



State of Israel  
State Comptroller and Ombudsman  
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Israel Electric Corporation

# **Asset Settlement with the Israel Electric Corporation and Its Effect on the Cost of the Reform**

Abstract



## Israel Electric Corporation

**Asset Settlement with the Israel Electric Corporation and Its Effect on the Cost of the Reform****Background**

The Israel Electric Corporation Ltd. (the IEC or the Company) operated until 1996 under a franchise granted to it by the British Mandate for a period of 70 years. At the end of the franchise period, the company was supposed to have returned the undertaking to the state. The Electricity Sector Law of 1996 replaced the directives of the franchise and formulated directives for handling the return of the company's assets.

In 2018, two significant settlements were formulated in the electricity sector. These were approved by the ministers and enshrined in legislation, reflecting benefits and costs of billions of shekels, through the assets settlement between the state and the IEC and the electricity sector reform, which ended a dispute that had lasted two decades.

**Key figures****NIS 85.9 billion**

the total value of the IEC balance sheet in 2018 in tandem with a decline in the scope of its commitments

**220**

number of assets the IEC has reported as substantial for the purposes of examining the settlement, out of 14,000 assets, most of which are small operational assets

**27**

number of assets for which the IEC has conducted appraisals  
The accumulated value of these assets is NIS 2.87 billion.

**16**

number of assets returned to the state as part of the assets settlement, appraised at NIS 1.67-2.5 billion

**NIS 2.5-2.8 billion**

net cost of the settlement to the state without many substantial assets, which remained in the hands of the IEC

**NIS 2.7 billion**

total decline in liabilities on the books of the IEC in exchange for a payment of NIS 15 million that led to recording a profit of NIS 2.6 billion

**8 ← 4.8**

the improvement in the IEC's EBITDA debt ratio in 2013-2018


**NIS 2.15 -2.45 billion**

gap between the state's estimate of the net cost of the assets settlement and the IEC's estimate

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## Scope


 From July 2018 to January 2019, the State Comptroller's Office examined the assets settlement signed between the state and the IEC and the interfaces with the electricity sector reform, including databases that existed at the time the agreement was formulated, the scale of the agreement and its possible impact. The audit was carried out at the Ministry of Finance, the Government Companies Authority, and the IEC. Supplemental examinations were carried out at the Israel Lands Authority (ILA) and the Electricity Authority. It should be noted that the report does not deal with the agreements formulated in the reform itself or the implementation of the reform.


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## Key Findings



 **Formulation of the assets settlement based on a partial list of assets:** The assets settlement was formulated on the basis of an IEC database that included only the company's substantial assets, excluding many secondary operational assets. The Ministry of Finance did not formulate its own independent list of assets. Therefore, many assets were never discussed in the negotiations over their return to the state. The possibility that some of them may be significant to the state cannot be ruled out.

 **The lack of evaluations of substantial assets held by the company:** At the time the settlement was signed, the state had an appraisal of only 27 assets out of a list of 220 assets handed over by the IEC to the state. Official appraisals were not made for the remaining assets. Therefore, the state did not possess information about the scale of assets held by the IEC and it was not possible to ascertain the extent to which the state exhausted its rights and on the scale of concessions it agreed to in negotiations with the company.

 **The Ministry of Finance has no strategy for handling asset recovery when a franchise expires:** Despite the state's repeated difficulty in enforcing its position on its rights at the end of a long franchise period, the Ministry of Finance has not formulated a strategy to address such issues. The absence of a strategy creates an incentive to toughen positions on the part of the side holding a franchise in order to extract benefits resulting from state concessions.

 **Shortfall presentation of costs and benefits of the reform in the electricity sector:** The cost of the assets settlement is evaluated at NIS 2.5-2.8 billion at least. The assets settlement is an integral part of the financing of the electricity

sector reform. However, the Ministry of Finance did not include the full financial implications of the assets settlement in its cost-benefit calculation of the reform to change the structure of the electricity sector.






**The end of the dispute between the IEC and the state:** The assets settlement brings an end to the years-long dispute between the state and the IEC over the issue of the ownership of IEC assets.

**A further improvement in the financial situation of the IEC:** The assets settlement improves the company's financial situation and the terms at which it raises capital. This improvement is in addition to the improvement made as a result of actions the company has taken over the past five years to reduce its commitments.

**Implementation of the electricity sector reform and the maximization of benefits to the public:** The assets settlement is an integral part of realizing the reform, both in terms of financing and in terms of implementing the company's obligations to sell production plants to private entities. It is important to implement the assets settlement in tandem with implementing the reform. The settlement enables the state to maximize the public benefit inherent in the assets that were held by the IEC and were returned to the state as part of the settlement.

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## Key recommendations

-  The Accountant General and the Government Companies Authority must **routinely maintain complete lists of assets held by all government companies**, including information on the nature of the asset and details of its use.
-  It behooves the Government Companies Authority and the Accountant General **to examine the formulation of a current and up-to-date control mechanism for the assets held by the IEC** as an alternative to the company's statements, as these fail to reflect the value of assets remaining in its hands, and to serve as a mechanism for supervising the future sale of the assets. Furthermore, we propose that such an examination be held also with respect to all government companies whose assets are not fully reflected in their financial reports.
-  State entities and the IEC must ensure that **the overall settlement on distribution of assets and the structural change agreed upon in the electricity sector are fully completed** to benefit both parties and reduce risks to the public weal. Furthermore, in future deals made by the state, it behooves the Ministry of Finance to reduce to a minimum the state's exposure to risk of not receiving full proceeds.

- 💡 The Ministry of Finance and the Accountant General must **formulate a strategy to return assets to the state when long-term franchises end and formulate rules for granting future franchises** that will leave no room for disagreement over future settlements. Furthermore, they must examine the need to formulate a mechanism to resolve long-lasting disputes between the position of the companies and their own.
- 💡 The Ministry of Finance must **ensure that it presents to decision makers with a full picture** of the costs of settlements or policy measures for which it seeks to receive authorization as well as reflect them accurately to the public.

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## Summary

The state, which serves as the public trustee for the management of state assets, is required to represent the public benefit in an optimal manner. Even though the settlement ended a multi-year dispute between the sides, its results are sub-optimal due to the government's lack of preparation or strategy on reclaiming assets from government companies and due to non-uniformity in the state's conduct. Lessons must be drawn from the current settlement to optimize the state's operations in formulating similar settlements when franchises end in the future.

### The assets held by the IEC in 2017

