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The Idiot's Guide to Running a Country's Coal Industry … into the Ground

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Our case study of worst practices involves two-state owned businesses, Hunedoara Energy Complex and Oltenia Energy Complex. They are both nearly insolvent, while the Government continues to pump money into their rescue, without, however, any real assurance that the effort will be worth it.

Romania extracts coal from two regions, both in the South of the country. Pit coal, with a caloric power of 3,650 kcal/kg, is produced in the Jiu River Valley, in seven mines. Three of them – Petrila, Paroșeni and Uricani – have been nominated for closure by 2018. This will be done by a specially designated company, tediously called The National Company for Closing Down Jiu River Mines.

The remaining four mines (Lonea, Livezeni, Lupeni and Vulcan), along with two thermoelectric power plants in the vicinity (Electrocentrale Paroșeni and Electrocentrale Deva), have been grouped together under the umbrella of the Hunedoara Energy Complex (CEH) under a 2012 governmental decision.

CEH, responsible for around 5% of the country's electricity production, employs over 7,000 people and produces the most expensive electricity in the country at Lei 270/MWh (€60.5/MWh), while electricity is currently being traded at an average of Lei 170/MWh (€38/MWh) on the Romanian energy exchange. However, this is the least of its worries, as CEH has been struggling to survive for some years now, with little respite.

State aid

The latest of its troubles came when the European Commission (EC) threatened the Complex with a €120 million fine in April 2015 for having failed to purchase the 1.2 million CO2 emission certificates that it is required to buy. The fine for this omission is €100/certificate.

The EC, however, did approve on April 21 a Lei 167 million (€37.7 million) support scheme to come from Romania's Energy Ministry as a six-month loan at market conditions. Still, for more than a month, the money failed to come through, as the Government realized, under EC pressure, that the loan cannot be granted until a previous debt is settled.

The reason for the pressure from the Commission was that this previous debt was the result of a grant made in 2008-2011 which the Commission has ruled was really a form of state aid. It came about through politically-driven bilateral electricity contracts between Electrocentrale Paroșeni and Electrocentrale Deva as the sellers (then separate entities, but now part of CEH), and state-controlled hydro-power plant Hidroelectrica as the buyer. Two consecutive former energy ministers put their signatures on the deals at the time. The electricity was bought by Hidroelectrica at a price higher than the one at which it later resold

it. Brussels decided this was state-aid to the amount of Lei 40 million (€9 million), which CEH now has to pay in order to benefit from the larger €37.7 million it so desperately needs to cover current expenses for the next six months, as well as the purchase of CO_2 certificates.

This, however, is not the CEH's sole debt. CEH still has to pay $7 million on an International Bank for Reconstruction and Development (IBRD) external credit – guaranteed by the state – for upgrading and modernization; a 1.05 billion Yen (€7.5 million) loan supplied by the JBIC (Japan Bank for International Cooperation) for the upgrading of the thermo-electric plant Paroșeni, also state-guaranteed; and €65.3 million received from the Finance Ministry for environment-protection investments. CEH also failed to pay taxes amounting to €27.5 million, according to the Romanian tax authorities. Eight insolvency requests have been filed by private businesses that are seeking to recover money from CEH as of June 8.

CEH's Administration Board became obsolete on April 12 when the third of its former five members quit the job. The Board's President had already turned in his resignation at the end of April in protest against the Government's slow handling of the previously discussed €37.7 million loan. Pressure from employees has also been high, with union representatives taking to the streets and even going on hunger strikes in fear of losing their jobs. Nevertheless, in a ridiculous twist, CEH is unable to even fire some of its personnel, as it cannot currently afford to pay the legal severance packages.

On May 14, with one stroke of the pen the Government approved, through an Emergency Ordinance, a 90-day loan of up to €9 million in order for CEH to repay its pending state-aid debt. Two weeks later, on May 28, the Government issued a second Emergency Ordinance granting the larger €37.7 million loan, as state aid intended for restructuring the Complex.

Eleventh-hour

No end in sight for CEH's woes however, as this latter six-month loan came with cumbersome conditions. As of the end of 2015, when it is due for payment, CEH will have to pay it back, or present a restructuring plan (in which case the repayment deadline would be postponed) or present a liquidation plan (if it cannot repay the credit). Both debt payment and restructuring seem unlikely at the moment, because of the significant total outstanding debt CEH already has – €581 million at the end of 2013

Former Energy Minister Răzvan Nicolescu already asked for a restructuring plan in 2014, but CEH has never presented it. A possibility was discussed last year for CEH to be privatized, as Texas-based Quintana Minerals Corporation showed interest in a bid. However, the dialogue started with Quintana by Mr. Nicolescu appears to have been discontinued after the new Energy Ministry's leadership took charge.

The Government's eleventh-hour decision, most likely with a populist subtext on account of growing anxiety in the mining sector, is little more than patchwork on an already failed company. It hasn't been just the aging, obsolete technology, or the hefty personnel numbers that have been at the heart of this failure. It has also been bad management, which has grown worse for the past three years.

Former Energy Minister Constantin Niţă, for example, forced CEH in 2013 to participate as a shareholder in the construction of the Tarniţa-Lăpuştești pumped-storage hydro-power plant, a €1 billion project that has failed to attract private investors, as the country is facing slumping electricity demand. CEH was supposed to allocate Lei 8.8 million (€1.9 million) to

the company in charge of Tarniţa-Lăpuştești, only 30% of which was actually paid given CEH's being in dire straits.

Another €2.2 million payment was levied on the company by order from Minister Niţă for the construction of the ever elusive Romania-Turkey undersea electric cable, which has been talked about for more than 10 years, with little concrete action as of yet.

Yet another third issue, which also caught the attention of the country's corruption watchdog DNA, has been CEH's policy of importing pit coal through intermediaries in Ukraine and Hungary. Apart from the murky aspects of the transactions, there are also questions about the opportunity of those imports.

The Complex, part Two

Should the reader find this first case not instructive enough, Oltenia Energy Complex (CEO) offers another scenario for running a coal industry into the ground, this time also enhanced with a criminal investigation, as well as inexplicable governmental support for the perpetrator.

CEO is Romania's largest lignite producer, a coal variety with lower caloric power than pit coal, at 1,800 kcal/kg, extracted from the country's Oltenia region. Unlike its dwindling pit coal deposits, Romania still has 15 years' worth of lignite at current average demand of 23 million tons a year. Yearly production (at around 33 million tons) actually surpasses demand, freeing up around 10 million tons for exports each year.

Apart from coal production facilities, CEO also owns several thermo-electric power plants, in total employing 18,000 personnel. CEO went from making a Lei 4.5m (€1m) profit in 2013 to a Lei 700 million loss (€157 million) in 2014, causing it to start firing, retiring or furloughing employees. CEO's chief executive, Laurenţiu Ciurel, announced just this April that the company will see a quarter of its activity shut down and 2,100 of its personnel dismissed in the next months as part of a larger plan to restructure the business and avoid insolvency.

Four thermo-electric units are to be shut down and decommissioned (Brăila 1 and 2, Turceni 1 and 6), along with several mining sites such as Seciuri and Tismana Sud, while other sites are to reduce activity. The goal is to reach a price level of Lei 48/ton of lignite by the end of the year, as agreed upon with the IMF and in accordance with the European policy of discouraging coal use in its member states.

CO2 certificates

To squash rumors of insolvency, Mr. Ciurel mentioned the €42 million purchase of CO2 emission certificates by the company in March 2015, as proof that CEO's finances are in order. Meanwhile, questions have arisen regarding a decision last year by the management not to enter a tender by the Serbian state which was looking to purchase a large lignite quantity at prices that would have benefited CEO.

CEO said it refused to join the bid because of the contract's transportation obligations, even though the deal had been discussed at ministerial level in September 2014 by former Energy Minister Răzvan Nicolescu and his Serbian counterpart, Aleksandar Antic. Instead, CEO chose to sell 1.2 million tons of lignite to a consortium comprised of Serbian Virom Group (controlled by Serbian national Dejan Oketic, sentenced to three years in a 2008 smuggling file in his country), DMB Transport Ltd. Ruma (employing just one person) and the newly

created Constanţa County-registered limited liability company, BVA Coal SRL. The price at which CEO sold the lignite to the consortium was €13/ton, three times lower than the one paid by the Serbian state (€36/ton) to BVA, and also lower than CEO's 2014 production costs – about €14.5/ton.

The management's defense has been that, even though the contract was signed in 2014, deliveries have only started in January 2015, with the 2015 production cost lower than in 2014 – estimated €11/ton in 2015 – due to new restructuring decisions. According to the national auditor, the Court of Accounts, the contract resulted in a Lei 8.4 million (€1.8 million) profit for CEO. The contract has now been suspended, with CEO management again blaming transportation costs and other expenses that have apparently not been paid by the Serbian side – at least according to CEO management's own explanations. According to Energy Minister Andrei Gerea, the National Criminal Investigator DIICOT has begun looking into the matter.

Laurenţiu Ciurel himself admitted in a televised interview in April that the contract has been a disadvantageous one. Mr. Ciurel, who was appointed as "private manager" of CEO in September 2012 in a disputed contest (as contrasted with the normal procedure of state-appointed managers), is already under DNA criminal investigation in a separate file of abuse of position. Despite this, no Energy Minister has yet managed to remove him from his position, which caused domestic media to talk of strong support for Mr. Ciurel by Prime Minister Victor Ponta.

In short, to run a coal industry into the ground, you have the following options: allow political control over contracts that should be dictated by market forces; cross-subsidize to the benefit of your ineffective companies instead of making the sector competitive; or, finally, turn a blind eye to industry managers' indiscretions, with resulting losses to be paid for by sector employees and state budgets. Any of these will do, though these two cases show that a combination of the three will prompt quicker and more significant results.