior	30 Nov 2014	
4	Incremental Operating cost (IOC) (1)		-				
5	Other consultants		CQ/IC				

*Note (1) This includes other individual consultants. Note (2) More details are provided in the detailed procurement plan.*

### **Frequency of Procurement Supervision**

32. All contracts for goods and consulting services will have a prior review. In addition to the prior review, at least one procurement supervision mission per year is recommended to review the status of procurement actions.

### **Environmental and Social (including safeguards)**

33. The project will consist of separate PIUs under OShEE (formerly CEZ Sh), KESh and OST for the implementation works of the project components. There will be a PMU at the MoEI responsible for the implementation of the TA component. World Bank's environmental specialist will also provide support and training according to the needs of the PIUs. OShEE, as the implementing agency of Component 2, will share the sub-project ESMPs (environmental and social management plans) with the Bank for no-objection and will disclose the final versions in country and share it with the Bank for Infoshop disclosure. OST, as the implementing agency of Component 3, will not be preparing Environmental Assessment (EA) documents assuming the investments will be Category C in nature. PIUs will also prepare and submit frequent monitoring reports to inform the WB about the status of the EA documents (if under preparation) and the compliance with the relevant EA documents during implementation.

34. In the event of land acquisitions involving resettlements under the second component, OShEE (formerly CEZ Sh) PIU will prepare site specific RAP/LAP (Resettlement Action Plan / Land Acquisition Plan) together with the respective legal department. Site specific plans will be prepared as specified in the RPF (Resettlement Policy Framework). Before any investment takes place, the PIU will carry out initial assessments to evaluate whether a social safeguard for each

sub-project is triggered. If the sub-project triggers a social safeguard, then a site specific plan will be prepared.

### **Project monitoring and evaluation**

35. The PMU will be responsible for results monitoring and evaluation (M&E) activities, including the submission of annual implementation progress reports to the World Bank. A simple management information system for M&E will be developed by the PMU to measure progress towards achievement of the PDO. The key results indicators are specified in Annex 1. For most of the indicators, the PMU will have to create a system for measuring, evaluating and reporting technical and commercial indicators. In addition, each PIU in every of the three power utilities will use its own existing company systems for the indicators.

36. Technical experts in the PMU will have capacity to collect and process data required for the M&E system. In addition, the World Bank team will supervise implementation progress at least twice a year, including results indicators defined in Annex 1 as well as additional financial management and procurement aspects of project implementation. A comprehensive evaluation of project results will be conducted during the project's mid-term review and at completion

37. In order to ensure effective coordination and communication between the project's main actors and stakeholders, a Project Committee will be formed, chaired by the Minister of Energy and Industry or a delegate, and comprised of representatives of the MOEI, KESh, OST and OShEE, with detailed membership, roles and functions as defined in the Project's Operations Manual.

**Annex 4**  
**Operational Risk Assessment Framework (ORAF)**  
**Albania: Power Recovery Project (P144029)**

**Risks**

Project Stakeholder Risks						
<b>Stakeholder Risk</b>	Rating	High				
Risk Description: Customers may object to enforcement of electricity payments, collection efforts and in the case of commercial customers becoming eligible consumers	Risk Management: A consultation process has already started, involving project areas. Further, the project includes a public campaign complemented by customer satisfaction surveys throughout the project, to ensure customer involvement in the process of recovery					
	Resp: Both	Status: In Progress	Stage: Both	Recurrent: <input checked="" type="checkbox"/>	Due Date:	Frequency: Quarterly
Implementing Agency (IA) Risks (including Fiduciary Risks)						
<b>Capacity</b>	Rating	High				
Risk Description: The Borrower may not be able to follow and comply with the Bank's FM and procurement procedures.  Delays in bidding process could result in substantial delays in contract and project implementation.  Insufficient knowledge of Bank's procurement rules and procedures, especially for CEZ, which	<b>Risk Management:</b> The Project Implementation Manual will describe clear procedures for project implementation and monitoring, to be followed by borrower, including detailed roles of the PMU and all three PIUs and their operating staff, and well as FM and procurement procedures. The PMU at the MOEI will closely coordinate and monitor implementation of all three project components, including PIUs activities.  PIUs of OSHEE, as well as OST and PMU at MOEI will hire procurement specialists with experience/qualification in Bank's procurement, as well as project coordinators and FM specialists. All four PIUs/PMU staff will attend the Bank's procurement training to get latest updates on applicable procurement guidelines and procedures. The PMU at MOEI will be assisted in carrying its function by a consulting firm with experience in project implementation and management.					

is responsible for the largest project component.	Resp: Both	Status: In Progress	Stage: Preparation	Recurrent: <input checked="" type="checkbox"/>	Due Date:	Frequency: Quarterly
<b>Governance</b>	Rating	Substantial				
Risk Description: The EC 2013 progress report finds that although there are improvements in the fight against corruption, there are still concerns on political party financing. State institutions dealing with the fight against corruption remain vulnerable to political pressure and influence.	<b>Risk Management:</b> The Team will provide close supervision and ensure ring-fencing of project resources. Guidelines on preventing and combating fraud and corruption will be discussed with the borrower during project negotiations. Independent audits of the financial statements and team review of the procurement plans will be carried out regularly.					
	Resp: Client	Status: Not Yet Due	Stage: Implementation	Recurrent: <input checked="" type="checkbox"/>	Due Date:	Frequency: Quarterly
<b>Project Risks</b>						
<b>Design</b>	Rating	High				
Risk Description: – Preparation risks due to the number of components covering distribution investments and policy reform actions and a new Management without experience in design and implementation of World Bank supported projects. – Institutional arrangements complexity – Timing: there is an urgent need to start tackling the issues in the sector, including preparing Bidding documents and TORs on required supporting studies.	<b>Risk Management:</b> During preparation, the team has coordinated with other IFIs to ensure the complementarity of all efforts, which is key to the success of this project.  The Government, through the Minister of Energy and Industry, has established an inter-Ministerial task force to ensure proper implementation of the loss reduction program and supporting projects/reform program, this will be strengthened with international consultants as needed. Assessment of market reforms have been supported by the Energy Community and donors, which have produced a draft Power Sector Law for consideration by Albania's Parliament.  If needed, retroactive financing is available to start implementation of needed investments, once the legal status of the distribution company is clarified.					
	Resp:	Status: In Progress	Stage:	Recurrent: <input checked="" type="checkbox"/>	Due Date:	Frequency: Quarterly
<b>Social and Environmental</b>	Rating	Moderate				
Risk Description: Social Most of the investments will focus on the distribution sector, no resettlements are	<b>Risk Management:</b> The Government has already started a public campaign to outreach consumers and has indicated its intention to improve targeting of subsidies to low income consumers.					

<p>foreseen for now. Consumers may resist enforcement of electricity payments and associated disconnection policies.</p> <p>Environmental The environmental impacts of the project are now only related to Component 2, which is improving the distribution system. Component 2 will consist of investments on distribution such as meters, cables and potential rehabilitation of selected existing substations. These will have temporary and limited environmental impacts and are expected to be Category B in nature.</p>	<p>The proposed works are not expected to trigger any new safeguard policies. However, if the implementing agency proposes investments in constructing new substations where there would be a need for acquiring new land that potentially involves resettlement, an RAP will be prepared to mitigate any adverse impacts of these investments.</p>					
	Resp: Client	Status: In Progress	Stage: Implementation	Recurrent: <input checked="" type="checkbox"/>	Due Date:	Frequency: Quarterly
<b>Program and Donor</b>	Rating	Low				
<p>Risk Description: Coordination with Donors and IFIs</p>	<p><b>Risk Management:</b> The Government recognizes the need to coordinate and complement donors program, therefore coordinating meetings are planned both during preparation and implementation. The service delivery unit (see below) will support this effort.</p>					
	Resp: Bank	Status: In Progress	Stage: Both	Recurrent: <input checked="" type="checkbox"/>	Due Date:	Frequency: Quarterly
<b>Delivery Monitoring and Sustainability</b>	Rating	Moderate				
<p>Risk Description: - Monitoring of delivery of results involving many institutions.</p>	<p><b>Risk Management:</b> The Government has established, under the PM office, a Service delivery unit that has included the energy sector as one of the key sectors to support. The project team will work with this unit in the establishment of proper M&amp;E systems.</p>					
	Resp: Both	Status: In Progress	Stage: Both	Recurrent: <input checked="" type="checkbox"/>	Due Date:	Frequency: Quarterly
<b>Other (Optional)</b>	Rating					
Risk Description:	<b>Risk Management:</b>					

	Resp:	Status:	Stage:	Recurrent:	Due Date:	Frequency:
<b>Other (Optional)</b>	Rating					
Risk Description:	<b>Risk Management:</b>					
	Resp:	Status:	Stage:	Recurrent:	Due Date:	Frequency:
<b>Overall Risk</b>						
<b>Overall Implementation Risk: High</b>						
<p>Risk Description:</p> <p>Overall implementation risk is rated "High" due to significant risks associated with the need for tariff adjustments, penalization of electricity theft, and gradual opening of the power market. The government is committed to enforce payment discipline among budgetary and not budgetary institutions, and to address the necessary community and stakeholder outreach.</p>						

**Annex 5: Implementation Support Plan**  
**REPUBLIC OF ALBANIA: Power Recovery Project (P143055)**

1. The proposed Project is the first project which lends directly to OShEE, after close to 10 years without lending activities in the distribution sector in Albania. KESh and OST have substantial past, and ongoing, experience of implementing World Bank projects and other IFIs. Close Bank implementation support is essential to successfully implement the distribution component in particular.

**Strategy and Approach for Implementation Support**

2. The strategy and approach for implementation of the Project stem from the risks associated with the implementation of the Project and mitigation measures as described in the ORAF. The following implementation support is proposed which reflect key risks of the Project:

- a. **Schedule of delivery of results and implementation.** The Bank has engaged with the Government, through the fiscal DPL, at a very early stage of Project identification to ensure development of key sectoral policy actions required to accelerate injection of liquidity in the sector. Furthermore, the team engaged with OST early on in preparation of the technical assessment to determine the road map for the removal of MV commercial consumers from the regulated market. Consultations with the Government, and ERE, on the key issues like tariff reform to reflect an updated market model, revision of the Power Law, gradual deregulation of the MV market. The similar proactive approach will be applied to the Project implementation, with particular attention to the coordination of actions with MOF (given the sector's fiscal risk), Min of Energy and other key stakeholders. As a 1<sup>st</sup> step in this direction, a Donors' meeting has been convened for April 8, 2014, to lay out the overall sector strategy and how this project will support it.
- b. **Environmental and social safeguards:** The Bank's environmental and social specialists will continue providing regular support to the Borrower in tackling safeguards related issues during the Project implementation and will closely monitor its compliance with the EMPs and small RPFs. For the distribution network component of the project, an environmental and social management framework (ESMF) has been prepared by OShEE since the exact footprints of the activities are not determined yet.
- c. **Technical inputs:** An individual or consultant firm will provide assistance to the distribution company for the technical review and design of feeder areas, preparation of technical specifications and implementation arrangements. Furthermore, a performance management contract will be established between the distribution company's management and the Ministry of Energy.
- d. **Procurement:** The PIUs established respectively within KESh, OST and OShEE will be responsible for implementation of their respective project components, including procurement activities. The PMU of MOEI will be responsible for overall project management and coordination, including implementation of forth



component. The procurement related implementation support will include training, particularly staff at the distribution company, on both procurement procedures and contract management. Staff at the distribution company have experience in commercial procurement practice, they will be supplemented by team of consultants to evaluate bids for supply and installation of equipment, and for selection of the supervision consultants.

- e. **Financial management** The FM related implementation support will include periodic and on job-training on Bank disbursement guidelines and FM practices, particularly staff at the OShEE and MOEI. Bank team will conduct risk-based financial management supervisions, at appropriate intervals, more frequent during the first years of implementation. During project implementation, the project’s financial management arrangements in the all four implementing units will be reviewed as follows: (a) review on a quarterly basis of the IFRs submitted by each implementing agency as well as the annual project’s audited financial statements and auditor’s management letter; and (b) during the FM on-site supervision missions. Areas for particular review will include the control over contract payments’ monitoring.
- f. **Operation:** The project team includes an experienced power engineer, co-TTL, based in the country office and will conduct periodic supervision of the project and coordinate with the client and other project team members to provide timely guidance and support to the client.

**Table 8: Estimated Resources Required for Project Supervision**

<b>Time</b>	<b>Focus</b>	<b>Skills Needed</b>	<b>Resource Estimate</b>
First year	Technical Review, procurement review, bidding documents	Power Engineer	10 Staff Weeks
	Procurement training	Procurement Specialist	3 Staff Weeks
	Social outreach design support	Social specialist	4 Staff Weeks
		Senior Social Specialist	2 Staff Weeks
	Environmental Supervision	Senior Environmental Specialist	3 Staff Week
	Financial Restructuring Supervision	Senior Financial Restructuring specialist (consultant)	12 Staff Weeks
		Financial Management Specialist	2 Staff Weeks
	Financial Management, Procurement, Disbursement	Financial Management Specialist	2 Staff Weeks
Procurement Specialist		2 Staff Weeks	
	Public outreach	Senior Communication Specialist	4 Staff Week
Years 2-6	Project Construction	IT/ engineer	4 Staff Weeks

<b>Time</b>	<b>Focus</b>	<b>Skills Needed</b>	<b>Resource Estimate</b>
		Procurement and contract management	3 Staff Weeks
	Environmental and Social Monitoring	Senior Environmental Specialist	2 Weeks
		Senior Social Specialist	2 Staff Weeks
		Social Specialist	3 Staff Weeks
	Financial Restructuring Supervision	Senior Financial Restructuring specialist (consultant)	12 Staff Weeks
		Financial Management Specialist	2 Staff Weeks
	Financial Management, Procurement, Disbursement	Financial Management Specialist	2 Staff Weeks
		Procurement Specialist	2 Staff Weeks
	Task Team Leadership	TTL	8 Staff Weeks

**Table 9: Skills Mix Required**

<b>Skills Needed</b>	<b>Number of Staff Weeks</b>	<b>Number of Trips</b>	<b>Comments</b>
TTLs	12 Annually	Field trips as required	HQ based
Senior Environmental specialists	2 annually	Field trips as required	Field based
Senior Social Specialist	2 Annually	Field trips as required	Field based
Social Specialist	4 for the first year 3 the second year	Field trips as required	Country office based
Senior Procurement Specialist	1 Annually	Field trips as required	International
Procurement Specialists	2 Annually	Field trips as required	Country office based
Power Engineer	6 for the first year then 2 Annually	Field trips as required	International
Senior Financial Management Specialist	1 Annually	Field trips as required	International
Communication Specialist	4 Annually	Field trips as required	Country office based

## **Annex 6: Economic and Financial Appraisal**

### **REPUBLIC OF ALBANIA: Power Recovery Project (P143055)**

#### **A. Overview and Summary**

1. The following evaluation of this project was undertaken on the basis of the operational and financial data and basic models of each of the three beneficiaries, KESh, OST and OShEE. While the three main components of the project will be undertaken by separate but related corporate entities, they are inter-related and have been assessed jointly for the sector. The components will be implemented by well established, albeit weakened, revenue producing enterprises and therefore the performance, financial health and viability of each has been assessed individually to ensure the project is fully funded, economically justified and financially sustainable in the longer term.

2. The collapse of CEZ Sh (now renamed to OShEE) has weakened the entire sector. Nevertheless, with focused investments, specific reforms and good management it is possible to turn the sector around. This turnaround will, however, take commitment and additional support if the benefits of the project are to be sustainable in the longer term

3. On the basis of the assumptions outlined below it is apparent that the project is economically viable providing a) real economic returns of 12.1 percent on the aggregate capital investment of US\$ 194 million and a combined net present value of US\$ 15.7 million; and b) a financial return of 19.6 percent and NPV of US\$ 67.2 million at 8 percent rate of discount as indicated in Table 10 below.

#### **B. Financial Projections**

4. *Financial Status of the sector:* The sector is in financial crisis arising from the failed privatization of the distribution company CEZ Sh (now renamed to OShEE) and, being entirely dependent on hydro resources, remains vulnerable to the climatic volatility. By any metric OShEE is insolvent and able to operate only with the support of the Government and the forbearance of both its lenders and suppliers. The entire sector has been negatively impacted and continues to sustain significant damage due to high energy losses and poor revenue collections. KESh and OST, while solvent—in part due a revaluation of their assets—remain highly illiquid due to the lack of consistent payments by OShEE. Key issues plaguing the sector include:

- (i) Insufficient capital investments. Since its privatization in 2008/9, CEZ Sh has exhausted its resources and, without support, is unable to import energy to cover technical and non-technical losses, settle its arrears to trade creditors, nor finance a key loss reduction program. Consequently, the company is now under temporary administration and controlled by the GoA. It has been unable to reduce power losses much below 44 percent by end 2013, and is unable to make consistent payments to KESh, OST and/or energy traders. Furthermore, the Vlore Thermal Power plant is not yet operational<sup>2</sup> and, due to grid bottlenecks arising from

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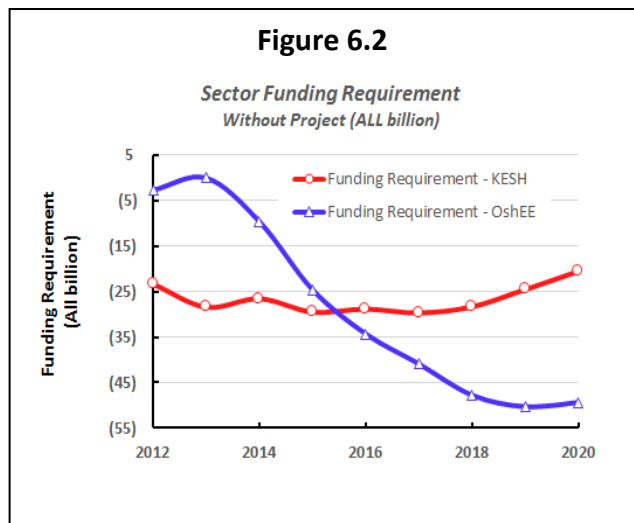
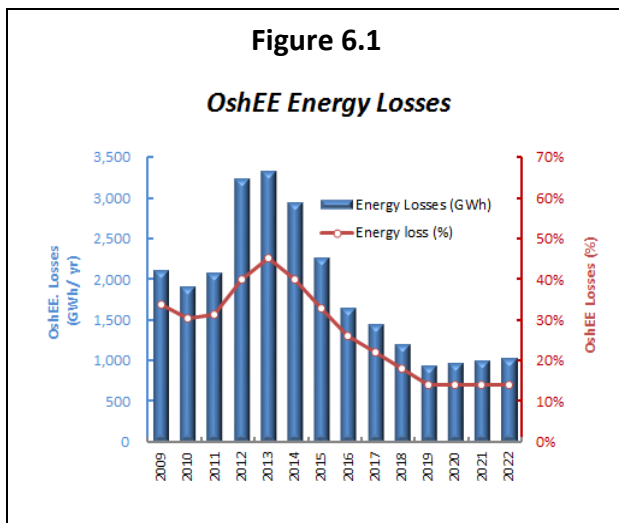
<sup>2</sup> KESh will shortly start an assessment to determine causes of water intake pipeline consecutive breaks and recommend an

deferred investment, OST cannot guarantee reliable transmission capacity for regional imports in case of emergencies. There is therefore an urgent need to make targeted investments to reduce losses in OShEE, commission KESh's Vlore TPP and expand and enhance OST's transmission grid to insure the security of supply.

- (ii) Lack of sector liquidity. The main power participants in the market—KESh and OShEE—are technically insolvent and are unable to meet their obligations or import necessary power required to satisfy domestic demand. At the end of 2013 KESh was overdrawn by US\$ 343 million, most of which was guaranteed by the GoA; and OShEE had a negative net worth of US\$668 million and was unable to access the capital markets. There is an urgent need to mobilize funds to:
  - rapidly inject liquidity into the system to ensure timely imports by both KESh and OShEE;
  - clean up the finances of the sector in order to restore viability, operational liquidity and creditworthiness of market participants; and
  - restore commercial market practices and relationships with suppliers and lenders to sustain operations and provide access to domestic financial markets;
- (iii) Sub-optimal performance. Lack of investment and poor management by CEZ Sh (now renamed to OShEE) has resulted in higher energy losses, lower collections and the erosion of the company's equity base greater than anticipated at the time of the privatization.
- (iv) Regulatory uncertainty and poor institutional capacity. The lack of independence and indecision by government had contributed to a degree of regulatory uncertainty, and limited investment and enforcement of agreements by both sides—this includes the lack of enforcement of commercial contracts, discretionary tariff policies, the absence of an effective market operator (a function of OST), and a private sector distribution company that had been unable or unwilling to make the investments required to effectively reduce technical and non-technical losses. Both sides bear the responsibility of this failure in turning the sector around and ensuring the security of supply.

5. Clearly, targeted financial, policy, and institutional support is needed to address the lack of modern management and institutional capacity to deal with these complex issues and ensure that appropriate market rules are revised and enforced, tariffs reflect the efficient cost of service (including all stranded costs), security of tenure for private investors is reestablished, and investments in the sector are encouraged. To ensure energy security in the longer-term will require dealing with all of the above issues with the full cooperation of, and in close coordination with, the donor community and the Ministries of Finance, Energy, and Economy.

6. Restructuring of OShEE, addressing large energy losses and funding a projected aggregate deficit of over US\$ 700 million is essential and long overdue (see Figs. 6.1 and 6.2 below). A review of the audited financial statements as at end 2012 and estimates for 2013 reveals the true extent of the financial crisis in the Albanian energy sector. OShEE is insolvent and the entire sector has been negatively impacted and continues to sustain high energy losses and poor revenue collections. KESH and OST, while solvent in part due a revaluation of the assets, remain highly illiquid due to the lack of consistent payments by OShEE. This position is unsustainable and can only be reversed by the urgent implementation of a comprehensive program of actions over a prolonged period of time, including improvement in cash collections, reduction of losses, and strong and experienced management teams at each of the utilities, increases of retail tariffs of around 20-25 percent over a period of time, and revision of the market model to facilitate the progressive migration of medium voltage commercial customers from the regulated market, and a power market operated on commercial principles. Without action OShEE's losses could remain high and KESH's funding requirement will continue to deteriorate to unsustainable levels shown in Fig. 6.2 below.



7. Compounded by the settlement cost of the dispute with CEZ a.s. and potential below average rain fall, the sector is in serious difficulty, the scope of which poses an unprecedented threat to Albania's fiscal stability. The proposed project, complemented with reform actions supported by the DPO series, is a necessary, though far from sufficient, first step to restore liquidity to the sector, reduce energy losses, improve revenue collections, and liquidate inter-company arrears.

8. *Incremental Project Projections.* Incremental financial projections for each of the companies and resulting economic and financial evaluations were made on the basis of the financial statements and projections of the companies, and on reasonable assumptions regarded as realistic and reasonable by the Bank team. The project will be financed by retained earnings, long-term loan from the World Bank and where possible short-term working capital loans from the shareholders and/or commercial lenders.

9. The main assumptions inherent in the project technical and financial projections include:

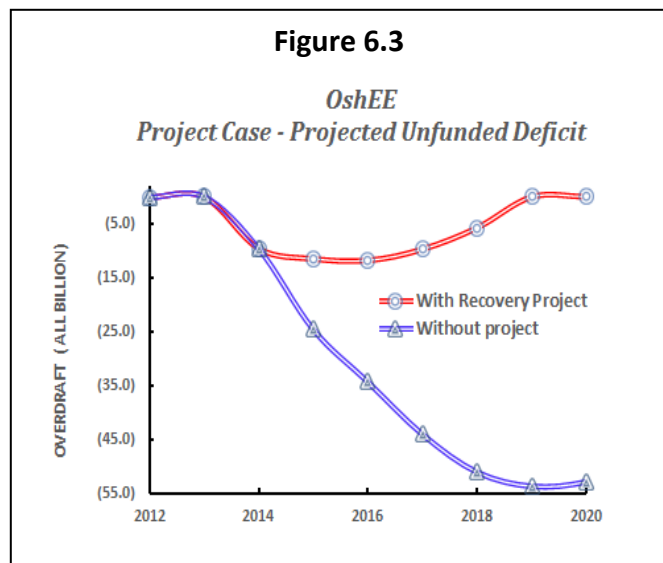
Divestment Settlement	The divestment negotiations with CEZ a.s. was concluded in July 2014 and comprises the repayment of the IFI loans and settlement of the outstanding shareholder creditors in an amount of €95 million with payment of €10 million on closure and four equal tranches starting in 2015. In return, ownership and operational control of the distribution company will pass to the GoA.
Projected energy balance	The energy balance for the sector taking into account increased billed sales arising from previously unbilled energy is set out in detail below.
Energy Tariffs (Lek/kWh)	Full cost recover tariffs, consistent with the prevailing regulatory framework and methodologies have been used
Regulatory Tariffs	Regulatory tariff include a provision of 30% for energy losses imports in 2015 reducing annually by 3 percent thereafter.
Economic Damage	10% of estimated energy losses
Exchange Rate	leke100/US\$; and leke 140/€
Capital Expenditure	<ul style="list-style-type: none"> <li>– KESh. US\$ 30 million (for purchase of imports)</li> <li>– OST US\$ 26</li> <li>– OShEE. US\$ 138 million</li> </ul>
Loan Terms: IBRD	<ul style="list-style-type: none"> <li>Loan: US\$ 150 million</li> <li>Interest rate: 0.75 % pa</li> <li>Front end fee: 0.25 %</li> <li>Term: 22.5 years (include grace period of 7 years)</li> </ul>
Commercial Bank (O/D)	<ul style="list-style-type: none"> <li>Interest rate: 6.0% pa</li> <li>Front end fee: 0%</li> <li>Term: overdraft renewable annually</li> </ul>
Taxes: VAT	20%
Income tax other	15%
Other	0%
Average Depreciation	20 years straight line
Energy prices - Imports	€54.5/MWh
- Export	€28.22/MWh

Energy	Losses	Technical	Non-technical (%)
	2015	14.5	18.5
	2016	14.2	11.8
	2017	13.7	8.3
	2018	13.4	4.7
	2019	12.6	1.4
Revenue Collections		95%	
Improved System Reliability		1.5%	

10. *Financial and Economic Impact of the project:* The cash flows of the sector have in the past been volatile and generally inadequate. Extensive intercompany arrears have accumulated while OShEE has exhausted its resources and asset base. Going forward, however, the cash flows of the OShEE are projected to improve from 2016 onwards as the benefits of the loss reduction program, funded by the project, begin to materialize as shown in the Fig. 6.3. This improvement results from energy losses falling aggressively from 42 percent in 2013 to 18 percent before leveling off from 2018/9 (see Fig. 6.1 above), increased billed sales arising from previously unbilled energy, and better revenue collections.

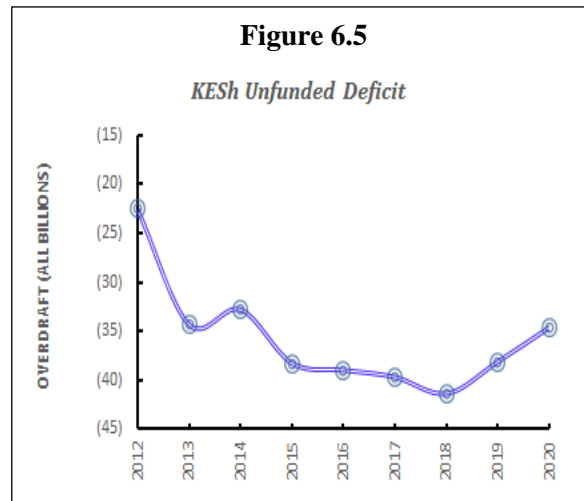
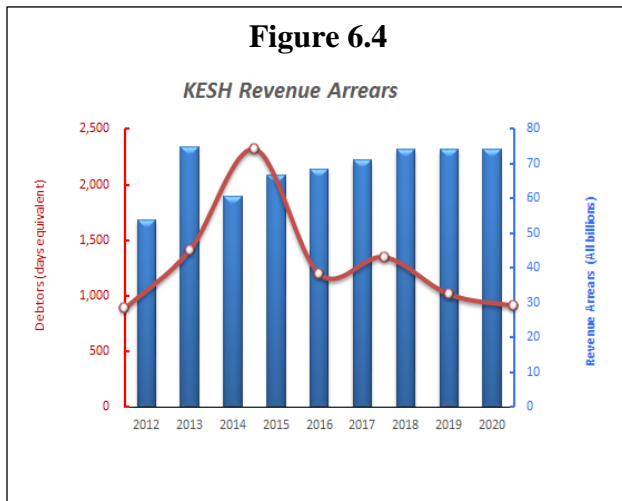
11. The expected financial results for each of the three companies are summarized in Annex 6 (ci)-(ciii). These projections show that with time, focused investment, cost reflective tariffs, and good management, the sector’s decline can be halted and the companies returned to reasonable health. Based on the above assumptions the projections suggest that:

- Distribution. Even with an increase in tariff of 15-20% percent to reflect more fully the prevailing cost structure, it will take OShEE a long time to recover. The project investment is only a first but important step in its recovery. The company can become profitable by 2015, but will still require an additional US\$ 118 million over the period 2014-2019, from IFIs or Government, to further lower losses, reduce arrears and import energy to compensate for technical and non-technical losses as indicated in Fig. 6.3. It will be seen, ceteris paribus, that OShEE will be able to repay this gap over the five years while extending its arrears to KESh and OST, who will bear the financing burden before beginning to liquidate its short-term liabilities by 2018 (Fig. 6.5 below) Of course these liabilities are structurally related and inversely correlated and any difference in the one will negatively impact the other. Finally OShEE’s equity base is negative and, absent a major



recapitalization, will remain so for a very long time. This implies that the company will only be able to continue to operate with the support of the State and any future credit requirements would need to be guaranteed by the State.

- **Transmission.** Despite remaining profitable throughout the collapse of CEZ Sh (OShEE), OST has also been impacted by mounting arrears from the distribution company. It was, however, better placed than KESh to adapt to the situation by curtailing investments. If left ignored this will begin to affect the transmission network, create bottlenecks in the system and delay the benefits of regional integration.
- After a proposed increase in wholesale prices in 2015, KESh will be able to reestablish and maintain profitability thereafter. Liquidity remains a challenge with overdraft facilities reaching just under US\$ 350 million by end 2013 as shown in Fig. 6.5. Mandatory minimum payments by OShEE to liquidate its arrears to KESh and as its position improves will enable KESh to reduce its short-term liabilities at a reasonable pace from 2018 as also indicated in Fig. 6.5. Despite this, KESh and its future outlook remain highly vulnerable to extreme climatic conditions. There is, as mentioned earlier, an urgent need to put in place an appropriate risk management mechanism to place a floor under the impact of below average rain fall patterns to protect the viability of the company and its fragile recovery.



12. Proposed Financial Covenants Covenants to ensure prudent financial structure, creditworthiness, sector liquidity and market operation on commercial basis will include:

- Debt Equity Ratio.** KESh and OST will not incur any debt if, after the incurrence of such debt, the ratio of debt to equity shall be greater than sixty (60) to forty (40).;
- Debt Service Coverage.** The Borrower shall take all the necessary steps to ensure that OST and KESh shall not incur any debt unless a reasonable forecast of the revenues and expenditures of OST and KESh shows that the estimated net revenues of OST and KESh for each fiscal year during the term of the debt to be incurred shall be at least



one (1.0 ) for the first thirty six (36) months and thereafter one and six tenths (1.6) times the estimated debt service requirements of the relevant Project Implementing Entity in such year on all debt of the OST and KESh, including the debt to be incurred.

(c) that a reasonable forecast of OShEE's net revenues and expenditures demonstrates that the ratio of estimated net revenue to debt service requirements is as follows:

- i. within thirty-six (36) months of the Effective Date, six tenths (0.6);
- ii. within the subsequent thirty-six (36) months, one (1.0); and
- iii. thereafter, one and six tenths (1.6).

13. Given the scope of additional required by the distribution it is important to ensure an adequate Flow of Funds throughout the energy sector. Therefor the Borrower shall not later than December 31, 2014, cause OShEE to open a Revenue Escrow Account in a financial institution/s satisfactory to the Bank and deposit its monthly revenues to pay for the energy purchase and transmission costs in accordance with the following schedule:

- (i) 85% of the monthly energy purchase invoice from KESh and 85% of the monthly transmission fees invoice from OST for each of the first twelve (12) months;
- (ii) 95% of the monthly energy purchase invoice from KESh and 95% of the monthly transmission fees invoice from OST for each of the subsequent twenty four (24) months;
- (iii) 100% of the monthly energy purchase invoice from KESh and 100% of the monthly transmission fees invoice from OST for each of the next subsequent thirty-six (36) months;
- (iv) 105% of the monthly energy purchase invoice from KESh and 105% of the monthly transmission fees invoice from OST until such time as the revenue arrears of each Project Implementing Entity are fully amortize and ;
- (v) Transfer any residual funds remaining after paying KESh and OST to OShEE on a monthly basis.

14. The OShEE revenue escrow account will be subjected to an annual audit and submitted to the Bank for review

15. Each of the companies will be required to produce five year business plans and financial projections on an annual basis for submission to the Bank for review. As is usual for revenue producing entities, annual financial audits will also be required.

16. In order to consolidate the sector's finances, monitor performance and ensure proper financing of the sector, the Government will be required to formulate a Power Sector Financial Recovery Plan satisfactory to the Bank on sector's financial and operational performance and based on it an action plan, including but not limited to sources of funding for: (a) power imports not financed by the Project; (b) retail power subsidies; (c) payments made to private power producers; and, (d) projected financial deficits for the power sector.

### C. Incremental Economic and Financial Analysis

17. *Economic analysis:* The energy sector is highly inter-dependent, and any change in the system cascades quickly from one company to the next. Accordingly the project analysis is based on the consolidated results of the sector and total project investment. The economic benefits of the project have been limited to significant quantifiable benefits that include the reduction of technical losses, savings of reduced consumption due to reduction of non-technical losses and reduction of energy not served due to poor reliability of power supply. Consequently the resulting economic net present value (NPV) and the economic internal rate of return (EIRR) should be seen a lower bound relative to the actual economic benefits derived from the project. The economic costs of the project include aggregate investment costs, and incremental operation and maintenance (O&M) costs associated with the investments. The economic valuation of the project adjusted for taxes, interest and other transfers, is set out in detail in Annex 6 (b) and summarized in Table 10 below. The economic analysis, based only on technical losses and improved reliability of supply, yields an economic NPV of negative US\$ 15.7 million and EIRR of 12.1 percent.

18. *Financial Analysis:* Again the financial analysis is carried out from the perspective of the sector as a whole. The main financial benefits of the project for the sector are the savings from lower imports and power purchase costs as a result of incremental loss reduction, and additional sales from the portion of non-technical losses that will be converted to additional billing. The main financial costs of the project are the capital investment costs and incremental O&M costs, inclusive of income tax and import duties.

19. Project returns based on incremental cash flows derived from the financial projections and are set out in detail at the end of this annex and summarized in Table 10 below. Based on conservative assumptions, the analysis demonstrates that the projects are robust and show net present value at an 8% rate of discount of US\$67.2 million and financial rate of return of 19.6 percent.

**Table 10: Incremental Financial and Economic Project Returns**

	Economic Evaluation	Financial Evaluation
Net Present Value <sup>1</sup>	US\$15.7million	US\$67.2 million
IRR	12.1%	19.6%

<sup>1</sup> Discounted at the social discount rate of 8%

20. *Sensitivity Analysis - Switching Values.* Switching values shown in Table 11 below demonstrate the sensitivity of the return on the aggregate investment due to changes in the more significant assumptions and/or variables underlying the financial projections and economic assessment. The values given represent the percentage change in the respective variables required to reduce the economic internal rate of return of the projects to the minimum required rate of return of 8 percent. From this analysis it is apparent that the project and its components are financially robust over a wide range of assumptions, which is not surprising given the state of

the sector and the low base against which the benefits of the project are measured. The project is economically justified but susceptible to small changes in the key variables, which is not unusual for projects of this kind.

**Table 11: Switching Values**

	Switching Values (%)	
	Economic	Financial
Energy Losses	n/a	-25
Capital expenditure	12	34
O&M	60	297
System Reliability	-34	n/a
Import Prices	-22	n/a

21. Financial projections KESh, OST and OSHeE. Projections supporting the above analyses are set out in detail in the project file and summarized in the section 6 (ci) – (ciii).

**Albania Energy System**  
**Sector Energy Balance (2012-2122)**

	(GWh)										
	-----Actual-----		-----Projected-----								
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Total Energy Demand</b>	<b>5,428</b>	<b>8,279</b>	<b>8,311</b>	<b>8,143</b>	<b>7,849</b>	<b>8,392</b>	<b>8,476</b>	<b>8,553</b>	<b>8,807</b>	<b>9,063</b>	<b>9,327</b>
less Distribution Losses (Imports by OshEE)	1,655	3,330	2,944	2,263	1,654	1,448	1,203	938	969	1,001	1,034
OShEE Own Use	3	83	82	77	71	74	74	75	78	80	83
Transmission Losses	169	213	168	189	175	177	176	172	179	181	182
Eligible customers - Industrial	0	600	700	720	740	760	782	804	826	849	873
- Commercial	0	0	0	300	500	800	800	800	800	800	800
<b>Net Domestic Tariff Sales (GWh)</b>	<b>3,600</b>	<b>4,053</b>	<b>4,416</b>	<b>4,594</b>	<b>4,709</b>	<b>5,133</b>	<b>5,441</b>	<b>5,764</b>	<b>5,955</b>	<b>6,152</b>	<b>6,354</b>
KESH Gen. - Drin Cascade	4,047	5,839	3,449	4,041	4,041	4,041	4,041	4,041	4,041	4,041	4,041
less Own consumption	3	4	3	3	3	3	3	3	3	3	3
Generation Losses	17	24	14	17	17	17	17	17	17	17	17
<b>Net KESH Gen.</b>	<b>4,027</b>	<b>5,812</b>	<b>3,431</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>
Other Hydros	398	262	36	0	0	0	0	0	0	0	0
<b>Net Hydro Generation</b>	<b>4,425</b>	<b>6,073</b>	<b>3,467</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>	<b>4,021</b>
Vlora TPP	0	0	0	0	0	270	450	500	750	750	750
less Own consumption & losses	3	3	3	0	0	25	42	47	70	70	70
<b>Net Thermal Generation</b>	<b>(3)</b>	<b>(3)</b>	<b>(3)</b>	<b>0</b>	<b>0</b>	<b>245</b>	<b>408</b>	<b>453</b>	<b>680</b>	<b>680</b>	<b>680</b>
add Concessions and IPPs	298	759	837	854	871	888	906	924	943	962	981
<b>Net Domestic Generation</b>	<b>4,720</b>	<b>6,830</b>	<b>4,301</b>	<b>4,875</b>	<b>4,892</b>	<b>5,154</b>	<b>5,335</b>	<b>5,398</b>	<b>5,644</b>	<b>5,662</b>	<b>5,682</b>
<b>Energy Exchanges</b>											
Imports	123	150	526	200	200	200	200	200	200	200	200
Exports	74	112	545	200	200	200	200	200	200	200	200
add Net Exchanges	48	37	(19)	0	0	0	0	0	0	0	0
less Injection direct into OshEE	0	0	0	0	0	0	0	0	0	0	0
<b>Net Injection to Transmission System</b>	<b>4,768</b>	<b>6,867</b>	<b>4,283</b>	<b>4,875</b>	<b>4,892</b>	<b>5,154</b>	<b>5,335</b>	<b>5,398</b>	<b>5,644</b>	<b>5,662</b>	<b>5,682</b>
less Transmission losses (OST)	169	213	168	189	175	177	176	172	179	181	182
add Injection direct into OshEE	0	0	0	0	0	0	0	0	0	0	0
Purchased Imports	881	171	384	0	63	230	357	612	568	750	938
less Exports	298	953	0	92	8	0	0	0	0	0	0
<b>Domestic Energy Demand</b>	<b>5,182</b>	<b>5,872</b>	<b>4,499</b>	<b>4,594</b>	<b>4,772</b>	<b>5,207</b>	<b>5,516</b>	<b>5,839</b>	<b>6,033</b>	<b>6,232</b>	<b>6,437</b>
<b>Wholesale Public Supplier</b>											
Energy from Concessions and IPPs	298	759	837	854	871	888	906	924	943	962	981
Energy from Vlore	(3)	(3)	(3)	0	0	245	408	453	680	680	680
Energy from KESH Generation	3,608	4,683	3,245	3,741	3,838	3,844	3,845	3,849	3,842	3,840	3,839
Energy from Other Hydros	398	262	36	0	0	0	0	0	0	0	0
Energy Imports by WPS	881	171	384	0	63	230	357	612	568	750	938
<b>Energy Supplied to OshEE</b>	<b>5,193</b>	<b>5,887</b>	<b>4,499</b>	<b>4,594</b>	<b>4,772</b>	<b>5,207</b>	<b>5,516</b>	<b>5,839</b>	<b>6,033</b>	<b>6,232</b>	<b>6,437</b>
TSO Balancing Energy for 2012	15	15									
WPS Eligible Customers for 2012	4	0									
Energy Supplied to OShEEfor OShEECustomers	3,600	4,030									
Energy Supplied to OShEEfor OShEELosses and in	1,593	1,857									
<b>Energy Supplied to OshEE</b>	<b>5,193</b>	<b>5,887</b>									

**Albania Energy Sector Recovery Project**  
**Incremental Economic and Financial Evaluation 2014-2029**

Leke million

	Incremental Economic Benefits								Incremental Financial Benefits							
	Billed Sales (GWh)	Loss Reduction (%)	Project Benefits			Capital Investment	O&M Costs	Net Economic	Billed Sales (GWh)	Loss Reduction	Project Benefits		Capital Investm	O&M Costs	CIT/VAT	Net Financial
			Technical Losses <sup>2</sup>	Reduced Consumption <sup>3</sup>	Power Quality <sup>4</sup>						Energy Losses <sup>2</sup>	Power Quality				
2014	4,416	0.0%	0		5,769	3,000	75	2,694	4,416	2.0%	691	3,000	75	600	(2,984)	
2015	4,954	0.0%	0	117	1344	4,248	75	(2,862)	4,954	6.0%	2,423	4,248	75	850	(2,749)	
2016	4,709	0.0%	0	104	1228	4,248	362	(3,278)	4,709	10.0%	4,009	4,248	362	850	(1,451)	
2017	5,133	0.5%	198	76	1238	4,248	362	(3,098)	5,133	12.8%	5,774	4,248	362	1,024	140	
2018	5,441	0.8%	336	62	1272	4,248	362	(2,940)	5,441	11.9%	5,632	4,248	362	1,003	19	
2019	5,764	1.6%	718	45	1336	140	362	1,597	5,764	11.3%	5,627	140	362	797	4,328	
2020	5,955	1.6%	742	47	1339	0	362	1,765	5,955	8.3%	4,130	0	362	565	3,203	
2021	6,152	1.6%	766	23	1401	0	362	1,828	6,152	8.0%	4,099	0	362	560	3,176	
2022	6,354	1.6%	792	24	1462	0	362	1,915	6,354	6.0%	3,108	0	362	412	2,334	
2023	6,354	1.6%	792	24	1462	0	362	1,915	6,354	6.0%	3,108	0	362	412	2,334	
2024	6,354	1.6%	792	24	1462	0	362	1,915	6,354	6.0%	3,108	0	362	412	2,334	
2025	6,354	1.6%	792	24	1462	0	362	1,915	6,354	6.0%	3,108	0	362	412	2,334	
2026	6,354	1.6%	792	24	1462	0	362	1,915	6,354	6.0%	3,108	0	362	412	2,334	
2027	6,354	1.6%	792	24	1462	0	362	1,915	6,354	6.0%	3,108	0	362	412	2,334	
2028	6,354	1.6%	792	24	1462	0	362	1,915	6,354	6.0%	3,108	0	362	412	2,334	
						<b>NPV<sup>1</sup></b>	<b>1,573</b>					<b>NPV<sup>1</sup></b>	<b>6,720</b>			
						<b>EIRR</b>	<b>12.1%</b>					<b>FIRR</b>	<b>19.6%</b>			

<sup>1</sup> Net present value at a 8 percent rate of discount

<sup>2</sup> Calculated at avoided cost of standby generators

<sup>3</sup> Savings of reduced consumption due to reduction of non-technical losses

<sup>4</sup> Imports to avoid standby generation/load shedding

**Power Generation Company (KESh)**  
**Summary Projected Consolidated Financial Statements**

(leke millions)

	2012 (actual)	2013	2014	2015	2016	2017	2018
<b>A. Pro Forma Income Statement</b>							
Domestic sales revenue	22,554	23,140	9,705	18,474	19,485	26,702	30,645
Energy exports	2,003	5,425	0	364	33	0	0
<b>Net Sales Revenue</b>	<b>24,557</b>	<b>28,565</b>	<b>9,705</b>	<b>18,838</b>	<b>19,518</b>	<b>26,702</b>	<b>30,645</b>
less: Energy imports	7,923	1,308	2,940	0	482	1,760	2,734
Operating Costs	7,578	11,230	11,274	11,472	11,694	16,790	19,873
Net Interest charge	3,795	2,196	2,994	2,919	3,129	3,127	3,115
add: other/extraordinary income	1,896	(4,468)	0	0	0	0	0
<b>Pre tax Profit</b>	<b>7,157</b>	<b>9,364</b>	<b>(7,503)</b>	<b>4,446</b>	<b>4,213</b>	<b>5,025</b>	<b>4,924</b>
less: Tax	719	1,405	148	667	632	754	739
dividend paid	0	0	0	0	0	0	0
<b>Net Distributable Profit</b>	<b>6,438</b>	<b>7,959</b>	<b>(7,651)</b>	<b>3,779</b>	<b>3,581</b>	<b>4,271</b>	<b>4,185</b>
<b>B. Pro Forma Cashflow Statement</b>							
<b>i) Cash Flows from Operations:</b>							
Net Income	6,438	7,959	(7,651)	3,779	3,581	4,271	4,185
add: depreciation	2,001	1,854	1,926	2,027	2,105	2,733	2,783
change in working capital	(91)	(20,266)	10,114	(7,934)	(4,084)	(4,429)	(4,909)
provision for Bad Debts							
<b>Net Cash Provided by Operations</b>	<b>8,348</b>	<b>(10,452)</b>	<b>4,389</b>	<b>(2,127)</b>	<b>1,601</b>	<b>2,576</b>	<b>2,060</b>
<b>II) Cash Flows from Investing Activities:</b>							
new capital expenditure/IDC	1,846	242	1,641	1,140	105	141	446
<b>Net Cash used for Investing Activities:</b>	<b>1,846</b>	<b>242</b>	<b>1,641</b>	<b>1,140</b>	<b>105</b>	<b>141</b>	<b>446</b>
<b>III) Cash Flows from Financing Activities:</b>							
equity receipts	4,499	0	0	0	0	0	0
add: proceeds from long-term debt (+)	(2,300)	(1,109)	(1,217)	(2,210)	(2,205)	(3,135)	(3,309)
less: dividends paid	0	0	0	0	0	0	0
<b>Cash used by Financing Activities</b>	<b>2,199</b>	<b>(1,109)</b>	<b>(1,217)</b>	<b>(2,210)</b>	<b>(2,205)</b>	<b>(3,135)</b>	<b>(3,309)</b>
<b>NET Inc./ (Dec.) IN SURPLUS CASH</b>	<b>8,700</b>	<b>(11,803)</b>	<b>1,532</b>	<b>(5,478)</b>	<b>(708)</b>	<b>(700)</b>	<b>(1,695)</b>
add: Bal ST deposits(+)/ Commercial Loan(-) b/f	(11,670)	(22,522)	(34,325)	(32,793)	(38,271)	(38,980)	(39,680)
<b>Balance ST deposits(+)/Commercial Loan(-) c/f</b>	<b>(22,522)</b>	<b>(34,325)</b>	<b>(32,793)</b>	<b>(38,271)</b>	<b>(38,980)</b>	<b>(39,680)</b>	<b>(41,375)</b>
<b>C. Pro Forma Balance Sheet</b>							
Other Current Assets	61,836	81,432	65,965	71,436	73,327	75,981	79,026
Short-term deposits	809	0	0	0	0	0	0
<b>Current Assets</b>	<b>62,645</b>	<b>81,432</b>	<b>65,965</b>	<b>71,436</b>	<b>73,327</b>	<b>75,981</b>	<b>79,026</b>
Net Fixed Assets	105,047	103,435	103,150	102,263	100,263	97,671	95,334
<b>Total Assets</b>	<b>167,693</b>	<b>184,867</b>	<b>169,115</b>	<b>173,699</b>	<b>173,589</b>	<b>173,652</b>	<b>174,360</b>
Other current liabilities	17,102	21,942	13,625	11,143	8,786	6,761	4,852
Overdraft	23,331	34,325	32,793	38,271	38,980	39,680	41,375
<b>Net Current Liabilities</b>	<b>40,433</b>	<b>56,267</b>	<b>46,419</b>	<b>49,414</b>	<b>47,766</b>	<b>46,441</b>	<b>46,228</b>
WB Loan							
Commercial loans	47,766	41,147	42,895	40,704	38,662	35,778	32,514
<b>Total Long-term Liabilities</b>	<b>47,766</b>	<b>41,147</b>	<b>42,895</b>	<b>40,704</b>	<b>38,662</b>	<b>35,778</b>	<b>32,514</b>
Paid In Equity	20,071	20,071	20,071	20,071	20,071	20,071	20,071
Reserves	48,251	48,251	48,251	48,251	48,251	48,251	48,251
Retained Earnings	11,171	19,130	11,479	15,258	18,839	23,110	27,296
<b>Total Shareholders' Equity</b>	<b>79,494</b>	<b>87,453</b>	<b>79,802</b>	<b>83,581</b>	<b>87,162</b>	<b>91,433</b>	<b>95,618</b>
<b>Total Capital &amp; Long-term Liabilities</b>	<b>167,693</b>	<b>184,867</b>	<b>169,115</b>	<b>173,699</b>	<b>173,589</b>	<b>173,652</b>	<b>174,360</b>
<b>D. Financial Ratios</b>							
Profit Margin (%)	26%	28%	-79%	20%	18%	16%	14%
Debt Service Coverage	3.0	(39.3)	(0.4)	3.4	3.5	4.3	4.4
Debt/Total Capitalization Ratio (%)	28%	22%	25%	23%	22%	21%	19%

**Albania Transmission Operator (OST)**  
**Summary Projected Consolidated Financial Statements**

(leke millions)

	2012 (actual)	2013	2014	2015	2016	2017	2018
<b>A. Pro Forma Income Statement</b>							
Domestic sales revenue	5,768	6,115	5,496	6,433	6,695	6,942	7,260
Energy exports							
<b>Net Sales Revenue</b>	<b>5,768</b>	<b>6,115</b>	<b>5,496</b>	<b>6,433</b>	<b>6,695</b>	<b>6,942</b>	<b>7,260</b>
less: Energy imports	0	0	0	0	0	0	0
Operating Costs	3,013	3,138	3,231	3,657	3,847	3,975	4,148
Net Interest charge	192	381	680	699	503	418	380
add: other/extraordinary income	0	0	0	0	0	0	0
<b>Pre tax Profit</b>	<b>2,563</b>	<b>2,596</b>	<b>1,586</b>	<b>2,077</b>	<b>2,346</b>	<b>2,550</b>	<b>2,733</b>
less: Tax	315	389	238	312	352	382	410
dividend paid	0	0	0	0	0	0	0
<b>Net Distributable Profit</b>	<b>2,247</b>	<b>2,207</b>	<b>1,348</b>	<b>1,765</b>	<b>1,994</b>	<b>2,167</b>	<b>2,323</b>
<b>B. Pro Forma Cashflow Statement</b>							
<b>i) Cash Flows from Operations:</b>							
Net Income	(0)	2,207	1,348	1,765	1,994	2,167	2,323
add: depreciation	0	1,123	1,261	1,519	1,731	1,857	1,857
change in working capital	0	(1,827)	(1,741)	(889)	(287)	(297)	(310)
<b>Net Cash Provided by Operations</b>	<b>(0)</b>	<b>1,503</b>	<b>868</b>	<b>2,395</b>	<b>3,438</b>	<b>3,726</b>	<b>3,869</b>
<b>II) Cash Flows from Investing Activities:</b>							
new capital expenditure/IDC	0	5,531	10,303	8,489	5,013	7,015	5,578
<b>Net Cash used for Investing Activities:</b>	<b>0</b>	<b>5,531</b>	<b>10,303</b>	<b>8,489</b>	<b>5,013</b>	<b>7,015</b>	<b>5,578</b>
<b>III) Cash Flows from Financing Activities:</b>							
equity receipts	0	0	0	0	0	0	0
add: proceeds from long-term debt (+)	0	1,208	11,087	11,554	2,534	2,675	(2,325)
less: dividends paid	0	0	0	0	0	0	0
<b>Cash used by Financing Activities</b>	<b>0</b>	<b>1,208</b>	<b>11,087</b>	<b>11,554</b>	<b>2,534</b>	<b>2,675</b>	<b>(2,325)</b>
<b>NET Inc./ (Dec.) IN SURPLUS CASH</b>	<b>(0)</b>	<b>(2,819)</b>	<b>1,653</b>	<b>5,460</b>	<b>959</b>	<b>(614)</b>	<b>(4,034)</b>
add: Bal ST deposits(+)/ Commercial Loan(-) b/f	0	124	(2,695)	(1,042)	4,417	5,377	4,763
<b>Balance ST deposits(+)/Commercial Loan(-) c/f</b>	<b>124</b>	<b>(2,695)</b>	<b>(1,042)</b>	<b>4,417</b>	<b>5,377</b>	<b>4,763</b>	<b>729</b>
<b>C. Pro Forma Balance Sheet</b>							
Other Current Assets	6,551	6,468	7,903	8,792	9,079	9,377	9,687
Short-term deposits	124	4	3	4,417	5,377	4,763	729
<b>Current Assets</b>	<b>6,675</b>	<b>6,472</b>	<b>7,906</b>	<b>13,210</b>	<b>14,456</b>	<b>14,140</b>	<b>10,416</b>
Net Fixed Assets	39,312	43,719	52,761	59,731	63,013	68,172	71,893
<b>Total Assets</b>	<b>45,987</b>	<b>50,191</b>	<b>60,667</b>	<b>72,941</b>	<b>77,469</b>	<b>82,312</b>	<b>82,309</b>
Other current liabilities	3,651	1,674	2,475	2,475	2,335	2,335	3,570
Overdraft	0	2,698	1,045	0	0	0	0
<b>Net Current Liabilities</b>	<b>3,651</b>	<b>4,372</b>	<b>3,520</b>	<b>2,475</b>	<b>2,335</b>	<b>2,335</b>	<b>3,570</b>
WB Loan							
Commercial loans	21,223	22,499	32,479	44,033	46,708	49,383	45,823
<b>Total Long-term Liabilities</b>	<b>21,223</b>	<b>22,499</b>	<b>32,479</b>	<b>44,033</b>	<b>46,708</b>	<b>49,383</b>	<b>45,823</b>
Paid In Equity	15,658	15,658	15,658	15,658	15,658	15,658	15,658
Reserves	3,176	3,175	3,175	3,175	3,175	3,175	3,175
Retained Earnings	2,279	4,486	5,834	7,599	9,593	11,760	14,083
<b>Total Shareholders' Equity</b>	<b>21,113</b>	<b>23,320</b>	<b>24,668</b>	<b>26,433</b>	<b>28,427</b>	<b>30,594</b>	<b>32,917</b>
<b>Total Capital &amp; Long-term Liabilities</b>	<b>45,988</b>	<b>50,191</b>	<b>60,667</b>	<b>72,941</b>	<b>77,470</b>	<b>82,312</b>	<b>82,310</b>
<b>D. Financial Ratios</b>							
Profit Margin (%)	39%	36%	25%	27%	30%	31%	32%
Debt Service Coverage	0%	2.3	2.1	1.5	1.7	1.9	2.0
Debt/Total Capitalization Ratio (%)	46%	45%	54%	60%	60%	60%	56%



**Albania Distribution System Operator Operator (OsHEE)**  
**Summary Projected Consolidated Financial Statements**

(leke millions)

	2012 (actual)	2013	2014	2015	2016	2017	2018
<b>A. Pro Forma Income Statement</b>							
Domestic sales revenue	37,779	37,706	46,903	59,482	56,217	63,673	66,752
Energy exports	0	0	0	0	0	0	0
<b>Net Sales Revenue</b>	<b>37,779</b>	<b>37,706</b>	<b>46,903</b>	<b>59,482</b>	<b>56,217</b>	<b>63,673</b>	<b>66,752</b>
less: Energy imports	8,866	21,403	22,560	22,092	12,740	11,094	9,215
Operating Costs	65,945	36,754	30,752	41,483	41,057	48,323	51,730
Net Interest charge	615	94	725	1,331	1,658	1,725	1,654
add: other/extraordinary income	(1)	(5,414)	1,106	0	0	0	0
<b>Pre tax Profit</b>	<b>(37,648)</b>	<b>(25,959)</b>	<b>(6,028)</b>	<b>(5,424)</b>	<b>762</b>	<b>2,531</b>	<b>4,154</b>
less: Tax	270	1,103	888	300	364	630	873
dividend paid	0	0	0	0	0	0	0
<b>Net Distributable Profit</b>	<b>(37,918)</b>	<b>(27,062)</b>	<b>(6,916)</b>	<b>(5,724)</b>	<b>398</b>	<b>1,901</b>	<b>3,281</b>
<b>B. Pro Forma Cashflow Statement</b>							
<b>i) Cash Flows from Operations:</b>							
Net Income	0	(27,062)	(6,916)	(5,724)	398	1,901	3,281
add: depreciation	0	3,472	3,557	3,632	3,804	3,977	4,150
change in working capital	0	19,654	(10,626)	(5,914)	(9,206)	(8,204)	(7,194)
Provision for Bad Debts	0	10,722	7,080	7,995	6,546	6,221	5,246
	0						
<b>Net Cash Provided by Operations</b>	<b>0</b>	<b>6,785</b>	<b>(6,905)</b>	<b>(11)</b>	<b>1,542</b>	<b>3,895</b>	<b>5,483</b>
<b>ii) Cash Flows from Investing Activities:</b>							
new capital expenditure/IDC	0	1,777	1,500	3,458	3,458	3,458	3,458
<b>Net Cash used for Investing Activities:</b>	<b>0</b>	<b>1,777</b>	<b>1,500</b>	<b>3,458</b>	<b>3,458</b>	<b>3,458</b>	<b>3,458</b>
<b>iii) Cash Flows from Financing Activities:</b>							
equity receipts	0	0	0	0	0	0	0
add: proceeds from long-term debt (+)	0	(5,741)	(1,179)	1,571	1,619	1,650	1,955
less: dividends paid	0	0	0	0	0	0	0
<b>Cash used by Financing Activities</b>	<b>0</b>	<b>(5,741)</b>	<b>(1,179)</b>	<b>1,571</b>	<b>1,619</b>	<b>1,650</b>	<b>1,955</b>
<b>NET Inc./ (Dec.) IN SURPLUS CASH</b>	<b>0</b>	<b>(733)</b>	<b>(9,584)</b>	<b>(1,898)</b>	<b>(297)</b>	<b>2,088</b>	<b>3,981</b>
add: Bal ST deposits(+)/ Commercial Loan(-) b/f	0	732	(1)	(9,585)	(11,483)	(11,780)	(9,691)
<b>Balance ST deposits(+)/Commercial Loan(-) c/f</b>	<b>732</b>	<b>(1)</b>	<b>(9,585)</b>	<b>(11,483)</b>	<b>(11,780)</b>	<b>(9,691)</b>	<b>(5,710)</b>
<b>C. Pro Forma Balance Sheet</b>							
Other Current Assets	14,921	9,904	7,621	5,122	5,174	5,642	6,265
Short-term deposits	834	0	0	0	0	0	0
<b>Current Assets</b>	<b>15,755</b>	<b>9,904</b>	<b>7,621</b>	<b>5,122</b>	<b>5,174</b>	<b>5,642</b>	<b>6,265</b>
Net Fixed Assets	24,589	22,894	20,837	20,663	20,316	19,797	19,104
<b>Total Assets</b>	<b>40,343</b>	<b>32,798</b>	<b>28,458</b>	<b>25,786</b>	<b>25,490</b>	<b>25,439</b>	<b>25,368</b>
Other current liabilities	65,020	89,624	83,370	82,905	80,264	78,445	77,119
Overdraft	102	1	9,585	11,483	11,780	9,691	5,710
<b>Net Current Liabilities</b>	<b>65,123</b>	<b>89,625</b>	<b>92,956</b>	<b>94,388</b>	<b>92,044</b>	<b>88,136</b>	<b>82,830</b>
WB Loan							
Commercial loans	14,932	9,946	9,192	10,811	12,461	14,417	16,372
<b>Total Long-term Liabilities</b>	<b>14,932</b>	<b>9,946</b>	<b>9,192</b>	<b>10,811</b>	<b>12,461</b>	<b>14,417</b>	<b>16,372</b>
Paid In Equity	30,099	30,099	30,099	30,099	30,099	30,099	30,099
Reserves	2,916	2,916	2,916	2,916	2,916	2,916	2,916
Retained Earnings	(72,726)	(99,788)	(106,704)	(112,428)	(112,030)	(110,129)	(106,848)
<b>Total Shareholders' Equity</b>	<b>(39,711)</b>	<b>(66,773)</b>	<b>(73,689)</b>	<b>(79,412)</b>	<b>(79,015)</b>	<b>(77,113)</b>	<b>(73,833)</b>
<b>Total Capital &amp; Long-term Liabilities</b>	<b>40,344</b>	<b>32,798</b>	<b>28,459</b>	<b>25,786</b>	<b>25,490</b>	<b>25,439</b>	<b>25,369</b>
<b>D. Financial Ratios</b>							
Profit Margin (%)	0%	-72%	-15%	-10%	1%	3%	5%
Debt Service Coverage	0.0	-8.8	-0.3	0.0	0.5	0.8	1.6
Debt/Total Capitalization Ratio (%)	0%	30%	32%	42%	49%	57%	65%