



# Office for South East Europe

European Commission/World Bank



4, rue du Trône – 1000 Brussels – Belgium  
Phone: (32-2) 504 09 90 Fax: (32-2) 504 09 99  
INTERNET: <http://www.seecon.org>

## International Financial Institutions Advisory Group meeting on Energy

September 25, 2007

Office for South East Europe, Brussels

### Draft Minutes

### **Background**

The Energy Working Group of the IFI Advisory Group (IFI-AG) met for the first time on September 25, 2007 at the European Commission/World Bank Joint Office for South East Europe. The meeting was chaired by Mr. Yngve Engström, DG Enlargement, and introduced by Mr. Dirk Meganck, Director, Directorate D, Financial Instruments, DG Enlargement both from the European Commission. The following institutions participated: the European Commission, the World Bank, the European Investment Bank, the Council of Europe Development Bank, the European Bank for Reconstruction and Development, KfW, The Black Sea Trade and Development Bank, The Nordic Investment Bank, and the Stability Pact for SEE.

### **1. Welcome**

**Mr. Meganck** opened the meeting by emphasising that the European Commission attaches great importance to the work of IFI AG. Economic and social development are becoming increasingly important in the pre-accession countries and for this reason, Mr Meganck expressed satisfaction that the IFIAG had broadened its scope to cover the Human Development sector, as well as those sectors (energy, environment and transport) previously covered by the Infrastructure Steering Group. Under the Instrument for Pre- Accession (IPA), Mr. Meganck underlined that the Commission is planning to enhance co-operation with the IFIs, both within the framework of national and multi-beneficiary programmes.

In the context of the multi-beneficiary programmes, cooperation will consist of three strands:

- *SME financing* through either (i) the European Fund for Southeast Europe (EFSE) or (ii) the SME Finance Facility (SMEFF), both of which aim to strengthen the capacity of financial sector institutions so as to enable economic actors – particularly SMEs and micro enterprises - gain access to finance in the long term.
- *Energy efficiency finance facility* (EEFF), which aims to stimulate energy efficiency investments in the industrial sector and in all types of building by making appropriate financing available to the end-borrowers thereby resulting in energy-saving and in the reduction of CO<sup>2</sup> emissions.

- *Infrastructure Projects Facility (IPF)*, which will include Technical Assistance component designed to support mainly project development (pre-investment, feasibility) but also implementation. Technical Assistance will be available for infrastructure projects aimed at upgrading transport networks, environmental schemes and investments improving energy efficiency and using renewable energy. It will also cover projects in social sectors such as health, education and urban redevelopment.

After this presentation, participants asked about the timing as well as the geographic and financial scope of the IPF. Mr. Meganck stressed that the details are at an early stage of development; the plan is, however, to have the IPF operational before the summer 2008, initially using CARDS funds to be complemented at a later stage by resources from the Instrument for Pre-Accession (IPA). As for geographic scope, the PIF will be available primarily for pre-Accession countries. This is because the accession countries (Turkey and Croatia) are eligible for funding under component III of the Instrument for Pre-Accession (IPA) and can draw also on the expertise support of DG REGIO.

## **2. Update on the Current Status of the development of the Energy Community**

The **Energy Community Secretariat (ECS)** made a presentation on the current status of the Energy Community. **Mr Slavtcho Neykov** explained that the contracting parties to the Treaty establishing the Energy Community share the major goals of EU energy policy, but face very different challenges in terms of: security of supply, environmental protection, competition and energy efficiency (eg, last winter the region experience a severe deficiency in electricity). All contracting parties, however, aim at the EU perspective and have supported the development of the treaty, its ratification and implementation. In terms of the latter, in November 2006 the contracting parties decided to start drafting ‘roadmaps’ and ‘action plans’ to identify concrete steps for implementation. These scopes of the roadmaps cover ten key legislative acts of the EU Energy Acquis, related specifically to: environment, renewables, competition, tariffs, market (retail, wholesale and priority access) and market integration.

At the last ministerial council of the Energy Community, contracting parties took a critical look at implementation of the roadmaps. For this reason, the ECS is putting together a report, expected to be published in October 2007, on delays and bottlenecks in implementation of the Treaty. This report follows the energy acquis relevant to the Treaty: institutional organisation, public service obligations, protection of pensioners, tender procedures, market opening and cross border trade. Preliminary findings suggest that the biggest challenges are at regional level:

- Market opening – not all parties have established deadlines for market opening, even though the Treaty has clear dates (2015).
- Cross border trade

In the follow up discussion, the **European Commission** (DG TREN) asked what upcoming studies were going to be tabled by the Energy Community secretariat. The **World Bank** commented that while the purpose of the Treaty was to establish a market, in reality the situation in South East Europe is one of huge shortages in which customers do not have real choice.

In response, the energy community secretariat outlined that the contracting parties are taking the issue of implementation very seriously, which is why the report is being drafted. In addition to this implementation report, the secretariat is obliged to produce an Annual Report on the Development of the energy community for the European Parliament and national parliaments. All documentation is available on the energy community website<sup>1</sup>. In response to the comment on

---

<sup>1</sup> <http://www.energycommunity.org>

market establishment, the **European Commission**, DG TREN, answered that the EC is increasingly looking at taking a regional approach to market opening; the EC would like to see the set-up of regional capacity auctions.

Following this, there was a brief presentation on the objectives and state of preparations for the Athens Investment Forum, held on September 28, and the Energy Community Secretariat distributed summary documentation on a set of investment projects proposed by the participating countries. Included on this list are some 165 projects which have been submitted by the contracting parties (including three from an observer country, Moldova). The list is split into two sections: the first part covering projects that are already ongoing (45) and a second part which covers less developed projects (120).

IFIAG meeting participants were supportive of this effort but noted that the quality and priority of the project proposals varied significantly, and that the IFIs would have to do substantial vetting in order to establish which proposals were realistically bankable. Participants noted that the position of many of the public sector proposals within a least cost planning framework (including the Generation Investment Study) was unclear; private sector projects would not need this justification provided that the sponsors would take market risks. In addition, it was noted that projects listed should closely relate to those priorities budgeted within the National Public Investment Programs (PIPs) of the contracting parties.

### **3. Discussion on the Regional perspective of EU Energy Policy**

The World Bank began the discussion with a case study presentation on the development of new electricity generation capacity in Kosovo (the Kosovo C project). Kosovo has abundant deposits of low-cost lignite resources with proven reserves estimated at around 12 billion tonnes. Despite having a total of 1513 MW in installed generating capacity, Kosovo has only around 600 MW available capacity due to age, poor prior maintenance, and damage caused during the war. For this reason, and because there remains a large unmet demand for electricity both in Kosovo and SEE region-wide, the Kosovo Provisional Institutions of Self-Government (PISG) has expressed interest in building new power plant that will increase electricity generation and lignite production

Through an IDA grant of \$10.5 million, the World Bank is offering technical assistance to the Kosovo C project, formally known as Lignite Power Technical Assistance Project (LPTAP). World Bank support in Kosovo C is organized around three main components: support to transaction, legal, and environment/social assessment advisors. In addition, the World Bank is also working hard to ensure that the bidding process will be open, transparent, and competitive.

The project will require 5 to 6 years for development and construction, with first unit(s) of Kosovo C power plant expected to come on-line around 2014. Overall, Kosovo C represents an opportunity to adopt climate-friendly technology ahead of business-as-usual practice in the region. For this reason, the Bank is currently exploring options for channelling this project through the Kyoto Protocol's clean development mechanism (CDM), possibly combining it with closure of Kosovo A. Carbon Capture and Sequestration (CCS) technology is being considered as well.

During discussion which followed, the **EIB** expressed the concern that private investors in the project must be protected from political interference, in order to provide electricity at least cost to the region. The **European Commission** noted that the project will be a major political issue, as it implies privatisation of Kosovo's only natural resource. In addition, the European Commission urged the World Bank to cooperate closely with the EC and to incorporate fully the EIA directive

and consultation processes. A separate question was raised by the **energy community secretariat** on the timing of the process and the EBRD asked for the TOR of the selected consultant (ERM of Italy) to be circulated to members of the group.

In response, the **World Bank** informed participants that consultations on the project have already been held in Kosovo and that cooperation with the European Agency for Reconstruction, Mr. Ian Brown, is ongoing. As far as timing is concerned, it was explained that the expectation is that there will be a call for proposals in the first half of 2008, with a winner selected by the fall. Financing would be closed by the end of 2008, after which construction could start, with the first units on line by 2014/2015. The World Bank agreed to circulate the TOR of the consultant.

Participants agreed with the Bank's approach to project structuring and environmental mitigation, concurring that Kosovo C could serve as a valuable regional demonstration of best practice (through thermal efficiency Kosovo C does offer a significant improvement in GHG performance). Participants agreed that the net GHG emissions impacts of Kosovo C were an important focus. Several IFIs concurred with the World Bank that the Kosovar authorities should be pressed to shut-down of Kosovo A, certainly once Kosovo C comes on line. Nevertheless, it was recognised that any conditionality for forcing closure of Kosovo A would be difficult because it is mine specific and employs a great number of people.

#### **4. Discussion on Energy Efficiency**

The **EBRD** opened the discussions by providing an overview of its energy efficiency facility which aims to stimulate energy efficiency (EE) investments in the industrial sector and in all types of buildings by making appropriate financing available to the end-borrowers, thereby resulting in energy-saving and in the reduction of CO<sup>2</sup> emissions. The EBRD also provided an overview of its new Sustainable Energy Efficiency Initiative (SEEI), launched last year following the G8 Gleneagles Summit. This initiative builds on the EBRD's EE experience and:

- Mainstreams EE into all work of the EBRD (EE team within EBRD has been reorganised)
- Sets a volume target for investment in energy efficiency, renewables and clean energy projects over the next three years of €1.5 billion
- Establishes a policy dialogue on sustainable energy – developing partnership both with governments / energy efficiency agencies and donors

The main areas of intervention for the SEEI are:

- Large scale industrial energy efficiency (eg, provision of free energy audits for small and larger size industry with the aim of turning these into financing operations for substantial energy savings)
- Financial Sector – through the aforementioned Energy Efficiency Facility
- Building Sector (an area of huge potential)

The **EBRD** also informed participants that it is also continuing to work though the municipal sector (eg, public buildings, district heating). The EBRD also works together with the EIB on the Multilateral Carbon Credit Fund as a key instrument in their strategy for combating climate change. Fully subscribed, with EUR 165 million in commitments, the MCCF is one of the few carbon funds dedicated specifically to countries from Central Europe to Central Asia. Participants were also informed that the EBRD is currently carrying out a study on tariff levels and their impact on EE activities for all Western Balkan countries.

The **European Commission** followed this with a brief overview of the Energy efficiency finance facility (EEFF). The Energy Efficiency Finance Facility (EEFF) is an investment support programme aiming at stimulating energy efficiency and renewable energy in the industrial sector

and in all types of building by making appropriate financing and incentives available to the end-borrowers. It combines credit lines from the IFIs with investments incentives that can be passed on to the promoters of energy efficiency investments, the local financial intermediaries involved in the distribution of loans, and financing of consultancy costs all along the implementation of the programme. The IPA programme in 2007 has made available EUR 34.7 million for EEFF.

During a discussion which followed the presentations, the **EBRD** expressed surprise that the Energy Community Secretariat's (ECS) list of projects contained little on Energy Efficiency. The ECS answered by pointing out that it was in the process of considering the establishment of a Task Force on EE initiatives (the Task Force would include all representatives from the contracting parties who have responsibility for EE measures as well as donors).

The **World Bank** asked the EBRD about their current approach to the establishment of ESCOs (an Energy Service Company - a business that develops, installs, and finances projects designed to improve the energy efficiency and maintenance). The EBRD explained that they tried extensively to develop these in the late 1990s, but that they had not proved fully successful. EBRD is now reconsidering these in some areas, particularly in Bulgaria and Romania, where municipalities have more mature institutions than a decade ago.

The **World Bank** recommended that IFIAG consider looking at energy efficiency activities by the IFIs in the region in a more coordinated fashion. There could be two areas of cooperation: i) overview of who is doing what (ef, EE funds, credit lines, ESCO approaches, institutional capacity) and ii) a discussion on principles and approaches to the use of subsidies in EE projects (eg, avoidance of market distortion and phasing out of carbon funds).

Participants agreed that a separate meeting be dedicated to this theme, which will take place before summer of 2008; the EBRD offered to host this meeting.

## **5. Tour de table of IFIAG members on their upcoming energy programs in SEE. Expected areas of intervention, size of investments, and supporting studies**

### **EIB:**

- Albania: Switzerland is currently carrying out a feasibility study on dam safety issues. This study should be appraised by the first half of next year by EIB, World Bank, EBRD, KfW and possibly Italy
- Bosnia and Herzegovina: The EIB has finalised the appraisal of a power rehabilitation project, but not much has happened yet. EIB would like to see movement in this project before considering other investments. Other possible areas of intervention include: a renewables project (Hydro power) and the district heating system of Banja Luka
- Montenegro: EIB is finalising a rehabilitation project in the power sector
- Serbia: EIB is negotiating a new power transmission sub station project and discussing the construction of a power interconnector with Romania (2008)
- Romania: EIB is considering a pump storage plant (Tahita), but require further studies before progressing

### **KfW:**

- See attached presentation

### **EBRD:**

- Albania: EBRD is keen to be involved in the dam safety project currently under preparation. Also interested in assisting with the privatisation of the electricity distributor, together with IFC (here, EBRD would like to repeat the success of the

- privatization of ESM in Macedonia). EBRD is also looking to finance a transmission line between Albania and Macedonia (a feasibility study on this has been completed)
- Kosovo: EBRD is interested in participating in the Lignite Power Project, and can see the need for a lot of IFI involvement in this major infrastructure project. EBRD cautioned that this project needs to be very carefully structured.
- Macedonia: Engaged in providing long term financing for the privatised distributor ESM – this loan may well be syndicated. EBRD is also looking at developing tenders for mini-hydro plants, as well as a tender for the CHP of Skopje

**IFC:**

- Is primarily providing advisory services through the Private Enterprise Partnership for Southeast Europe (PEP-SE). The programs operate in Albania, Bosnia and Herzegovina, the FYR Macedonia, Serbia, Montenegro, Croatia, Bulgaria, Romania and Moldova. They were formally launched in July 2005 and have been established for an initial period of five years. For the energy sector PEP-SE provides services solely for energy efficiency initiatives
- Bosnia and Herzegovina: IFC is working together with KfW through the EFSE
- Albania: Particularly active though preparing PPPs and working on the unbundling and privatisation of KESH (the electricity company). In this context, IFC has helped the government to prepare a law on concessions and is now supporting the establishment of a concessions agency in Albania.

**World Bank:**

- Albania: Engaged in the dam safety project as well as a distribution upgrade project
- Croatia: In early stage discussions with HEP on a Greenfield hydro project
- Kosovo: Investigating a partial risk guarantee operation in the energy sector
- Macedonia: In early stage discussions on a hydro power rehabilitation project
- Montenegro: Aim here is to replicate the successful Serbia energy efficiency project (focused on schools and hospitals)
- Romania: Also working on the Tanita pump storage project, pending successful feasibility study
- Turkey: Preparing a hydro power rehabilitation project
- Region: Working on a GEF ‘Geofund’ – an innovative contingent finance mechanism designed to offset geothermal drilling development risks. The World Bank is also hoping to develop regional investments in gas transmission distribution.

**6. SEE gasification. Presentation of draft results of a World Bank / KfW Study and discussion on plans for the creation of a Western Balkan Gas Transmission Ring**

The World Bank made a presentation on the findings from the ongoing World Bank/Kfw SEE Gasification Study<sup>2</sup>. The challenge for this sector in South East Europe is that there are substantial investment requirements for power and gas to close emerging energy supply and demand gap. The objective of the study was to identify viable regional, cross-border and country-specific gas infrastructure. The key tasks of the study were to investigate:

- Long term gas demand forecasts
- Analyze various piped gas sources (Russia, Caspian and Middle East)
- Economics of new gas transmission pipelines

---

<sup>2</sup> the draft final report “South East Europe: Gasification Study” is available on the Energy Community Secretariat homepage - <http://www.energy-community.org>

- Economics of LNG compared to piped gas
- Regulatory and institutional barriers

The study has found that that demand will increase from just over 25 bcm/year to 45 bcm/year between now and 2025; most of this being driven by power generation requirements. To meet this growing demand, the SSE Gasification Study proposes: substantial gas infrastructure development in SEE; and, the creation of a ‘Gas Ring’ to integrate Western Balkan markets. The benefits of this approach would be to:

- Unite 7 Balkan Energy Markets
- Link 7 Gas Markets with EU Neighbors
- Enable the Development of Gas Fired-Power Plants (Cobined Cycle Gas Turbines; CCGT)

In terms of the magnitude of investment, the EC Gas Ring is projected to cost about US\$ 1 billion. Given the high cost, the EC Gas Ring could be developed in phases, but would need to be synchronized with CCGT power station development

Participants recognized the large energy security, poverty reduction and environmental benefits of the proposed Gas Ring. The amount of investment funds to be mobilized, while daunting, was not seen as insurmountable. Rather, overcoming the high costs of the multi-party cooperation externality was viewed as the key barrier. In line with this, participants concurred that the Gas Ring could be advanced as a longer-term vision or ‘master plan’. In terms of moving forward on investment, the World Bank (and other IFIs) was urged to attack the problem through a series of discrete transmission lines strategically connecting 2 or 3 countries (and associated CCGT generation projects). It was further proposed that the Bank organize a pre-meeting among Albania, Croatia and Macedonia on November 8 on the margins of the November 9 Gas Forum in Maribor.

### **7. Brainstorming on EU Project Preparation Facilities (PPF) in support of the energy sector and modes for managing PPFs**

The first PPF for the Western Balkans was established in 2002. The objective of the PPF was to prepare good quality project proposals that have regional dimension. Some €3.2 million have been provided for PPFs in the Western Balkans since 2002:

- CARDS 2001: €2.70 million - The Transport Project Preparation Facility
- CARDS 2002: €3.70 million: The Danube Investment Support Facility (DISF)
- CARDS 2003: €1.80 million: The Environment Project Preparation Facility (EPPF)

The **European Commission** outlined plans to replace the PPF facility with an Infrastructure Projects Facility (PIF) now under development. The IPF is a work-in-progress, but would be designed to support mainly project development (pre-investment, feasibility) but also implementation in the Energy, Transport, Social and Environment sectors. The IPF would be initially capitalized at about €16 million (CARDS funds for 2005 and 2006 amounting to around €16 million are still available for PPFs). More resources will then be added from IPA. Access to the Facility would be through and centered on countries; projects with a trans-border/regional character would get enhanced priority and the country(ies) would need to identify potential investment funding sources in their PIF application, including prospective IFI partner(s).

During a discussion which followed, the **EBRD** asked whether the project pipelines emerging from the South East Europe Transport Observatory (SEETO) and the Energy Community Secretariat were under consideration for support under the new PIF. The **European Commission**

concluded that these need to be taken fully into account and will help to identify regional priorities.

The **World Bank** emphasised: (a) The need to maintain maximum flexibility in the IPF criteria, (b) priority should be accorded to project preparation activities, and (c) preparatory studies for projects seeking private sector financing should also be eligible.

It was concluded that the needs in this area are huge and that the private sector needs to be brought in as well. Strict criteria will be required for inclusion of projects that will benefit from the PIF. Further details concerning the PIF will be circulated by the European Commission before the end of the year.

#### **8. AOB - Aarhus Convention rules and impact on the Vlore Thermal Power project**

The World Bank provided an overview of the recent actions taken by the Compliance Committee of the Aarhus Convention relative to the Vlore (Albania) power plant. This was followed by a general discussion on the implications of the Convention for IFI social and safeguards processes in the infrastructure sectors.

The EBRD's Environment Department provided participants with a key clarification on the issue. Albania was found in violation of the Convention due to two key failures: (a) Issuance of zoning instructions for Vlore power plant development by the Government of Albania to its ministries and municipal authorities in advance of the public consultation meeting to review site options and evaluation findings, thereby seemingly discounting the possibility of influential public input; and (b) inadequacy of documentation on public participation in consultation meetings. The latter point could be due to a failure to adequately notify a wide range in stakeholders, and/or a failure to keep good records. The implications for IFI safeguards policy are still undetermined in light of the ongoing World Bank Inspection Panel review and comparable process in EBRD. The Inspection Panel review is unlikely to finish deliberations before the spring of 2008.

It was agreed that the issue should be discussed again following the Inspection Panel review next year. A note outlining the key issues will be prepared by the World Bank and the EBRD.