

PPIAF Assistance in Montenegro

Since 2007 PPIAF has supported four activities in Montenegro, two in the energy sector, one in the transport sector, and one in the water sector under PPIAF's Sub-National Technical Assistance (SNTA) window. The ongoing energy activity is helping the energy regulator in Montenegro prepare new tariff methodologies to comply with European practices, and will also compare the Montenegro electricity market to relevant European markets and provide capacity building support to regulatory staff.

Technical Assistance for Montenegro's Transport Sector

The Government of Montenegro intends to increase private sector participation in the road sector. It has identified the construction of a highway between the Port of Bar and Boljare at the border with Serbia as the pilot project. Reflecting years of underinvestment, the current state of road infrastructure in Montenegro is poor, and the mountainous terrain coupled with maintenance backlogs result in high costs for road users.

In 2007 PPIAF provided technical assistance to the government for a detailed analysis of the Bar–Boljare project. The work carried out included a review of the economic and financial analysis undertaken for the road investment; a review of the institutional framework for public-private partnerships (PPPs) in the road sector; and an assessment of PPPs in the highways sector.

Various PPP options were identified for the Bar–Boljare project based on international practices in terms of possible risk allocation schemes and compared in terms of impact on bankability, affordability, and value for money. In 2008 the International Finance Corporation signed an agreement with Montenegro's government to provide advisory services on structuring and implementing a PPP for the Bar–Boljare Motorway.

The Bar–Boljare highway is envisaged to run as a full motorway from the port of Bar to connect to Boljare in Serbia. From Boljare a connecting road will lead to Belgrade and further into the region. The Bar–Boljare highway is potentially the first motorway in Montenegro. The project is to be considered as an engineering challenge as the road is to be constructed largely in mountainous areas with about 30% of the length as structures (92 bridges and 36 tunnels).

Following various unsuccessful efforts to bid the Bar–Boljare project as a PPP, the Government of Montenegro is now exploring different options for motorway construction, including negotiations with various investors.

Results of PPIAF's Activities in Montenegro's Transport Sector

Category	Outputs
Enabling environment reform	
<i>Analyses/assessments prepared</i>	<ul style="list-style-type: none"> • Assessing the options for public private participation in the highway sector in Montenegro, 2008

Category	Outcomes
Project cycle-related assistance	
<i>Transactions facilitated</i>	<ul style="list-style-type: none"> • Bar–Boljare highway project (being developed)

Technical Assistance for Montenegro's Energy Sector

The Government of Montenegro adopted a long-term energy sector development strategy in 2007, which estimates that €1.5 billion in investment in new generation capacity will be needed until 2025. Planned investments will include the development of wind, small hydro, and solar power plants, as well as the extension of Pljevlja 2 thermal power plant capacity and the construction of new larger hydropower plants. According to the action plan, the government aims to attract substantial private sector participation for future power generation investments.

It is in this context that in 2009, the government requested PPIAF technical assistance to carry out a study to assess PPP options for new power generation capacity in Montenegro. It was envisaged that this study would help to define a clear PPP strategy for power generation permitting authorities to move away from the current case-by-case approach to a more strategic approach to address the long-term energy needs, taking into consideration all possible PPP options.

The main objective of the support was to advise on the development of an effective legal, institutional, and regulatory framework to facilitate suitable options for private sector participation for developing new power generation sources for Montenegro. The study focused mainly on the following areas: i) review of existing institutional, regulatory, and legal arrangements and environment for PPPs in power generation; ii) options for PPPs in power generation based on best international practice; and iii) recommendations for suitable PPP options for Montenegro and necessary changes to the institutional, legal, and regulatory framework.

To disseminate the findings, conclusions, and recommendations, as well as to ensure incorporation of the findings of the report in the process of finalizing relevant policy and legal documentation and initiate relevant institutional changes, the Ministry of Economy organized a Dissemination Workshop in Podgorica in April 2010.

Following the workshop, consensus was reached on the need for harmonization of the public sector goals and private sectors objectives, and sensible and sustainable management of PPPs, having in mind goals of both sides and associated risks they are facing, and mitigating the uncertainty and risks associated with a stable legal, institutional, and regulatory framework. Currently, the International Finance Corporation is providing advisory services to the Government of Montenegro to mobilize private sector participation for development of hydropower plants on the River Moraca.

Results of PPIAF's Activities for Montenegro's Energy Sector

Category	Outputs
Enabling environment reform	
<i>Analyses/assessments prepared</i>	<ul style="list-style-type: none"> • PPP Options for Future Power Generation in Montenegro, 2010
Capacity and awareness building	
<i>Workshops/seminars</i>	<ul style="list-style-type: none"> • Workshop "PPP Options for Future Power Generation" to disseminate the findings, conclusions, and recommendations, April 2010
Category	Outcomes
Capacity and awareness building	
<i>Consensus achieved</i>	<ul style="list-style-type: none"> • Consensus on the need for harmonization of the public sector goals and private sectors objectives, and sensible and sustainable management of the PPP process

Technical Assistance through the Sub-National Technical Assistance (SNTA) Program

In 2008 the Podgorica Water and Sewer Company and its owner, the Municipality of Podgorica, requested PPIAF assistance through its SNTA program. Podgorica, the capital and largest city in Montenegro, wished to upgrade and extend its water system and examine financing options for the company's priority infrastructure investments. However, before detailed investment planning and project design activities could be conducted, an assessment of the governance structures, managerial capacity, and financial and operational performance of the company was required.

PPIAF financed a study to evaluate the current structure and performance of the company, assess its financing options, identify possible areas for private sector participation, and create an action plan for priority infrastructure needs. The report found the company had good coverage and water quality levels but its operating efficiency and fiscal performance required significant improvement. It concluded that current investment was insufficient to meet projected future demand and financing would be required in order to reach the necessary levels of funding.

The results of the study were discussed at a consensus building workshop in March 2010. As of December 2010 the Podgorica Water and Sewer Company had accepted the action plan but had not decided on a way forward.

Results of PPIAF's SNTA Program's Activities in Montenegro

Category	Outputs
Enabling environment reform	
<i>Plans/strategies prepared</i>	<ul style="list-style-type: none"> Options for Upgrading and Expanding Water and Waste Water Services, 2009
Capacity and awareness building	
<i>Workshops/seminars</i>	<ul style="list-style-type: none"> Consensus building and dissemination workshop, 2010

Category	Outcomes
Enabling environment reform	
<i>Plans/strategies adopted</i>	<ul style="list-style-type: none"> The Podgorica Water and Sewer Company adopted the action plan and recommendations to improve creditworthiness

Support to the Energy Regulator (ERA) of Montenegro

PPIAF assistance was requested in 2011 to support the Energy Regulatory Agency of Montenegro (ERA) in preparing new tariff methodologies to comply with European practices. The activity also aimed to compare the Montenegro electricity market to relevant European markets and provide capacity building support to regulator staff.

The ERA is an independent and non-profit organization, autonomous in its exercise of authority, which includes the power to issue tariff methodologies, fix tariffs upon the proposal of energy sector undertakings, set connection costs, issue licensing rules and licenses, hear and resolve customer complaints, and approve the grid code and market rules upon submittal by the market operator. The ERA was in the process of drafting methodologies for multi-year regulation of tariffs for regulated consumers. Unlike the previous (temporary) methodologies that were based on annual costs review and approval of regulatory allowed revenue (and price) under the "cost plus" method, the new methodologies were to be incentive-based on the "price cap" method, and there was to be an adjustment of the regulatory period from one to three years. The ERA was supported by a European Union (EU)-funded consultant, whose

contract was to expire in July 2011. The deadline for the application of permanent tariff methodologies was April 1, 2012, and based on that deadline the ERA was to adopt the methodologies at least six months in advance.

The main objectives of this PPIAF activity thus included helping the ERA prepare new tariff methodologies so as to be in compliance with relevant European practices and fitting those tariffs to the peculiar conditions of the Montenegrin electricity market. Under the grant, a consultant specialized in regulatory economics and with detailed knowledge of the workings of the tariff methodologies of EU countries would be hired by the International Finance Corporation (IFC) to work with the regulatory agency to: i) review the tariff methodologies in place in EU countries, and in any other country with experiences and characteristics relevant to the specific characteristics of Montenegro; ii) analyze the Montenegrin electricity market and propose a draft permanent methodology and a detailed set of recommendations on how to structure and process tariff methodologies; and iii) provide “on-the-job capacity-building support” for the staff of the regulator and for selected electricity market stakeholders.

By supporting the work of the ERA and the development of high-quality tariff methodologies, this activity is expected to improve the long-term financial sustainability of the electricity generation and distribution sector, which is one of the pillars of the growth strategy of Montenegro, promoting the image of Montenegro as an attractive destination for investors in the electricity sector. In addition, IFC had been working since December 2008 as the Lead Advisor of the Government of Montenegro on the implementation of a transaction for the development of the first merchant hydropower HPP in South East Europe: the 250 MW Morača HPP project, which would be the first privately funded, renewable energy, independent power producer with full market risk (merchant plant), developed in South Eastern Europe. At the start of this PPIAF grant, the transaction was well under way, with technical and financial offers expected in late September 2011. Potential investors expressed some concern about existing regulations, the technical capacity of the Montenegrin Regulator, and the overall financial sustainability of the sector. The PPIAF activity supported the ongoing IFC Advisory transaction for the Morača hydropower plant, as it would greatly reduce perceived country regulatory risk, leading to increased foreign investment in the sector. It is hoped that the successful closing of this transaction will have a trigger effect on a long pipeline of energy generation transactions that have not yet come to closure in the South Eastern Europe Region. This region has a significant potential for renewable energy generation which is untapped, and on which the countries of the Balkans are betting to promote economic development.

A final report was submitted in October 2011, providing a review of tariff setting methodologies in similar countries (volume 1) and a final draft of the tariff-setting methodologies developed (volume 2), which includes a methodology for determining regulatory revenues and price for use of the electricity transmission system, for use of the electricity distribution system, and regulatory revenues of public supplier and regulated tariffs for electricity supply. The ERA, in collaboration with a consultant financed by the European Union, had prepared draft versions of these methodologies. The PPIAF-funded consultant reviewed and provided recommendations on these drafts before developing the final version to be used for tariff-setting. The final report was submitted to the ERA, which subsequently continued working on these methodologies in Montenegrin and issued them for public comment.

In addition, an important component of this activity was to provide the ERA with on-the-job capacity building support. The PPIAF-funded consultant provided this by:

- Submitting a note to the ERA dated August 29, 2011 entitled “Recommendations for Improving the Energy Regulatory Authority’s Draft Methodologies for Setting Tariffs.”
- Engaging in a frequent exchange of emails with the ERA regarding specific questions on the draft methodologies.
- Providing training to the ERA in Montenegro during the week of September 26, 2011. A presentation was made on some key aspects related to tariff setting, and discussions ensued. The topics covered during those sessions included: i) a detailed review of the proposed timing for issuing the tariff methodologies, reviewing the tariff applications received from the regulated companies, and final approval of the corresponding tariffs; ii) dealing with planned capital

investments and depreciation when determining the regulated asset base; and iii) the development and use of a financial model for reviewing the tariff applications.

The ERA expressed great satisfaction and thanks for the training and support received from the PPIAF-funded consultant. The ERA has also expressed interest in having the consultant provide further support during the rest of the process required to review and approve the tariff applications from the regulated companies.

As a result of this activity, the new methodology was approved by the Government of Montenegro. The ERA has applied the new methodology and set the new tariffs. There have been effects for the Morača HPP transaction, but not entirely positive: the Government chose to sign a Memorandum of Understanding with the regulated energy producer and distribution company, outside the tender.

Results of PPIAF's Activity to Support the Energy Regulatory Agency of Montenegro

Category	Outputs
Enabling environment reform	
<i>Analyses/assessments prepared</i>	<ul style="list-style-type: none"> Recommendations for Improving the Energy Regulatory Authority's Draft Methodologies for Setting Tariffs (provides an assessment and recommendations on the "draft" tariff methodologies developed by the ERA with the consultant financed by the EU), August 29, 2011 Final Report: Volume 1 – Review of Tariff Setting Methodologies in Similar Countries, October 31, 2011
<i>Policies prepared or legal or regulatory changes recommended</i>	<ul style="list-style-type: none"> Final Report: Volume 2 – The Final Draft of the Permanent Methodologies (provides the final version of the methodologies for setting tariffs which were submitted to the ERA), October 31, 2011
Capacity and awareness building	
<i>Workshops/seminars</i>	<ul style="list-style-type: none"> Training to the ERA in Montenegro on some key aspects related to tariff setting during the week of September 26, 2011

Category	Outcomes
Enabling environment reform	
<i>Policies adopted, legislation passed/amended, or regulations issued/revised</i>	<ul style="list-style-type: none"> New electricity tariff methodology approved by the Government of Montenegro, 2012
<i>Institutions created or strengthened</i>	<ul style="list-style-type: none"> ERA able to set new tariffs and apply the methodology, 2012
Project cycle-related assistance	
<i>Transactions facilitated</i>	<ul style="list-style-type: none"> Morača HPP transaction: expected competitive bids from reputable investors, but the Government chose to sign a Memorandum of Understanding with the regulated energy producer and distribution company, outside the tender
Capacity and awareness building	
<i>Technical capacity enhanced</i>	<ul style="list-style-type: none"> Technical capacity of the ERA enhanced, 2012