Restructuring Paper

On a

Proposed Project Restructuring of the

Electricity Access (Rural) Expansion Project Phase II
Credit Number 4344 - ET

To the

Federal Democratic Republic of Ethiopia

June 9, 2014

Energy Group (AFTG1)
Sustainable Development Department
Country Department AFCE3
Africa Region

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ABBREVIATIONS AND ACRONYMS
Exchange rate effective May 31, 2014

US$ 1.54 = SDR 1

EEP Ethiopian Electric Power
EEPCo Ethiopian Electric Power Corporation
EAREP II Electricity Access (Rural) Expansion Phase II Project
EEU Ethiopian Electric Utility
EFY Ethiopia Fiscal Year
GoE Government of Federal Democratic Republic of Ethiopia
ICB International Competitive Bidding
IDA International Development Association
IFRs Interim Financial Reports
LV Low Voltage
Wp Watt peak
KWp Kilo Watt peak
MoFED Ministry of Finance and Economic Development
MoST Ministry of Science and Technology
MoWIE Ministry of Water, Irrigation and Energy
MV Medium Voltage
PDO Project Development Objective
PIU Project Implementing Unit
PV Photovoltaic
REF Rural Electrification Agency
RVP Regional Vice President
SDR Special Drawing Rights
SHS Solar Home System
TEC Tender Endorsing Committee
UEAP Universal Electricity Access Program
WB World Bank

<table>
<thead>
<tr>
<th>Regional Vice President:</th>
<th>Makhtar Diop</th>
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<tr>
<td>Country Director:</td>
<td>Guang Zhe Chen</td>
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<tr>
<td>Sector Director:</td>
<td>Jamal Saghir</td>
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<td>Sector Manager:</td>
<td>Lucio Monari</td>
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<td>Task Team Leader:</td>
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FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

ELECTRICITY ACCESS (RURAL) EXPANSION PROJECT PHASE II

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ELECTRICITY ACCESS (RURAL) EXPANSION PROJECT PHASE II

RESTRUCTURING PAPER

A. SUMMARY

1. This Restructuring Paper seeks approval of the Country Director to proceed with changes in the subsidiary financing as well as the implementing arrangements of the Electricity Access (Rural) Expansion Project Phase II (EAREP II) (P101556) and accompanying amendments to the project’s legal documents as follows: (a) change of the Project Implementing Entity necessitated by the December 2013 unbundling of the national power sector; (b) revision of the financial/procurement management provisions to reflect the new fiduciary organizational setting; and (c) the addition of dated covenants to mitigate risks emerging from the organizational reshuffling. There is no change to the project development objective or the safeguard category of the Project. Therefore, the proposed restructuring qualifies as a level two restructuring under OP 10.00.

2. In December 2013, the Government of the Federal Democratic Republic of Ethiopia (GoE) initiated the reorganization of the Ethiopian Electric Power Corporation (EEPCo) by means of unbundling the entity into two separate public enterprises namely: (i) the Ethiopian Electric Power (EEP), that is mandated to carry out investment, expansion and operation of generation and transmission assets; and (ii) the Ethiopian Electric Utility (EEU), that is responsible for the management of distribution networks, bulk power purchases and retail to customers.

3. By letter dated December 23, 2013, following the aforementioned reorganization, the GoE informed IDA that EEP would assume the obligations of EEPCo related to EAREP II and as a consequence act as the Project Implementing Entity for EAREP II.

B. PROJECT STATUS

4. The second phase of EAREP, in the amount of SDR 86 million was approved by the Board on July 3, 2007 and became effective on March 31, 2008. The project development objective (PDO) is to establish a sustainable program for expanding access to electricity in rural communities, thus supporting broad-based economic development and helping alleviate poverty. The EAREP II is comprised of three components: (i) Grid Access Expansion, (ii) Off-Grid Access Expansion; and (iii) Stand-alone Systems and Productive Use of Electricity (Pilots), Capacity Building, and Technical Assistance.

5. Project implementation was slower than anticipated primarily due to: (a) a national moratorium on grid extension and rural access imposed by the GoE following severe power shortages in the country (2008-2010), and (b) procurement delays by both implementing agencies, EEP and Ministry of Water, Irrigation and Energy (MoWIE). Moreover, an internal re-organization of the Rural Electrification Fund (REF) responsible for implementing the off-grid component created additional delay. Consequently, the original closing date of December 31, 2011 was extended twice to December 31, 2014 and SDR7.13 million was cancelled in November 2013.
6. Project performance is currently rated Moderately Satisfactory for implementation progress and Moderately Satisfactory for achieving development objectives. The loan amount is 75% committed. Cumulative disbursements now stand at 55.61% of the Credit (compared to 41.43% in November 2013). The November 2013 restructuring helped to unlock key contracts for concrete pole supply (US$18.4 million) as well as conductor/accessories ($8.3 million) which had been stalled for some time, paving the way for a significant increase in the pace of network construction and disbursement.

7. Implementation status of each project component is as follows:

**Component 1: Grid Access Expansion (US$91.1 million from IDA)**

8. Progress on construction of distribution network: As of end April 2014, 285 rural towns/villages were electrified and 1284 km of MV line and 827 km of LV line were constructed. The electrification work of the remaining 81 towns & villages is on track. It is expected that the project will therefore meet the target of 365 villages set for the current credit closing date. However, the number of household customers connected is only 33,628 and as per the current connections pace (i.e. only 5,738 connection since January 2014), it is unlikely that the target of 130,000 by end 2014. Procurement of 1,000,000 meters initiated before EEPCo split is still not completed.

**Component 2: Off Grid Access Expansion (US$22.4 million from IDA)**

9. Component 2 is meant to enhance access to electricity though the installation of solar lighting to remote clinics, schools and households. The mini-grid activity under this component was dropped as part of the last restructuring. As per end April 2014, 28,735 Solar Home Systems (SHS) are already procured and 24,250 installed. Within the scope of the November 2013 restructuring, a scale up was agreed consisting of the procurement and installation of 10,000 additional SHS for an estimated $5 million. REF is currently evaluating the bids and the activity is expected to be completed by the closing date. REF recovers the cost of the SHS through cooperatives with Development Bank of Ethiopia as a Trust Agent.

10. 500 local technicians were trained as part of the supplier contract to provide after sales services in the regions concerned.

**Component 3: Stand Alone Systems and Productive Uses of Energy (via pilots), Technical Assistance and Capacity Building, and (US$3.94 million from IDA)**

11. The November 2013 restructuring added workshops and training activities to help REF strengthen its capacity and build a business plan to promote off-grid projects. Within the scope of these additional activities, the training of 500 local technicians on SHS maintenance and 10 REF and MoWIE experts on off-grid rural projects is under preparation and planned for July and August 2014 respectively.

12. Thus far, the activities that have been implemented under this component are: the

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1 SHS size are in the range of 8 to 130 watt peak (Wp)
recruitment of the Supervising Engineer and an international procurement consultant, the preparation of the Generation-Transmission Master Plan study, and the supply and installation of a PV system testing facility. These contracts have been completed for a total cost of US$2.76 million. The Power Sector Master Plan is currently being considered by the Government for adoption.

13. A PV system testing facility was handed over to Ethiopian Conformity Assessment Enterprise (ECAE) which is one of the institutions in charge of standards under the Ministry of Science and Technology (MoST). Training was provided to operators as well as to staff from the Ethiopian Revenues and Customs Authority (ERCA), the Regulator – Ethiopian Electricity Agency (EEA) and Ministry of Water, Irrigation and Energy (MoWIE).

**Project Ratings**

14. The performance ratings under the last archived implementation status report (January 2014) are as follows:

<table>
<thead>
<tr>
<th>Rating</th>
<th>Previous Rating</th>
<th>Current Rating</th>
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<tbody>
<tr>
<td>Progress towards achievement of PDO</td>
<td>Moderately Satisfactory</td>
<td>Moderately Satisfactory</td>
</tr>
<tr>
<td>Overall Implementation Progress (IP)</td>
<td>Moderately Unsatisfactory</td>
<td>Moderately Satisfactory</td>
</tr>
<tr>
<td>Financial Management</td>
<td>Moderately Satisfactory</td>
<td>Moderately Unsatisfactory</td>
</tr>
<tr>
<td>Project Management</td>
<td>Moderately Satisfactory</td>
<td>Moderately Satisfactory</td>
</tr>
<tr>
<td>Counterpart Funding</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Procurement</td>
<td>Moderately Unsatisfactory</td>
<td>Moderately Unsatisfactory</td>
</tr>
<tr>
<td>Monitoring and Evaluation</td>
<td>Satisfactory</td>
<td>Moderately Satisfactory</td>
</tr>
<tr>
<td>Overall Risk Rating</td>
<td></td>
<td></td>
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</tbody>
</table>

**Safeguard Ratings**

<table>
<thead>
<tr>
<th>Safeguards</th>
<th>Previous Rating</th>
<th>Current Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Safeguards Rating</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Environmental Assessment (OP) (BP 4.01)</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Involuntary Resettlement (OP) (BP 4.12)</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
</tr>
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15. The downgrading of the procurement and M&E ratings are due to the adverse impact of the EEPCo splitting process which created further delays in following procurement processing, bid evaluation reports and contract award. Financial management supervision/assessment was conducted at the project and the entity level to review: (i) the status of the project financial management arrangements, risk, issues, agreed actions, etc. and (ii) the financial management
capacity of the new entity EEP. As such, the mission concluded that it was appropriate to maintain the downgraded financial management rating of MU due to the number of challenges noted. The financial management risk remains Substantial. Staffing is an issue; there are serious capacity constraints at the MoWIE and the financial management staff assigned for the project at REF is not capable. The recruitment of capable staff is ongoing. Budget monitoring/control at REF has deteriorated. Overall project disbursement lags were also observed. Internal audit oversight on the project has been nonexistent. There were delays in the submission of quarterly unaudited financial reports (IFRs) and quality concerns were also noted particularly for the MoWIE implemented components. The year ended July 7, 2013 audit report of the former EEPCo (entity audit report) was submitted with delay by mid-April 2014. The project audit reports are clean but the entity audit report of the former corporation has been qualified with management letters showing a number of weaknesses. Action plans have been prepared to address the challenges and weaknesses observed and which have been noted in the above mentioned financial management supervision/assessment report. To address the former corporation’s financial management issues, a “Just-in-Time” (JIT) study on fiduciary accountability system and corporate governance was undertaken identifying issues that would need strengthening, either through training, or updating of software, systems, and processes. Although the ongoing projects, Ethiopia Electricity Network Reinforcement and Expansion Project (P119893) and the Eastern Electricity Highway Project under the First Phase of the Eastern Africa Power Integration Program (P126579), have been following on the implementation of the recommendations of the Study, the progress has been disappointing (virtually no satisfactory actions have been undertaken to address the findings or apply the recommendations). The above mentioned active projects will support the hiring of a consulting firm to support the new entity EEP/EEU address the findings and recommendations made under the JIT study.

16. The REF is still strengthening its capacity as agreed in the 2013 restructuring with the recruitment of: (i) an experienced FM specialist under the project to ensure timely delivery of audit and Interim Financial Reports (IFRs); and (ii) an off-grid electrification expert to improve implementing capacity.

17. At the end February 2014 interim arrangements were agreed to enable disbursement under the ongoing contracts, in light of the dissolution of the EEPCo. Therefore, progress has continued on both procurement and construction activities. Some improvement in project implementation has been observed, however new contract signing has been delayed in the transition between implementing agencies and the fast approaching closing date leaves no room for further slippage in contract execution. The team will continue to follow up monthly on progress made and provide timely advice to the Project Coordinating Unit and EEP management.

C. PROPOSED CHANGES

18. The change from EPPCO to EEP as the Project Implementing Entity necessitates changes to the projects: (a) institutional arrangements informed by assessments of EEP’s fiduciary and procurement capacity; (b) disbursement arrangements; and (iii) Legal Agreements. Specifically, the Financing Agreement will need to be revised and new Project (between the Bank and EEP) and Subsidiary (between the GoE and EEP) Agreements drafted.
Institutional Arrangements

19. The Project will be implemented by the newly established entity EEP, formed by the Council of Minister’s Regulation No. 302/2013 dated December 27, 2013. EEP is responsible for design and development of electricity generation, transmission, and substations and is mandated to implement the bulk of ongoing and future IDA infrastructure financing in the sector. EEP is governed by Public Enterprises Proclamation No. 25/1992 and EEP Regulations No 302/2013. EEP will be supervised by the Ministry of Water, Irrigation and Energy (MoWIE) and retains the same supervisory Board as its predecessor, EEPCo.

20. The structuring and staffing of EEP has been progressing, key management positions have been filled and the appointment of technical and administrative positions is well advanced.

21. As regards implementation of the EAREP II, the GoE has advised that the staff of the existing Project Coordinating Unit has been transferred to the EEP and will be attached, as previously, to the Universal Access Program (UEAP) Department, led by an Executive Officer reporting directly to the CEO.

22. The GoE and EEP will be required to prepare a Subsidiary Agreement governing the transfer of resources and the obligation of each party to the other in relation to the implementation of the EAREP II. The Subsidiary Agreement must be satisfactory to the Bank. The effectiveness of a Subsidiary Agreement between GoE and EEP will be an effectiveness condition for the revised Financing Agreement between IDA and the Borrower.

Financial Management

23. The Financial Management team carried out a review of the financial management arrangements of the existing project and assessed the EEP’s capacity to manage IDA funds adequately. Following the review, the team concluded the financial management arrangements of the EAREP II project will not be materially changed by the EEPCo restructuring.

24. Overall, the financial management arrangements are adequate and EEP’s financial management capacity is still intact and meets the minimum requirements for financial management under OP/BP 10. Action plans have been prepared to address the challenges and weaknesses observed and which have been noted in financial management supervision/assessment report. The task team will work with EEP to resolve the challenges observed.

Procurement

25. **Procurement legal framework:** The team has assessed the capacity of the new entity to handle World Bank procurement and contract management. As is the case for financial matters, the former EEPCo staff dealing with Bank procurement have been retained by the PIU. The EEP is governed by Public Enterprises Proclamation No. 25/1992 and EEP Regulations No 302/2013. To allow a smooth transition from EEPCo to EEP, the GoE decided to retain the EEPCo Board members to govern EEP. The Board is responsible for all high value contracts procurement award decisions. As a public enterprise, EEP is required to have its own procurement operational manual and the said manual is to be approved by its Board and used as a procedural guide for its procurement activities. EEP is in its formative stage with most of the systems and process still under development. However, EEP has confirmed its decision to adopt EEPCo’s Procurement Manual as the basis for managing its procurement function. The EEPCo Procurement Manual
defines four hierarchies for procurement. A procurement unit for everyday processing of procurement requests and as a secretariat, an ad hoc bid evaluation committee comprised of experts in the subject procurement matter for evaluation of tenders, a tender award committee comprised of departmental heads for endorsing the bid evaluation reports and the Board for award decisions.

26. **Procurement staffing:** The Procurement Unit has been established under EEP’s Department of Procurement, Logistics & Warehousing and a Manager with necessary qualification and experience has been appointed. About twenty (20) staff has already been assigned to the department. EEP has already appointed a Tender Endorsing Committee (TEC). Finalizing the staffing will enable the EEP to carry out and continue with its ongoing project implementation and EEP Board, which is already in place, will have the final approving authority.

27. **Risk identification:** The assessment concludes that the basic procurement legal framework, institutional set up and staff assignment is in place. The existing EEPCo Procurement Manual, which the EEP has decided to adopt, sets out the procurement process flow and business delivery standard with a clear decision matrix. The manual has a well-defined procurement complaints handling system/procedure. Based on this information, the institutional arrangement is acceptable. The possible risk are related with the following: (i) although it has taken over majority of the staff and working procedures of EEPCo, as a new organization, the EEP needs some learning time to perform as a team; (ii) the new staff and the new Tender Endorsing Committee members may lack experience to perform effectively; (iii) the weak practice of slow decisions making and loose accountability may be inherited from EEP’s ancestor, EEPCo; and (iv) efficiency of contract administration may continue to be a challenge.

28. **Risk mitigation measures:** To mitigate procurement implementation risks that are associated with the low capacity emerging from the restructuring and transfer of staff, and possible risks, the following actions are agreed to be taken:

<table>
<thead>
<tr>
<th>I/no.</th>
<th>Issues</th>
<th>Actions to be taken</th>
<th>Responsibility and time frame</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>As a new organization, it will take some time for the staff to perform as a team</td>
<td>Bank team to provide close support and more frequent implementation support missions</td>
<td>Joint World Bank and EEP (continuous support)</td>
</tr>
<tr>
<td>2</td>
<td>Some of the staff and the new Tender Endorsing Committee members lack procurement experience in Bank financed projects and may delay the process</td>
<td>EEP procurement and project managers to attend Procurement and contracts management training organized by joint EMI and the World Bank; The Bank team needs to organize procurement and contracts management clinics to the selected target group</td>
<td>EEP, by end of July, 2014</td>
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Disbursement arrangements

29. The change from EEPCo to EEP will necessitate a change in disbursement arrangements. The designated account has not been replenished since the dissolution of EEPCo. Interim arrangements were made where MoFED is overseeing the disbursement and signing on withdrawal applications. Once this project is restructured, the responsibility for managing this account will be transferred to EEP and signatories will be changed.

Changes to the Legal Agreements

30. The proposed restructuring will necessitate revisions to the Financing Agreement to (i) reflect the change from EEPCo to EEP and (ii) amend the Project description (Schedule 1) and Project Execution (Schedule 2) accordingly. An amended and restated Financing Agreement is an attachment to this restructuring paper.

31. The Project Agreement between EEPCo and IDA will be amended and restated to remove EEPCo and reflect EEP as the new Project Implementing Entity. The amended and restated Project Agreement is an attachment to this restructuring paper.

Covenants in the Legal Agreement

32. Effectiveness Conditions: A Subsidiary Agreement, satisfactory to the Bank, will be prepared and signed between GoE and EEP as an effectiveness condition for the amended Financing Agreements.

33. Financial Covenants:

- The amended and restated Financing and Project agreements should maintain an entity Audit report as a requirement. However, due to the unbundling of EEPCo, an entity audit for the EEPCo’s operations form July 8-December 9th 2013 will be required to be submitted 6 months after Dec 9 2013. Once opening balance is set, it is then recommended that the entity audit requirements should commence for the Ethiopian fiscal year, EFY - 2007 (or for the year ended July 7, 2015) by the EEP.

- The following financial management covenants should be maintained:
  - Submission of unaudited quarterly financial reports 45 days of end of the quarter by EEP and MoWIE;
  - Submission of annual audit reports (audited financial statements of the project EAREP II) within 6 months of the end of the EFY by EEP and MoWIE.