



# Public-Private Partnership Stories

## Panama: Instituto de Recursos Hidráulicos y de Electrificación



IFC advised the government of Panama on the privatization of its electricity generation and distribution companies created from the restructuring of its vertically-integrated utility, IRHE. The privatization resulted in an immediate private capital inflow of \$600 million and 10 percent reduction in retail tariffs, as well as more than \$1 billion in private investment in the privatized companies. The transaction was completed in 1999.

Strategic stakes in the generation companies were sold for a total of \$302 million: 49 percent of Fortuna was awarded to a Coastal Power and Hydro-Quebec consortium for \$118 million, 49 percent of Bayano and Chiriqui was sold to AES Corporation for \$92 million, and 51 percent of Bahia las Minas was awarded to Enron International for \$92 million. Strategic stakes in the distribution companies were sold for a total of \$301 million. Union Fenosa acquired Metro Oeste and Chiriqui for \$212 million, and Constellation Power acquired Noreste for \$89 million.

*This series provides an overview of public-private partnership stories in various infrastructure sectors, where IFC was the lead advisor.*

IFC Advisory Services in  
Public-Private Partnerships  
2121 Pennsylvania Ave. NW  
Washington D.C. 20433  
[ifc.org/ppp](http://ifc.org/ppp)

*Overall, the restructuring and privatization of the electricity sector is considered to have been a success for Panama, with an immediate 10 percent reduction in the average level of end-user tariffs.*

## BACKGROUND

The government of Panama hired IFC to advise on the restructuring and privatization of its vertically-integrated electricity utility. The government's objectives were to introduce competition in the sector, improve efficiency and service levels, attract private capital for large investments needed, and prepare the sector for the introduction of regional competition in the Central American energy market.

In 1997, the utility, Instituto de Recursos Hidráulicos y de Electrificación (IRHE), had 920 megawatts (MW) of installed capacity—two-thirds hydroelectric and one-third thermal, a distribution grid with 454,000 connections, 4,600 employees (overstaffed relative to international benchmarks), and annual revenues of \$350 million. In addition, its system had technical losses of 21 percent, including 15 percent in its distribution network (also high by international standards). IRHE estimated that an additional 560 MW of generation capacity would be required over the next ten years to meet expanding demand, together with the rehabilitation of 236 MW of existing generation capacity. The total required capital expenditures for these generation projects and related investments in transmission and distribution was estimated at more than \$1 billion.

## IFC'S ROLE

IFC was hired by the government in late 1997 to act as lead adviser in the privatization of the generation and distribution companies resulting from the restructuring of IRHE. IFC's role encompassed not only the sale of the companies, but also financial validation of the proposed restructuring and advice on the pricing and contractual arrangements between the new generation, transmission and distribution companies. IFC assembled a multidisciplinary advisory team (that included technical and legal consultants) and worked closely with IRHE's restructuring consultants and interministerial committee that was managing the process. The committee was chaired by IRHE's CEO who played a key role in leading the overall privatization.

## TRANSACTION STRUCTURE

The privatization of IRHE was part of a broader sectoral reform program that involved establishing a new regulatory framework, introducing a wholesale electricity market, and adopting a new tariff regulation. IRHE was restructured into four generation companies (Bayano, 192 MW; Bahia las Minas, 292 MW; Fortuna, 300 MW; and Chiriqui, 222 MW); three distribution companies (Metro-Oeste, 195,000 customers; Noreste, 148,000 customers; and Chiriqui, 65,000 customers); and one transmission company that would remain in state hands. The privatization involved the strategic sale of 51 percent of the shares of the distribution and thermal generation companies, and 49 percent of the shares of the hydroelectric companies. Under the newly enacted electricity law, proceeds from the sale of shares were earmarked for a special investment fund for health and education projects.

## BIDDING

Seventeen operators were prequalified to bid on the distribution companies and 26 on the generation companies. Bidders were permitted to bid on individual companies or selected combinations within overall restrictions on vertical and horizontal integration. The distribution companies were tendered two months before the generation companies. This sequencing ensured that buyers of the generation companies would have creditworthy private distribution companies as power purchasers.

The public competitive price-only bid process was held in September 1998. Strategic stakes in the three distribution companies were sold for a total of \$301 million. Union Fenosa (Spain) acquired Metro Oeste and Chiriqui for \$212 million, and Constellation Power, a subsidiary of Baltimore Gas & Electric, acquired Noreste for \$89 million. Ten percent of the shares were reserved for purchase by employees at a 6 percent discount on the price offered by the strategic investors.

Two months later, strategic stakes in the four generation companies were sold for a total of \$302 million: 49 percent of the shares of Fortuna were awarded to a consortium formed by Coastal Power and Hydro-Quebec for \$118 million, 49 percent of Bayano and Chiriqui were sold to AES Corporation for \$92 million, and 51 percent of Bahia las Minas was awarded to Enron International for \$92 million. Ten percent of the shares of Bahia las Minas and 2 percent of the shares of the generation companies were set aside for employee purchase at a 6 percent discount.

## EXPECTED POST-TENDER RESULTS

Overall, the restructuring and privatization of the electricity sector is considered to have been a success for Panama. Its highlights include the following:

- Proceeds of \$600 million for the government.
- The transfer of \$250 million in government-guaranteed debt to the private sector.
- The transformation of a state power monopoly into seven private companies.
- An immediate 10 percent reduction in the average level of end-user tariffs.
- Capital investments totaling more than \$1 billion by the privatized companies from 1999-2007.
- Improvements in technical service quality.

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