

SAR POLICY BRIEF No. 53

Romania gets one more chance to restore ANRE as one of the well performing regulators in EU, if there's political will, says SAR

DON'T WASTE YET ANOTHER CHANCE:

Restore ANRE's credibility and continue energy reforms



Romanian energy regulation has not improved since our assessment in October, while the EC threatens Romania with a lawsuit for its failure to liberalize the energy market and restore regulatory independence and credibility. But there's a window of opportunity: if Romania decides to transpose adequately the EU's Third Energy Package, in both the spirit and letter of the Directives, the energy sector reforms could receive a push.

Our last assessment showed that Romania used to be one of the top performers in Europe in the energy market reforms, but after EU accession a slow, but continuous deterioration was visible. The energy regulator was not spared. ANRE, one of the key institutions in the energy sector and once a best practice regulator in the EU copied by even developed countries, has in the meanwhile been stripped of its independence, core competencies and funding.

What can be done? If Romania indeed wants to return to the right track, the EU is helping with a push. We performed the second detailed independent analysis of ANRE's regulatory governance and substance in our "Citizens for Energy" project. This Brief summarizes our main findings and



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focuses on key, urgent recommendations that have to be implemented urgently. Again, we warn there is no time to lose. ANRE needs to recover from its weakened position, **not only because the EU says so, but also because it's in the interest of the country, honest investors and citizens.** Failure to independently implement good regulations has led to a real danger that some companies would go insolvent. 4 of 6 large private investors have withdrawn from a 4 bn EUR project, Energonuclear, because the investment climate in Romania's energy sector does not provide credibility. What's most surprising is why Romania finds itself in this position: unlike other countries, it was on a fast track to reform before EU accession, foreign investors were competing for this emerging market, then the country reversed to its past track of bad governance.

Following several scandals in recent years involving ANRE's management of human resources and budgets, the Government subordinated the regulator to the PM's office. In fact, the regulator was highly dependent on the political leadership even well before then: in 5 years the Authority had no less than 5 different presidents. However, the energy regulator indeed needs to regain its independence to be in line with EU's actions towards a common energy market, and to ensure that the regulator is not subject to populist pressures to regulate prices at unsustainably low levels. This is why we renew our plea: **the Government must give ANRE back its independence, while in exchange ANRE commits increased and proven accountability, transparency, regulatory predictability, and quality of regulation.**

1. ANRE cannot operate independently...

While the regulator receives most of the blame for all that goes wrong in the sector, in reality there's little it can do.

Subject to loss of financial independence, completely subordinated to the Prime Minister's office and being exposed to Parliament or Government initiatives with strong political backing but which affect energy markets, ANRE is powerless in acting as a challenge function and enforcing clear market rules opposing those who pull the strings in Cabinet, whenever needed. What is worse, a drop of 60-70% in ANRE's salaries drove many competent people away, to the better paid jobs in the private sector.

The regulator must be effectively independent from the Executive: the government, more specifically the Ministry of Economy, owns a large part of the regulated industry (electricity and gas producers, distributors, transmission grids). If the Executive decides to merge capacities increasing market concentration, or if it requires one of its SOEs to sell at below market prices distorting the competitive market, ANRE would definitely need independence from the owners of the companies, competence and strength to actually monitor and enforce market principles. Excessive government control also leads to populist pressures, in a country that seems in a perpetual electoral campaign: who dares to say that gas prices must increase, even if we have the lowest gas prices in Europe and low prices mean fast depletion of resources?

For actual independence, the regulator's leadership must be appointed by the Parliament, fixed-term, on competence criteria, and its replacement mid-term must be clearly linked to non-performance. The regulator also must have own revenues from license fees, for budgetary autonomy. ANRE has however recently been subordinated to the General Secretariat of the Government, and its funding currently flows through the state budget. Recent proposed amendments to the law restore the financial sources, but favor politicization, by not establishing a minimal set of criteria for appointments of key persons in the regulator. This is

not so in other regulators, even in Romania: the most effective are those subordinated to Parliament (BNR, CNVM) or with strong external supervision (Competition Council, monitored closely by EC's DG Competition).

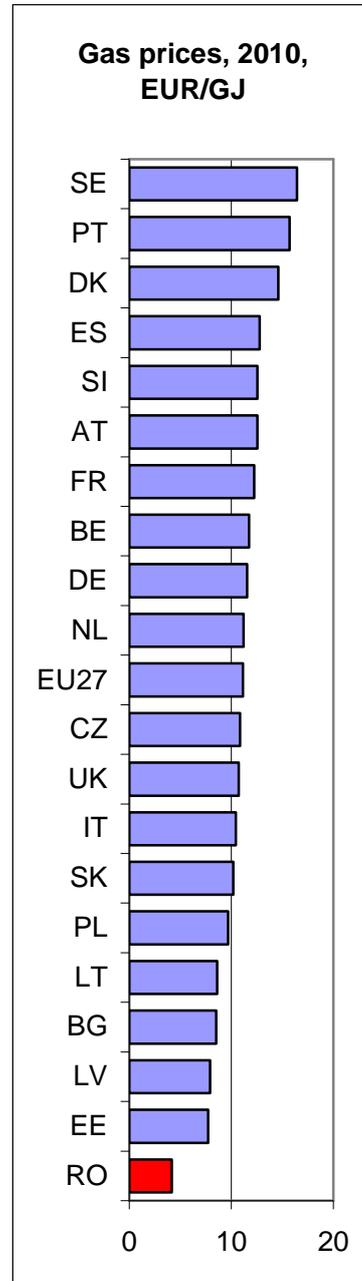
For things to change, the Government must have political will to render ANRE truly independent.

That is, with no informal or formal pressures; no direct subordination or coordination to the Executive; and no direct control of ANRE's finances. That does not mean that the regulator should have full discretion on what it does and how it manages its funds: but a very effective control can be ensured by ANRE preparing a solid Annual activity report, submitted to the Parliament, and which must include audits of financial statements. **We don't ask for anything different than what is already in place for the best performing Romanian regulator: the National Bank of Romania.**

2. ... but real independence and effective regulation is also a quick win for the Government

Romania needs foreign investment in its depreciating energy sector, which relies heavily on capacities from the '60s and '70s. If the country is to resume economic growth, this can be done by attracting foreign investments (that bring money, jobs and taxes) more than by any other stimulus packages; but investors do not come when there's no predictable regulatory environment and when even current market participants accustomed to the local games complain they don't know what to expect in several months. Some companies make heavy losses, because regulated prices do not cover actual costs (gas suppliers); while others cannot collect their bills but are not allowed to disconnect (electricity and CFR). Under these conditions, maybe SOEs can survive for a few years by subsidies, paid from our own pockets,

but private companies go insolvent. Can we really afford that?



Source: Eurostat, 2011. Romania has by far the lowest prices for gas in the EU, but this happens just because we keep artificially the gas prices at regulated levels. The situation is the same for prices for large industrial users. Who pays? Remarkably, most of this is done at the expense of private suppliers, who made a loss of around 1 bn. EUR in just 2009-2011.

We explain in the report that ANRE is effectively not implementing its own regulations, being pressured to maintain regulated prices, at below market levels, for the population to appreciate and big companies to benefit preferential deals.

This has reached incredible proportions in 2009-2011 in the gas sector, for example. Suppliers are required to continue their supply at low prices, though they purchase gas in much more expensive conditions. Put simply, we buy at regulated prices of about 200 USD/1000 m³ gas that is purchased by suppliers at 300 USD/1000 m³. And it's not only us who benefit this subsidy, but also large fertilizer and chemical companies. In the report we explain how this has been possible.

But before we indulge in the idea that we get cheap electricity or gas, we must know that all this comes at a cost that will be borne by us and the next generations. We waste resources, particularly our gas that is expected to last for another about 15 years; our industry remains highly energy intensive because there is no incentive to invest in modern technologies; and investors cannot come in a country where the risk that low regulated prices would not allow them to recover their investments.

And this is why we need a strong regulator: to ensure that not just everybody receives subsidies, but only those who actually deserve, while everybody must pay a correct market price. The EC says that we need to identify vulnerable consumers and support only those, but not with cheap energy, but with targeted income subsidies. Energy prices will follow market conditions and ensure attractiveness of investments only if the regulator remains free from cheap populism and does its job with competence and responsibility.

3. The regulator must respond adequately not only to the Parliament, but also to its most important stakeholders. That is, it must be accountable to us as consumers, to the regulated industry and to the general taxpayer. For this to actually happen, the broad directions of the regulator's actions (including regulations, enforcement, monitoring

etc.) must be agreed with representatives of a Consultative Council. ANRE used to have indeed such a body that consisted of representatives from businesses, employers' associations, unions, consumer protection, local authorities, and Ministry of Economy. In the best years of ANRE's functioning, the Consultative Council used to be very frequently consulted, well respected, and regulations largely followed the non-mandatory advice of this body of expertise. But now, we see that the Council has lost most of its clout, its members rarely actually meet, and two new proposed laws even eliminate the criteria for the members of the Council to represent the interests of the stakeholders.

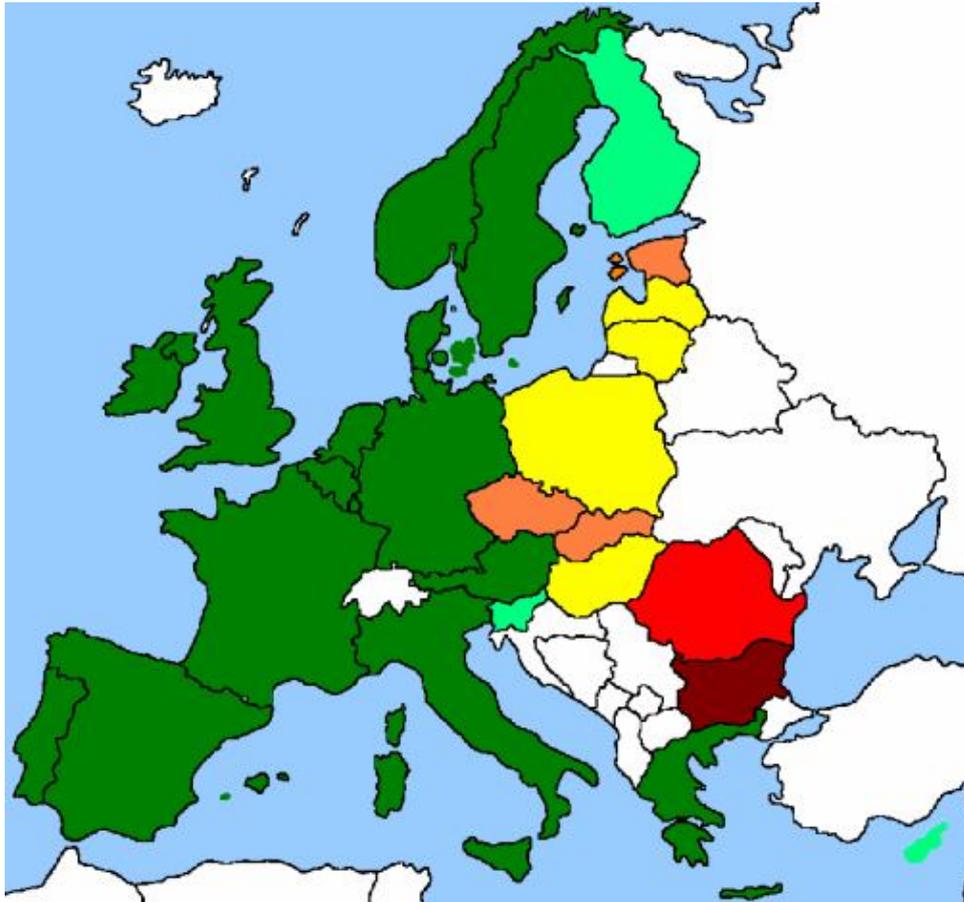
In order to be accountable to the general public, the regulator must be fully transparent on the operation and use of its resources. What is more, ANRE's key role should be market monitoring, not so much the tariffs and certainly not the regulation of prices in competitive areas such as energy production and supply. Of course effective market monitoring would be difficult if there is no independence, either from the political parties in government or from the regulated industry. But the general public would benefit greatly having a watchdog that monitors and challenges publicly issues such as:

- bilateral contracts with cheap electricity and gas, benefiting companies selected in a non-competitive manner; if the producer is an SOE, the discount between market price and contract price is a state aid that distorts competition;
- the extent to which non-payments of electricity bills by other SOEs such as CFR represent state aid imposed on electricity companies and affect the market functioning by rendering power suppliers insolvent (CFR arrears to the

- electricity sector amount to almost 2 bn RON);
- whether the creation of 1-2 integrated companies in energy is indeed beneficial to the end user, considering also matters such as consumer choice, possibility of cross-subsidization of inefficient plants from profitable ones, and competition on the market to drive prices down. In this matter, ANRE should be able to provide support to and/or act jointly with the Competition Council, which was left alone in deciding on this highly sensitive matter from a political perspective
- what would be the impact on competition of the new law for renewables (220 or 139, after final approval), considering that green certificates are state aid that is compatible with EU's regulations as long as it is not excessive
- how did the market respond to Government or Parliament initiatives to provide cheap gas for a special category of large industrial consumers, and whether this has affected in any way competition in the gas market
- also, is it good or bad that a new idea emerged in Parliament just these days, that Romania's gas exports must be strictly forbidden.

Romanian Academic Society (SAR)
61 Eminescu, Bucharest 2
tel/fax (4021) 211 1477
office@sar.org.ro
www.sar.org.ro

Cover photo:
<http://www.telegraph.co.uk/finance/personalfinance/2802689/Dont-get-burnt-by-your-gas-bill.html>



Map: energy intensity in Europe. Cheap energy supply to energy-intensive industries (fertilizers, chemicals, aluminum, steel) lead to little incentives for reduction of energy consumption per unit of GDP. Data from Eurostat, 2011.

Scorecard ANRE

	2004	2010	2011	2012*	2013*	Immediate measures (by 2012, to reach target)	Mid term measures (by 2013, to reach target)
GOVERNANCE							
Independence						Govt: no direct control on ANRE; only approval of ANRE's report	Govt: control only through approval of ANRE's Report in Cabinet
Budget and subordination						Govt: repeal HG 1428 (budget, subordination to GSG); good transposition laws for 3rd Package	Govt: check financial statements in Report
Change in leadership						Govt: amend and implement Law 13, leadership changed only for performance	Govt: replace leadership if Report is rejected
Informal political pressures						Govt: abstain from statements on prices, integrated cos, or laws to give cheap energy to some	Govt: social protection, if any, completely outside prices
Relations with regulated sector						ANRE: interdiction of staff to leave to cos	ANRE: no inappropriate relations to cos (shares, nepotism)
Accountability							
Reporting and confirmation of leadership						ANRE: report on activity at 2004 level and full audited report on finances	ANRE: performance and financial reporting
Accountability to consumers, industry, public						Govt: change management only by Parliament decision, on performance	Govt: change management only by Parliament decision, on performance
Financial and auditing						ANRE: respond adequately to complaints, accusations in media	ANRE: full reporting on activities targeted to different audiences
Ethics and enforcement						ANRE: publish audited financial statements	ANRE: publish audited financial statements
						ANRE: reinstate Code of Conduct, adapt, enforce, publish	ANRE: continue to publish results on ethics enforcement
Transparency							
Publish decisions (regulations + decision-making process)						ANRE: publish and consult on all major decisions; 2004 level reports on website	ANRE: full performance reporting on website (Ofgem target)
Proper consultation						ANRE: publish reg committee decisions and link decisions to objectives	ANRE: all decisions on objectives, monitor deadlines, explain delays
FOIA responses						ANRE: Consultative Council, public hearings or e-comments on all major decisions	ANRE: launch e-debates on all major decisions, publish all comments
						ANRE: respond in full to all FOIA requests	ANRE: respond in full to all FOIA requests
Predictability							
Consistency and justified amendments						ANRE: maintain consistency on regulatory periods	ANRE: link decisions to sustainable goals & objectives
Adaptability to environment changes						ANRE: publish justifications for all amendments to Orders; work program on objectives; cost pass through	ANRE: full work program on objectives, explain deviations or changes
						ANRE: full debates on changes (tariffs, regulations)	ANRE: identify and launch debates on changes in environment, e.g. private participation in generation
SUBSTANCE							
Tariffs							
Economically sound						ANRE: eliminate distortions on tariffs	ANRE: revise tariff policy to enhance competition, eliminate regulated prices for producers & consumers
Periodic reassessments						ANRE: review tariffs for regulated consumers; abandon talk about regulating prices	ANRE: review tariffs for networks (transmission - transit, zonal tariff)
						ANRE: change of tariffs only on fundamental changes in environment, but with inflation	ANRE: announce in time reassessment of tariffs and debate
Monitoring markets and licensing							
Enforceability of decisions						ANRE: clarify and enforce regulations	ANRE: refocus its activity on markets, not tariffs
Transparent criteria for licensing/withdrawal						ANRE: better sanctions, monitor sensitive aspects in market, challenge function to Govt measures	ANRE: Enforcement code with full procedures
Consumer protection, management of complaints against industry						ANRE: start work to streamline Enforcement guidelines	ANRE: Enforcement guidelines
						ANRE: respond to complaints with clear justifications, no talk of social tariffs or prices	ANRE: Definition of vulnerable consumers; consumer rights

Legend

*	Achievable target
■	Unsatisfactory
■	Moderately satisfactory
■	Good
■	Best practice
■	N/A or no evidence

Reason to change or maintain scores 2010 - 2011 (explanations in Detailed Assessment):

- 1. Independence:** ANRE would not be depoliticized in the new proposed laws, it recovers only financial independence, appointments in key positions would be made just as now by the PM, at the proposal of president of ANRE, without clear criteria.
- 2. Accountability:** New draft laws do not provide for additional safeguards for better accountability to stakeholders (Consultative Council is not representative); ANRE would not account for its performance to an external body (preferable to Parliament); it is not audited
- 3. Transparency:** Fair response on FOIA, though the quality of responses on the most sensitive matters could be improved; public reports do not contain politically sensitive information, such as ANRE's position on the set up of the two integrated champions or hydro's bilateral contracts.
- 4. Predictability:** Tariffs follow methodology, but ANRE does not follow consistently its own regulations (cost pass through)
- 5. Tariffs and prices:** The practice of regulated prices continues.
- 6. Market monitoring:** ANRE does not monitor the contracts or measures of Government that have a potential anti-competitive effect.