

INSTITUTIONAL DEVELOPMENT SECTOR FACILITY

INSTITUTIONAL DEVELOPMENT OF CADAPE

(VE-L1005)

EXECUTIVE SUMMARY

Borrower and guarantor:	Bolivarian Republic of Venezuela	
Executing agency:	Compañía Anónima de Administración y Fomento Eléctrico [Electric Power Administration and Development Company] (CADAPE)	
Amount and source:	IDB (OC):	US\$ 5,000,000
	Local:	<u>US\$ 5,000,000</u>
	Total:	US\$ 10,000,000
Financial terms and conditions:	Amortization period:	20 years
	Grace period:	3 years
	Disbursement period:	3 years
	Currency:	U.S. dollars from the Single Currency Facility
	Interest rate:	Adjustable option / LIBOR-based option
	Inspection and supervision:	0.00%
	Credit fee:	0.25%

The interest rate, credit fee, and inspection and supervision fee mentioned in this document are established pursuant to document FN-568-3 Rev. and may be changed by the Board of Executive Directors, taking into account the available background information, as well as the respective Finance Department recommendation. In no case will the credit fee exceed 0.75%, or the inspection and supervision fee exceed 1% of the loan amount.¹

¹ With regard to the inspection and supervision fee, in no case will the charge exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount, divided by the number of six-month periods included in the original disbursement period.

Objectives: The general objective is to help CADAFE overcome institutional limitations and promote its sustainability. The specific institutional objectives are to develop an action plan and specific recommendations for adapting the structure of the CADAFE business group for the legally-mandated modernization of Venezuela's power sector. In addition, for sustainability, it seeks to fund parts of the technological solution needed to solve some of the company's acute billing and collections problems.

Components: The Government of Venezuela has launched a program of activities designed to improve certain aspects of CADAFE, which is a key company for the development and sustainability of Venezuela's power sector. To support this effort, the government has requested technical and financial support from the Bank to find an urgent and much-needed solution for adapting the company to comply with current legal provisions, which will simultaneously help modernize the sector; it has also requested support to develop a modest, complete, and autonomous component for strengthening business management that will encourage implementation of the larger overarching project for restructuring business management called "PARTICIPA."

In view of the foregoing and given the spirit of the public utilities policy, the Bank is proposing a financing operation that is framed essentially as an institutional development project for CADAFE to support the institutional retooling of this company and to restructure it with a view to achieving financial sustainability. The characteristics, purpose, and urgency of the project qualify it as an institutional development project eligible for financing through the Institutional Development Sector Facility (IDSF). It has the following two components:

Institutional development and strengthening component (US\$1 million). This component will fund a study aimed at preparing a concrete plan for priming CADAFE for the modernization of the Venezuelan power sector that was mandated by law and by other rules and regulations. This component also seeks to prevent this company, by its sheer size in the power sector, from obstructing modernization of the sector. The plan provides a transition from the current situation; it includes development of structural and operational plans suited to the model of each business and the framework in which they must operate, including analysis of processes, functions, and procedures, use of available physical and human resources, identification of new resources needed, and assessment of the viability of any recommended changes and how they would be implemented.

Component to support business management restructuring (US\$3.76 million). This component will finance the billing subprocess of the PARTICIPA project, which is the large undertaking to improve CADAFE's business management. This component includes the following activities: (i) contracting technical services to configure systems, implementing the technological solution, parametrizing variables, and sharing information and technological know-how; (ii) training the implementation team; (iii) procuring servers and other major hardware and support equipment for data management and transactions processing, as well as software for business management and database management and operating systems; (iv) updating of the list of existing customers and incorporating new ones; (v) updating the communications infrastructure and incorporating new data transmission systems; (vi) procuring the personal computers, printers, and validation printers needed for offices and business procedures; (vii) procuring portable meter reading equipment and inspection of the reading equipment; and (viii) identifying equipment to be replaced and deciding on environmentally appropriate disposal procedures.

This component—which is critical because the company's billing system is obsolete and at the end of its useful life—will be introduced in a pilot project in the areas of Aragua, Anzoátegui, and Carabobo, which account for 30% of CADAFE's customers and 40% of its total sales. The scale of the pilot project is appropriate for what is essentially a billing project in which the most expensive equipment will be tailored to the size of the coverage area.

The two components are independent of one another in the sense that implementation of either one is not contingent on the execution, implementation, or success of the other. The design of the component to support business management restructuring is sufficiently flexible to permit future implementation of the institutional development and strengthening component taking into account its expected results, especially those related to the segmentation of power distribution currently concessioned to CADAFE subsidiaries.

The two components are complete, autonomous projects, each with its own costs and benefits. The component to support business restructuring will produce more benefits if it goes hand in hand with other subsystems in the PARTICIPA project, such as metering.

Special contractual clauses:

Prior to the first disbursement, the executing agency will present to the Bank:

- Evidence that the borrower and executing agency have signed an agreement in which the former delegates to the latter all duties and obligations related to project execution, and the latter accepts them.
- Evidence that the project's general coordinating unit has been formally established.
- The final procurement plan and bidding information for the procurement of goods and contracting of consulting services for both components.

Eighteen months after the contract takes effect or when 50% of the financing resources have been disbursed, whichever occurs first, the executing agency will present to the Bank evidence that:

- The action plan for adapting CADAPE in light of power sector modernization, to be prepared as part of the institutional development and strengthening component, has been submitted for approval by the company's Board of Directors.

Relationship of the project to the Bank's strategy with the country and in the sector:

The Bank's strategy with the country covers social, economic, and institutional areas, as well as science and technology. The proposed project is in line with and contributes to the strategic institutional objective because it aims to improve the performance of CADAPE, a State-owned company whose institutional situation has threatened not only its own sustainability but also that of the entire Venezuelan power sector.

One of the primary objectives of the Bank's strategy for the power sector is to support the consolidation of institutional, structural, and economic reforms (economic, financial, environmental, social, and political sustainability).

The project's strategy is consistent with this objective in the Bank's sector strategy since the institutional development and strengthening component supports the consolidation of institutional reforms in CADAPE, the largest electricity distributor in Venezuela, and makes it feasible to implement the Electric Power Service Act (LOSE). In addition, the component to support business restructuring promotes the company's financial sustainability, by strengthening it financially. This strengthening is a step toward financial sustainability for the sector, especially as regards EDELCA, which is the company that supplies the electricity and operates the Tocoma Hydroelectric Plant, for which Bank financing is being considered.

Coordination with other official development institutions:

The project team coordinated with the Andean Development Corporation during preparation of this project. No other agency is involved with this company (paragraph 1.30).

Environmental and social review:

No direct or indirect environmental impact is anticipated. The institutional development and strengthening component includes review and strengthening of environmental systems in light of the Electric Power Service Act. The component to support business management restructuring will identify the type of equipment to be replaced and determine environmentally appropriate disposal procedures.

The institutional development and strengthening component is not expected to have a direct or indirect social impact. The component to support business restructuring has a direct social impact on the customers who receive lesser service or who do not pay. To mitigate this, a culture of timely payment, efficient use of electricity, and proper individual behavior will be promoted.

Potential benefits:

The institutional development and strengthening component will facilitate orderly, widespread implementation of reforms in the Venezuelan power sector, because it identifies how to modernize CADAPE, which is the top business-related objective of the sector reform. The minimum potential benefits of this component are the expectations it can create in the process of sector modernization, which will produce many benefits related to proper resource allocation.

The main potential benefits of the component to support business management restructuring are expected to be the freeing up of resources that have a high opportunity cost in the company itself and in the economy in general.

In terms of electricity use by customers served by CADAPE, improved billing will increase the amount paid by users. This will in turn reduce consumption. The benefits will be the difference between the lower economic cost of electricity not used because of the price effect, and the corresponding loss of the consumer's surplus.

With respect to labor, the new billing process will displace semiskilled workers. The benefit of this is equal to their opportunity cost in the labor market. The new billing process will also permit payment of bills at any collection office or electronically, with savings in the cost of transportation and how long it takes customers to pay

their bills.

Potential risks: One potential risk of the operation is resistance to change. At this time, the company and the Ministry of Energy and Mines (MEM) support execution of both components, which they consider to be necessary and urgent. The project also has the support of the business community. However, if this support disappears there would be the risk that the project could not be executed. Mitigation of this risk involves motivating the MEM and the company, based on the project's intrinsic merits, the legal mandate, the real need for reform, and the driving force of the commitments assumed. Mitigation on the side of the business community involves having workers participate on the CADAPE Board of Directors.

There is a financial risk involving the timely availability of counterpart funds. The Government of Venezuela has agreed to timely allocation of counterpart resources, which have been budgeted for the first year. To mitigate this risk, budgetary allocations should be encouraged and verified for subsequent years.

Outside of CADAPE, there is the potential risk of failing to instill the cultural change required for the success of the component to support business management restructuring. This risk may be heightened by the fact that the improved billing is likely to coincide with expected rate increases, which may erroneously be perceived as having the same origin. Mitigation of this risk depends on the educational activities set forth in the PARTICIPA project, which encourage good citizen behavior and rational use of electricity.

Poverty-targeting and social equity classification: This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Furthermore, this operation does not qualify as a poverty-targeted investment (PTI).

Procurement plan and timetable and thresholds for international competitive bidding: Goods will be procured and consulting services contracted in strict compliance with Bank policies and procedures. Before the selection process begins, and once any local requirements are met, the project coordinating unit will present for the Bank's no objection all documentation concerning the procurement of goods and hiring of consulting services.

Annex II presents the tentative procurement plan. The thresholds above which international competitive bidding will be required are US\$350,000 for goods and US\$200,000 for consulting services. National law will govern procurements below these thresholds.

Key At the conclusion of the project, the following indicators will be used

**performance
and monitoring
indicators:**

to measure attainment of the goals and purposes:

Goals:

- Sector reform implemented;
- Sector institutions and companies comply with the provisions of the Electric Power Service Act.

Purposes:

- Transition procedure approved by the end of project execution;
- In the areas covered by the pilot project, 100% of billing uses the new system by the end of the third year of execution;
- Collection increases from 66% to: 70% by the end of the first year; 74% by the end of the second year; and 78% by the end of the third year of execution.

**Arrangements
for joint
presentation of
reports by the
Bank and the
executing
agency:**

Midterm and final evaluations. There will be two reviews—a midterm evaluation when 50% of the total loan amount has been disbursed and a final evaluation, when 95% of the total has been disbursed.

Semiannual progress reports. The project coordinating unit will submit progress reports to the Bank every six months. These reports will be prepared in accordance with Bank rules and will evaluate progress in implementing the project.

Availability of information. The project coordinating unit will collect and file all information and performance indicators concerning the monitoring and evaluation of project execution, audit reports, project evaluation reports, etc. This information will be available for review: (i) when preparing the midterm evaluation and the project completion report; and (ii) as input for preparation of evaluation reports by the Office of Evaluation and Oversight (OVE) or other interested parties, based on their own criteria and in accordance with Bank policies on the subject (GN-2254-6).