PRIORITY INFRASTRUCTURE PROJECTS

Progress Update Report

I. BACKGROUND AND SCOPE

This report was prepared by the Energy Community Secretariat for the 5th Ministerial Council meeting and refers to:

- Progress with the infrastructure projects on the current Priority projects list, approved by the 3rd MC in December 2007 in Belgrade
- The request to introduce a limited number of new projects, that have regional significance, on the initial list
- Investment facilitation activities by the Energy Community Secretariat.

The report was prepared on the ground of the explicit guidance of the Ministerial Council.

II. INFRASTRUCTURE PRIORITY PROJECTS: UPDATE

1. Summary

The Secretariat has prepared a progress update 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 up to 1 November 2008.

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.

2. Progress with the projects listed in Part A:

Most of the electricity projects in this part have made significant progress, or at least enough progress to give confidence that these will go through in the near future.

Electricity Interconnections

Of these, the construction of two interconnections (Albania – Montenegro and Croatia – Hungary) has started in 2008 and the third, the national transmission line in Albania, that is essential for the cross border interconnections have signed the construction contract in 2008. These projects are of great importance for the creation of the regional market and the trade of electricity.

1 Conclusion 10, 3rd Ministerial Council Meeting Belgrade, 18th December 2007.
Power generation

In power generation, progress was registered in Albania (Vlore Power plant continues works as planned) and in Bosnia and Herzegovina that has selected the investors for two large coal fired power plants, of which, one is more advanced in documentation and permits. Nevertheless, there are concerns about the finalization of the joint venture between CEZ and the RiTE Gacko power plant announced by the Government in February 2008.

Another very important project for the regional market, Kosovo C, has made progress with environmental and social safeguards issues, legal and regulatory issues and transaction related issues. Nevertheless, the selection of investor is not expected before mid 2009, if everything goes according to the planning.

Gas

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 2008 the feasibility study is under preparation and expected to be finished by the year end.

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

3. 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.

Electricity Interconnections

These include the electricity interconnection between Albania and Kosovo\(^2\), for which the German government has committed funds in the two intergovernmental negotiations, and KfW is currently engaged in financial negotiations for Development Loans with the governments.

Another key electricity interconnection, between former Yugoslav Republic of Macedonia and Serbia made significant progress, when the Macedonian government- as a result of a competitive tender - announced the selection of the International Financial Institution (the World Bank) to finance the project. On the Serbian side, construction works are well advanced and the European Energy Agency has allocated the unspent funds before its closure, to this project.

It is recommended that these two projects should be “upgraded” to Part A of the list, as the financing is now secured for them.

Power generation

In power generation, in Albania two concessions to build and operate them were given for Ashta hydropower plant, and respectively to the Devoll River cascade power plants to private foreign investors. Considering the need for new generation capacity in Albania in order to reduce the import dependency, the construction of new hydropower plants will have a positive impact on the national and regional market.

It is recommended that these two projects should be “upgraded” to Part A of the list as well, as the financing is now secured for them.

In Bosnia and Herzegovina, the government took a principle decision to award to foreign investors the right to construct a new unit in each of the two existing coal fired power plants. Nevertheless, as to have

\(^2\) Pursuant to UN Security Council Resolution 1244.
the contracts between the two parties signed, the Parliament needs to approve the selection of investors, and this is approval is still pending. The time frame, from the government approval to the Parliament’s may be as long as over one year (since December 2007, in these cases).

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 and B to this report.

Gas
In gas, 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. This project is recommended to be “upgraded” to Part A. 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.

4. New project proposals

Two 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:

- 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. The expected overall cost is 700 Mio. Euro.

- New Generation unit TPP Nikola Tesla B3, lignite-fired 700 MW (Serbia): The pre-feasibility study and the General plan for urbanism are completed; the pre-qualification tender launched in 2008.

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

1. 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 - the: Project Preparation Facility for Infrastructural Investments Project Facility (IPF), launched in the first quarter of 2008. This was done to both PHLG members in March 2008 and to the participants to the Technical Workshop on investments, organized in April 2008.

As a follow-up, the Secretariat assisted some Contracting Parties to prepare and submit applications to the Facility, in form of the Technical Assistance Project Description Format (TAPDF). This support was provided to the following Contracting Parties: Albania, Bosnia and Herzegovina, former Yugoslav Republic of Macedonia, Montenegro and Serbia, which submitted TAPDFs before the deadline in May 2008.

Out of these, four applications were shortlisted for Technical Assistance under IPF, as follows:

- TA – Albania Upgrade of transmission system
- TA – Former Yugoslav Republic of Macedonia Feasibility Study for the pilot project wind park development
• TA – Montenegro
  Feasibility Study for the electricity network development

• TA – Serbia
  Pre – feasibility study and for the OHL 400 kV

The Secretariat is planning to continue further cooperation with DG ELARG and the IPF Fund Manager (WYG International) to promote the next selection round in January 2009 and assist the Contracting Parties to prepare good applications.

2. Investment promotion Conference

The Energy Community Secretariat in cooperation with the Kosovo Ministry of Energy and Mining, and under the Albanian Presidency in Office, organized an Investment Conference in Prishtina on 7 October 2008.

The focus was on concrete aspects, related to promotion of investments in practical terms e.g. the developments with the regional regulatory framework and especially on the Coordinated Auction Office and the congestion management; experience with successful financing modules; views of investors and traders on barriers to investment and, use of Kyoto Protocol flexible mechanisms to finance investments. The conference was attended by over 150 representatives of governments, regulators, energy companies, regulatory authorities, private investors, International Financial Institutions and the donors' community.

Several significant conclusions were outlined during the Conference:
- One of the most important pre-requisites to have a functional regional energy market is the level play – field, fairness and non-discriminated third party access (TPA) and capacity allocation, as well as clear and harmonised procedures for licensing and authorisations;
- Dispute settlement instrument is expected to enhance transparency and give place to follow-up procedures before national courts that are asked to pronounce themselves. The role of ECS both the moderator and mediator in the process was clarified;
- The high importance, which is given by investors to the regional versus national prioritization, when development of investments and markets is considered.
- The investors need confidence that some risks are taken outside the project by the creditworthiness of the project’s sponsors and that the project can absorb the remaining risk. The project sponsor remains the most important “ingredient”, but regulations and the off take/revenues need to have also strong fundamentals.
- Issues of concern on the investors/traders side included: sustainability of the 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.

3. Investors’ business meeting

Further to the relevant events in the Energy Community calendar, the Secretariat organized an informal business meeting (working dinner format) on 30 October 2008 in Vienna. Focusing explicitly on

3 Pursuant to UN Security Council Resolution 1244.
electricity issues, this meeting provided basis for discussions on the most important requirements and expectations by the investors that are essential to support larger and faster investments in the Energy Community.

The approach was strongly welcomed by the business community. Further to a similar meeting for gas, the Secretariat plans to organize such events on regular basis.

IV. CONCLUSIONS

Since December 2007, some projects made significant progress and these are mainly in the transmission power lines. In terms of new power plants, only few have found an investor or a financier, or started actual construction works.

Gas investments are in general lagging behind electricity, and no significant progress was registered up to date.

There is a lot of enthusiasm on the side of the Energy Community governments to promote investment projects; however, it seems that the decisions take too long and are sometimes reversed, or postponed in implementation.

Investors and International Financial Institutions are more prudent as a consequence of the world financial crisis, the competition for capital has increased and other markets may be more attractive in terms of bigger size, lower political risks, and more stable regulatory environment and good governance.