2002 and counting

01/04/2001

If Poland earned a dollar every time its power potential was mentioned it would not need foreign investment. The reality is that it has (earned many dollars through potential) but it still needs foreign cash ? although not as much in relative terms as might have been predicted 10 years ago.

Potential has fuelled a shopping spree by foreign power companies, foreign banks (only savings bank PKO is still state-owned) and foreign manufacturing. And potential has ensured that the Polish government's slow progress with privatisation programmes ? a cat and mouse game in which the Poles have been largely successful in getting the most from the investor market ? has not diminished investor interest.

And although Polish privatisation is sometimes a byword for bankruptcy (at best ?profitable but in need of a complete overhaul'), Polish assets are a bargain in the long-term, even taking into account investment needs. Small wonder then that the likes of Vattenfall and EdF are stomping all over the Polish power market and paying in cash.

Estimates of how much needs spending on Polish power over the next 10 years vary from between $20 billion to $40 billion. At the moment Poland has generation over-capacity of around 25%, but plants are in need of modernisation. Polish Power Grid company PSE estimates that as much as 20GW of the 33GW installed capacity needs upgrading and that 2.8GW needs to be retired before 2005.

With vast reserves of lignite ? enough to produce cheap electricity for the next 25 years ? the coal-based Polish power sector could easily rival French nuclear in terms of cost. But whether to maintain over-capacity for export is in the balance. Despite current over-capacity, government estimates put a needed increased output of energy at 43% by 2010 to meet predicted domestic use. And whether Poland will be able to export is by no means certain given EU reciprocity agreements.

What this means for power project financing is buckets of potential and continued patience ? until 2002 that is.

Sense of urgency

The pace of Polish power privatization is finally picking up speed. Since 1998 the number of deals has fallen short of expectation (see box). Not for much longer. The government envisages selling 17 electricity generators, 19 CHPs and 33 power distributors by the end of 2002.

Last month the sale of the 1725MW Rybnick plant to EdF and EnBW netted the government $120 million with an added $84 million plant upgrade pledge running up to 2010. And the treasury also released a number of new sales advisory mandates for plants in Bytom, Zabrze and Kozienice.

In addition to generation opportunities, bankers and utilities are waiting on the distribution sell-off, gambling that consumption and regulated retail prices will grow in the run-up to European Union membership.

All content © Copyright 2025 IJGlobal, all rights reserved.

Poland's electrical power network, part of the regional CENTREL system, was connected with western Europe's UCPTE network in 1995, and EU membership could and should create major power export opportunities once the country enters the EU.

Poland and Unified Energy Systems of Russia signed an agreement on exports of Russian electricity to Europe last month and the two countries are already co-operating on the joint export of electricity to Germany.

G8 is the second distributor to be sold, after a tender for 25% of the southern GZE firm attracted hefty demand late in 2000 before it was sold to Sweden's Vattenfall for $960 million in cash and long-term investments.

But G8 comes with a twist ? Aldona Kamela-Sowinska, treasury minister, announced last month that bidders will be obliged to place an offer for at least one of four energy generators located in Stalowa Wola, Ostroleka, Kozienica and Dolna Odra. And the Treasury and Economy ministries have set a 15% limit on market share (based on turnover) for a single investor.

The G8 group of plants are centered in northern Poland and are ZE Koszalin, ZE Slupsk, Energa Gdansk, Elblag ZE, Olsztyn, Torun, Plock and Energetyka Kaliska. The group holds 16.6% of the nation's distribution market across an area covering over 74,000 square kilometers, about one-quarter of the area of Poland. Annual G8 sales are PLN3.9 billion on a volume of nearly 16.5 GWh.

The amended program, which holds that generators will be sold before distributors, has still to go to the Ministerial Economic Advisory Council (KERM) for approval, and then on to the government.

The Treasury has shortlisted six bidders for the G8 distributors including one domestic group ? Elektrim ? and five foreign groups: Electrabel International Holdings, Endesa, ESB International Investments, Iberdrola and a consortium of E.On Energie and Energie Nord.

Of those investors, E.On has said it would be interested in the purchase of a distributor and generator and Elektrim is ready to establish a wider consortium in line with the treasury's interests.

Shape of finance to come

Despite what appear to be upcoming opportunities, it is uncertain what shape future financing in the Polish power sector will take ? particularly given the end of power purchase agreements (PPA).

Poland's local bank market ? albeit largely foreign owned ? cannot support the huge investment needs. And even if it could, domestic banks are only able to lend up to the equivalent of 25% of bank capital/equity base to any one client (this includes all client subsidiaries).

The Turow Phase III deal demonstrated how far local banks can go in raising project debt ? and it came with the added comfort of a PPA. Four Polish banks, Handlowy, BRE, PKO and PEKAO put up a combined $250 million with a 14-year tenor as part of Turow's $670 million rehabilitation programme. But the deal also came with a $100 million dollar tranche, and a $250 million project bond is in the offing to be arranged by UBS Warburg and Salomon Smith Barney.

IPP financing has been fairly successful to date. Poland's largest IPP, the landmark Elektrocieplownia (ELCHO) deal, sponsored by PSEG, was launched into syndication last November, sole lead arranged and underwritten by Dresdner Kleinwort Wasserstein.

The deal pushed Polish IPP power tenors to a record 18.5 years and came with a 20-year PPA with PSE and PEC

All content © Copyright 2025 IJGlobal, all rights reserved.

Katowice, the district heating company serving the city of Katowice and its surrounding communities.

But as Poland heads towards a merchant market there are concerns that such tenors will be hard to achieve, particularly given the country's fledgling Energy Exchange ? currently accounting for 1% of electricity turnover and unlikely to do more than 10% ? and uncertainty over future bilateral contracts.

In fairness, the Polish government has announced an hourly balancing market and a three-phase system to renegotiate long-term contracts in a deregulation program approved by the Ministerial Economic Advisory Council KERM and recommended to the government last month.

Free electricity trade is slated to begin this July. At the end of April, a company will be split off from the domestic electricity grid operator PSE that will operate a compensation fee system and manage the renegotiation of long-term PPAs.

Official regulations for the compensation-fee system are to be completed and published by 30 May 2001, while the hourly balancing market will be up and running by 1 July 2001. Long-term contract renegotiations will be conducted in three phases ? by 1 July 2001, 1 December 2001 and 31 March 2002. KERM also recommends the setting up of a special unit to monitor the energy market and analyze the effects of liberalization on the domestic economy. The team would inform about potential threats to electricity users and to companies in the industry.

The program is in line with the expectations of national power grid operator PSE. The company has stressed that it wants to withdraw from electricity turnover and focus on transmission. But the speed of the withdrawal depends on the implementation of a replacement system for the SOK compensation system, which has been subsidizing plants that invest in cleaner energy. The SOK system involves temporary subsidies for power plants that invest in cleaner but more expensive electricity. The system was set up to help such plants sell energy at lower prices than those offered by power plants that do not upgrade.

SOK is estimated to have cost $2 billion and was secured by long-term fixed price PPAs with PSE. Such credits constitute 10% of PSE's credit portfolio and 70% of electricity turnover is currently accounted for by PPA's, while 25% is sold by distribution companies and 1% traded on the power exchange.

But with the demise of PPAs Polish power should enter an era of true project finance and bankers are not even dismissing the emergence of hybrid deals. Many of the projects closed already have been done through Dutch BVs to overcome perceived (rather than real) lack of legal clarity over security. More complicated structuring is only a step away.

Thank you for printing this article from IJGlobal.

As the leading online publication serving the infrastructure investment market, IJGlobal is read daily by decision-makers within investment banks, international law firms, advisory firms, institutional investors and governments.

*If you have been given this article by a subscriber, you can contact us through **www.ijglobal.com/sign-in**, or call our London office on +44 (0)20 7779 8870 to discuss our subscription options.*

All content © Copyright 2025 IJGlobal, all rights reserved.