PRIORITY INFRASTRUCTURE PROJECTS
Progress Update Report

I. BACKGROUND AND SCOPE

This report was prepared by the Energy Community Secretariat for the 7th Ministerial Council (MC) meeting and refers to:

- Progress with the infrastructure projects on the current Priority projects list, approved at the 3rd MC in December 2007 in Belgrade, and updated at the 5th MC in December 2008 in Tirana.
- The necessity to introduce a limited number of new projects that have regional significance, on the updated list.
- Investment facilitation activities by the Energy Community Secretariat.

The report was prepared on the ground of the explicit guidance of the Ministerial Council\(^1\) and reflects the status as on 25.10.2009.

II. THE ENERGY INVESTMENTS OUTLOOK (2008-2009)

Since the Energy Community Secretariat reported to the Ministerial Council in December 2008, a significant financial and economic crisis has made visible its impact on energy investments globally, and even more, on the Energy Community. The global economic crisis was triggered by the financial crisis that took a dramatic turn in the second half of 2008.

- The financial and economic crisis

Energy investments in most regions and sectors are expected to drop sharply in 2009, mostly in the OECD countries\(^2\). The financing environment is getting tougher, the final demand for energy is weakening and the cash flows are falling. Both supply and demand investments are being affected. The energy supply infrastructure is being affected in three ways by the financial and economic crisis:

- Tighter credits; energy companies find it more difficult to obtain credit for both ongoing operations and new projects; in some cases, the cost of capital has risen in absolute terms, making marginal investments uneconomic;
- Lower profitability of new power generation investments
- Less need for capacity, with the falling demand for energy caused by economic downturn.

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\(^1\) Conclusion 10, 3rd Ministerial Council Meeting Belgrade, 18th December 2007.

The GDP growth and energy demand forecast

The EBRD, in its publication of Transition Report (to be officially released in November 2009), revises down 2009 economic forecasts: the economies of central and eastern Europe are expected to contract by an average of 6.3% in 2009; signs of positive growth in the third quarter of 2009 suggest that the recession is now bottoming out in many countries of the EBRD region; however, any upturn in 2010 is likely to be fragile and patchy.

In 2008 – 2009, in the Energy Community, the electricity consumption has varied widely, with mostly sharply decline, on a year to year comparison (Feb.2009/Feb2008) across in the Energy Community, as follows: by + 5.6% in Albania; - 6.3% in the FBiH; +10.3% in BiH – RS, - 1% in Croatia; -6.2 % in the Former Yugoslav Republic of Macedonia; - 22.1 % in Montenegro, and +1.4% in Serbia.

The energy consumption forecast 2010 to 2020, as presented by the Contracting Parties in their recently published Security of Supply Statements (July 2009), gives a moderated average electricity growth of: 3.027%/year in Albania; 3.6%/year in Bosnia and Herzegovina; 2%year (2010-2012) in Croatia; 2.5 %/year in former Yugoslav Republic of Macedonia; no forecast available for Montenegro;1.79 %/year (2010-2015) in Serbia; 3.63% (2010 – 2018) in Kosovo.

The uncertainty of the future economy growth coupled with the decreasing demand for electricity as compared to previous years makes investors even more prudent.

Implications for energy security, climate change and energy poverty

Most probably, the Energy Community as a region will suffer from the economic and financial crisis even more than the OECD countries, as the economies in transitions are more fragile; moreover their energy sectors need more new infrastructure investments, as well rehabilitation and life extension of existing installations.

Most of the investments in the region are made by international power companies that are facing problems in financing operations and new investment on their own markets, and therefore have become even more cautious in less known and predictable, and also smaller markets. Recent tenders in the Energy Community have received relatively weak responses from the key energy players, and in some cases had to be re-tendered.

The postponed energy related investments will only affect capacity with a time lag that amounts to several years. This means that, when the region’s economy will recover, there will be an even greater lack of capacity that will lead to increased energy prices.

The implications on the climate change depend on the type of technology being chosen in the near future (less energy efficient, most probably), but also on the currently low carbon prices that could result in lower investments in clean energy technologies.

The energy poverty may deepen as result of less access to poor households to electricity and other forms of modern energy.

Operating under these additional constraints, investments in the energy infrastructure have registered a limited progress, as compared to 2008.

3 Net consumption figures with the exception of Bosnia and Herzegovina; sources: Albania (ERE); BiH (the power companies and the FBiH Ministry of Energy and Mining), Croatia UCTE), Former Yugoslav Republic of Macedonia (MEPSO); Montenegro (EPCG Prenos); Serbia (EPS).
4 Pursuant to UN Security Council Resolution 1244.
III. INFRASTRUCTURE PRIORITY PROJECTS: UPDATE

1. Summary

The Secretariat has prepared a progress update (please, see Attachment) based on the information collected from the Contracting Parties (the PHLG members, the incumbent energy utilities and transmission system operators) as well as from the publicly available sources. This refers to the progress registered from 15 November 2008 up to 25 October 2009.

The first indicative priority list contained:
- 20 projects (12 in electricity and 8 in gas) in Part A, that includes more advanced projects; and
- 23 projects (20 in electricity and 3 in gas) in Part B - this lists projects in preparation and looking for investors or financiers.

At the Ministerial Council Meeting in December 2008, three new projects were added to the list.

2. Progress with the projects listed in Part A

Some electricity projects, especially interconnections, in this part A have made progress as expected, or at least enough progress to give confidence that these will go through in the near future.

i. Electricity Interconnections

The construction of the OVHL 400 kV interconnection Albania – Montenegro is progressing well on both sides and the line is expected to be commissioned by mid 2010; “the line will represent a valuable asset for Albania and constitutes an important missing link in the regional power network”\(^5\) link. The construction of the OHL 400kV transmission between Tirana and Elbasan (Albania) is also progressing accordingly and expected to be finished by April 2010. This will also an important link in the Albania, but also regional electricity market.

The OHL 400kV interconnection between Albania and Kosovo\(^6\) has made progress in the sense that the two TSOs signed an agreement to build this ramification from the interconnection between Albania and Montenegro, already being built; the financial agreement with KfW Entwicklungsbank is under negotiations; the construction expected to start in 2010 and finish 2012.

The OHL 400kV interconnection between Croatia – Hungary that started in 2008 is expected to be finalized by June 2010; construction is progressing according to plans; this has been also co financed under the EU TEN – E Projects of common interest; the line is expected to increase the energy security of Croatia, as well as the region.

The OHL 400 kV between the former Yugoslav Republic of Macedonia and Serbia has also progressed well in Serbia which finished Section I of the line and works are ongoing for Section II; in former Yugoslav Republic of Macedonia, the Environment Impact Assessment study is progressing with IPA IPF funding and the financing is being finalized with the World Bank. The line will increase the net transmission capacity at the border and two more substations will be connected at the Serbian side.

ii. Power generation

In power generation, progress was registered in Albania: the CCTP Vlore was commissioned and operates at partial capacity (25-30MW); it is expected to be fully operational by end of October 2009;

The construction of Ashta HPP on Drin River also made progress with the mechanical equipment being contracted in September 2009 and the environmental clearance granted by the Ministry of Environment in April 2009; this is expected to be operational in 2012, reducing Albania’s power deficit.

\(^5\) UCTE Transmission Development Plan (adopted in April 2009)
Another very important decision was made by the authorities in Kosovo\(^6\) regarding the downsizing of the planned 2000MW lignite fired “Kosovo C” power plant now re-named “New Kosovo” power plant; after the tender launched in 2006, three international consortia: EnBW (Germany)/ WGI (US), Enel (Italy)/ Sencap (Greece US) and CEZ (Czech Republic)/AES (US) and the energy company RWE AG (Germany) were selected to advance in the prequalification procedure. In summer 2009, two of the prequalified investors (EnBW/WGI and RWE AG) withdraw from the tender, and later, in October 2009, the Ministry of Energy and Mining announced the decision to build a 2x500 MW TPP with a first phase of 500 MW. Strategic environment assessment was prepared. Guidelines for Transaction Advisors for preparing Request for Proposal for short listed investors are being prepared. The negotiations with the investor are expected to be closed in 2010; the new value of the mine and the power plant is 2.7 billion Euro.

### iii. Gas interconnection

The Gas Transmission Pipeline Bosiljevo - Ploče in Croatia has progressed accordingly: The construction of the 1st section Bosiljevo – Split is finished; 2\(^{nd}\) section – Josipdol – Gospić the construction has started; the remaining three sections are in different phases of permitting. The funding is provided by Plinacro and the EIB. This pipeline represents the link to the Ionian Adriatic Pipeline and also facilitates the gasification of Bosnia and Herzegovina.

In gas, one of the most important pipelines for the regional market is the Ionian Adriatic Pipeline for which Intergovernmental Declaration for Ionian-Adriatic gas pipeline and MoU on implementation of this project between Swiss Company EGL and Plinacro Ltd. (Croatia) were signed in September 2007. In December 2008, Bosnia and Herzegovina signed also the Intergovernmental Declaration and by this has become party in the project; 2009 the pre-feasibility study (the technical part) was finalized and the market study is in preparation.

Gas Transmission Pipeline System connecting Hungary (Section I), Croatia (Section II) and Bosnia and Herzegovina(Section III) made progress in the Sections I and II for which construction is planned to start in December 2009, respectively started in October 2009. Section III is in the preparation phase with Preliminary design finished, EIA study in progress, Basic design in progress.

The developer of the Sava pipeline (Bosnia and Herzegovina) that represents part of the link between the Bosnian and Croatian gas network was selected in 2008. The EBRD has approved a €100 million loan for the project, which is contingent on the approval of the governments of both FBiH and Republika Srpska. In 2009, Srbijagas started negotiations with Slavija International, which holds the concession to build the gas pipeline through northern Bosnia and Herzegovina, to become an investor in the pipeline. The Sava pipeline may represent the link to the South Stream gas pipeline.

More detailed information on these, as well as on other projects that have registered some progress is presented in Annex A.

### 3. Lack of progress or limited progress with projects listed in Part A

Construction of interconnection line: the former Yugoslav Republic of Macedonia - Albania – Italy:
The Italian TSO TERNA took the decision to invest in a HVDC undersea interconnection Montenegro – Italy (375 km); under these circumstances MEPSO will review the feasibility of a new interconnection project comprising only of the 400 kV OHL Bitola (former Yugoslav Republic of Macedonia) – Elbasan (Albania) and will consider the new issues arising from the latest Albanian and Italian development strategy.

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\(^6\) In the Energy Community context, the reference to Kosovo is only as to a territory pursuant to UN Security Council Resolution1244. This is valid throughout the report and the relevant annexes and reflects the fact that UNMIK is the Contracting Party to the Energy Community Treaty.
4. Progress with the projects listed in Part B

A few projects from the Part B made significant progress in securing financing from International Financial Institutions, or in selecting a strategic investor or a strategic partner for Public Private Partnership.

i. Electricity Interconnections

*High-Voltage Direct Current (HVDC) interconnection (submarine cable) Croatia - Italy*: Common feasibility study - final report is under preparation by both TSOs (HEP-OPS and Terna) involved in the project.

*Construction of the OHL400 KV Serbia – Romania* has progressed with consultancy services (Feasibility study, Cross – border study, Preliminary design study and EIA study) contracted in May 2009. The feasibility study is finalized and prepared to be adopted soon. The preliminary design study and EIA study to be finished in June 2010. A second Joint Position paper – paper will be signed before the end of 2009. The line will increase the net transmission capacity at the Serbian Romanian border and contribute to a greater security of supply in the region.

*New HVDC undersea interconnection Montenegro – Italy* (375 km): In December 2007, the Ministers of economic development of Montenegro and Italy signed an intergovernmental agreement to develop the interconnection; this was followed by the inter companies agreement between EPCG (Montenegro) and Terna (Italy). The feasibility study was finalized in April 2008 and its conclusions were accepted by the project’s steering committee. In 2009, a Draft Agreement for construction of the new Italian-Montenegrin interconnection system and realization of strategic partnerships between Terna S.p.A. and Prenosa AD was prepared and initialed by representatives of the two companies and it’s expected the final signature.

ii. Power generation

*HPP Gornja Drina (former Buk Bijela) on the Drina river (Bosnia and Herzegovina and Serbia)*: the power company EPRS in Bosnia and Herzegovina and its subsidiary signed a protocol of understanding with EPS, the power company in Serbia in February 2008 for the establishment of a joint venture to build, own and operate the Gornja Drina hydro power plant. A smaller capacity option (150MW) is considered currently (2008); for this, the cost estimation (2008) is 200 Mill.Euro; In 2009, the pre-feasibility study for option “Small Buk Bijela (app 150MW) was finalized and the feasibility study for this option is being prepared.

*New HPP Cebren (3x 110.85 MW) and HPP Galiste (3x 64.50 MW) with the associated dams – (former Yugoslav Republic of Macedonia)*: The government retendered the project with pre-qualification deadline 15 April 2009; 3 three prequalified bidders: RWE (Germany), Verbund (Austria), Enel (Italy), deadline for final bids is 31 March 2010. Up to date RWE and Enel collected tender documents.

*New HPP Komarnica on Komarnica River, 168 MW (Serbia)*: In the framework of the bilateral cooperation between Montenegro and Austria, the Prefeasibility study is done by Poyry Consultants and financed by Voith Siemens (AT). The scope is verifying the technical economic merits of the project and validates the investment decision, to be taken by the Assembly of Montenegro.

*TPP Kolubara B, new 700 MW (2x350 MW) lignite-fired subcritical power plant (Serbia)*: Following the public tender, four investors have been short listed: Edison (It), CEZ (Cz), EnBW (De) and AES (USA). Up to date, two of them have applied to continue the selection process. By the end of January 2010, the final bids should be submitted.

*TPP Nikola Tesla B3, new lignite-fired unit 700 MW (Serbia)*: The pre-feasibility study and the General plan for urbanism are completed; the pre-qualification tender launched at the beginning of 2009. Five investors have been short listed (Edison (It), CEZ (Cz), RWE (DE), EnBW(De), AES(USA). Up to date, three of them have applied continue the selection process. By the end of January 2010, final bids should be submitted.
**New hydropower plant Zhur, 292.8 MW installed capacity (Kosovo)**: The WB has provided finance for the review and update of the feasibility study that was finished in June 2009, together with the pre-environmental assessment. The tendering process is expected to start early 2010, after the interministerial steering committee presented a precise timetable and concrete steps for the implementation.

Other power generation projects have made progress with the preparation of documentation or the tendering for selection of investors. More detailed information is provided in Annex A to this report.

**5. Lack of progress or limited progress the projects listed in Part B**

**Construction of the OHL 400kV Serbia (SS Sombor 3) - Hungary (Pecs):** Initially, this project was listed for technical assistance under the Infrastructure Projects Facility (IF) in 2008, but later was withdrawn by the IPF Steering Committee from the list because of lack of clear political support for the construction of the interconnector. It is recommended to be withdrawn from the Project Priority list as

**New unit TPP Gacko 2, lignite fired (Bosnia and Herzegovina):** A Joint Venture between the CEZ and RITE Gacko TPP was announced in February 2008 by the Government, to modernize the existing Gacko I plant, build a new coal fired capacity of 600-700 MW as well as develop the adjacent coal field.

The proposed partnership did not materialize due to legal issues related to stakes in the new joint venture company, and a high level Bosnian delegation met with CEZ in Prague in September 2009 to find a solution to the blocked project.

**New generation unit at TPP Tuzla VI, unit 7, 1x 370 MW, coal fired (Bosnia and Herzegovina):** the construction of Tuzla VI unit 7 was in principle awarded, in December 2007, when the FBiH Government approved the selection of EnBW Germany as the strategic partner for the construction and exploitation of the power plant; nevertheless, the Government had to cancel its decision, because of the lack of Parliament support, at the end of December 2008.

**New generation unit, TPP Kakanj 8, 1x230 MW (Bosnia and Herzegovina):** Kakanj 8 was in principle awarded in December 2007 (decision of the Parliament was pending), by the government to KazTranGaz and the Swiss Kazakh group BMG, that were selected as strategic partners for the construction and exploitation of the power plant. Nevertheless, the FBiH Government did not receive the Parliament’s approval and had to cancel the decision in December 2008.

For other interconnections (Croatia and Montenegro and Croatia – Bosnia and Herzegovina) a decision whether to build is postponed beyond 2012, respectively 2015.

No significant progress was reported for the gas pipelines under the Part B of the priority list.

**6. New project proposals**

Three Contracting Parties have proposed two new projects that appear to be important for the region, to be introduced in the Part B of the list, as follows:

**Construction of new thermal power plant 2x250 MW and exploitation of coal from Maoce basin (Montenegro):** the invitation for prequalification for concession will be published during November 2009. The estimated investment cost is approximetly 1.2 billion Euros. A German consultant prepared the study for “Development and private sector participation in Pljevlja thermal power complex”; this also includes the proposed transaction structure for the and new TPP Maoce (500 MW).

**Gas interconnection Croatia (Omišalj – Zlobin Rupa) – Slovenia (Kalce):** This is a link connecting the two gas transmission systems, which is also important for gas transit from new supply routes and the Adria LNG terminal, expected to be built. The project is in the development phase: For the section: Omišalj – Zlobin, the Preliminary design, EIA and Basic Design are finalised; For the section: Zlobin – Rupa: the Preliminary design and EIA are finalised. The project cost on the Croatian side is: the pipeline Omišalj – Zlobin is estimated at 25 Mio. and Zlobin – Rupa, at 45 Mio. Euro.

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7 Pursuant to UN Security Council Resolution 1244.
Construction of the pipeline Nis-Dimitrovgrad (Serbia): the energy license for the construction was issued to company "Jugorosgaz". This company planned to finalise the project documentation in the course of 2009 and all preparatory works for the construction of this pipeline. The estimated investment costs 50 Mio. Euro. Through the interconnection with Sofia (Bulgaria), this pipeline may become one of the sources of gas for the Energy Community Gas ring.

7. Additional Gas projects of regional significance (currently not included in the list):

Energy Community Gas ring (concept): The concept was developed by the SEE Regional Gasification Study link. The ring concept emerged from consideration of the synergy between the notional regional transmission pipeline branches defined for the separate markets. The concept connects all the seven Contracting and takes thereby into account the electricity sector development, as well as the existing or planned regional pipelines, LNG terminals and storage facilities that could be connected to the Gas Ring. The Permanent High Level Group, in its March 2009 meeting agreed to the establishment of a Gas Ring Group, chaired by the European Commission, with a view to discuss investment options and priorities within the overarching concept of the Energy Community Gas Ring.

LNG Adria (Regasification terminal in the Croatian Coast): In 2009, the Croatian Government selected the Island of Kirk as location for the LNG terminal; Adria LNG company has the following shareholders: OMV (Austria), Total (France) E-On Ruhrgas (Germany), RWE Gas (Germany) and Geoplin (Slovenia). The Croatian Ministry of Environmental Protection and Physical Planning issued on June 2, 2009, the Instruction for the Scope of the Environmental Impact Study for the terminal. The investment (15 bn bcm/year) is estimated at approx. 800 Mio. Euro.

IV. FACILITATION OF THE INVESTMENT PROCESS BY THE ENERGY COMMUNITY SECRETARIAT

i. Assistance to use IPA - Investment Project Facility (IPF)

The Secretariat invited the European Commission DG TREN and DG ELARG to present to the Contracting Parties updated information on the IPA Multi beneficiary initiative link - the Project Preparation Facility for Infrastructural Investments (IPF), launched in the first quarter of 2008. As a follow-up, the Secretariat assisted all Contracting Parties to prepare and submit applications to the Facility, in form of the Technical Assistance Project Description Format (TAPDF). Up to date, five projects (Albania, Montenegro, Former Yugoslav Republic of Macedonia, Serbia with 2 projects), have been approved in 2008-2009 and are being implemented, and eleven have been submitted for the 3rd selection round in October 2009 (Albania:3, Former Yugoslav Republic of Macedonia:1, Montenegro: 5, Serbia:1, UNMIK: 1).

ii. Regional Energy Forum, EBRD – Energy Community


The Forum was attended by over 150 participants including the EBRD President and the European Commissioner for Energy, high level representatives from governments, utilities, regulators, private investors and the IFIs, as well as the and donor community

The focus was on generation from both conventional and renewable sources; the Forum discussed what sort of financing can be envisioned in the recessionary climate and it investigated the role of the regulatory framework for the promotion of renewable energy sources and looked into energy efficiency financing model in transition economies.

iii. Investors’ business meeting

Further to the relevant events in the Energy Community calendar, the Secretariat is organizing an informal business meeting (working dinner format) on 19 November 2009, in Vienna. Focusing explicitly
on electricity issues, the meeting is providing a basis for discussions on the most important requirements and expectations by investors, who are instrumental to supporting larger and faster investments in the Energy Community.

The approach is strongly welcomed by the business community. A similar meeting on gas, will be organized on 26 January 2010.

V.  CONCLUSIONS

Between November 2008 and October 2009, investments in the Energy Community progressed moderately, especially in the electricity generation and gas pipeline development.

The credit crunch and the economic crisis had and still have a severe impact on the decision to go forward with new infrastructure projects, or even to continue the ones planned.

Beyond these, other factors are influencing negatively the investment process:

- Many investment priorities announced by companies and governments, but limited capacity (both financial and administrative) constrain the achievements in a timely manner; more focus of resource allocation is recommend for better implementation;
- Long delays in announcing tenders and selecting the investors; in many instances, decisions are reversed and projects re-tendered, but with similar terms of reference;
- Projects costs were significantly shifted upwards after the feasibility studies were updated;
- Turn key contracts (preferred in the region) are currently difficult to secure given the many uncertainties;
- Equipment contracting becomes more problematic; prior to the crisis, prices went significantly up and so did lead time for manufacturing energy technologies;
- Tender documentation is in many cases not sufficiently well prepared, and there are more growing concerns about the natural resources availability in case of hydro power plants, where water is also use for irrigation purposes; the concession or association terms are often unclear, and leave room for the possibility of non transparent negotiations; this concern may be the case for often very low number of expressions of interest from the leading investors in the region;
- The markets remain small and fragmented and the investment decisions are still influenced by “energy nationalism”;
- The issues of concern on the investors/traders side, remain: sustainability of rules and regulations, as well as licensing conditions; responsibilities and liabilities for old units; common trading structure in the regional market; the high voltage grid must be prepared for the new power supply; the CO2 market’s prospects has a significant impact on the fuel competition.

Nevertheless, some positive developments in the Energy Community are expecting reduce barriers

- The Dispute settlement instrument was already exercised in the Energy Community and the role of ECS both the moderator and mediator in the process was clarified;
- The advancement of the Coordinated Auction Office will help alleviate some of these barriers to investments.