

Policy Brief no. 12, October 2012

The Parliament decided on October 23 who will be in the Regulatory Committee of ANRE. Now that is unfortunate: we (and DG Energy) were hoping for more. For example, we were expecting the Parliament to follow, if not the new law, at least the EU Directives, and appoint true professionals, not party friends.

Checkmate for ANRE?



- **The Regulatory Committee is the brain and muscles of the energy regulator.**
- **The Parliament's decision to appoint the members of the committee in clear violation of the EU Directives, in a non-transparent and non-competitive process, has not escaped EC's attention. Romania risks new sanctions in as soon as two weeks.**

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It is still hard to believe, at least for the external observer in Washington or Brussels, how an institution that was once a model of good practice in Europe could go so wrong. It is even more difficult for us, who have made two rounds of recommendations for ANRE's governance and regulations, to understand how the legislator managed to follow 99% of our recommendations and still achieve zero improvement, by one single disastrous move.

In fact, everybody interested in energy was hoping now that the long and sad saga of ANRE, a long neglected regulator that lost independence and competent staff in a series of bad policy decisions, would finally have a happy ending. The law just published in October had met the prerequisites to reinstate it as a credible, competent and independent regulator. In our third evaluation of the energy regulator ANRE

we were finally **happy to give higher scores on many of the governance indicators**. However, Romanian harsh realities stroke back: the Parliament decided to appoint a new regulatory committee in a process that might formally meet some provisions in the law, but **it definitely breaches both the letter and spirit of the European Directives of the 3rd Package** – and maybe the Romanian Parliament does not know, but Directives supersede Romanian law.

In the law, indeed, there are improvements in the manner to appoint the members of the regulatory committee, including the president and vice-presidents. Subordination to Parliament, the fact that the other members of the committee are not subordinated directly to the president as staff of the regulator like until now, the suggestion that selection of the most qualified people would be done competitively; the budgetary autonomy; the renewed capacity of the consultative council and the reporting to Parliament were good provisions. Not only that: they have worked quite well for other regulators, such as the National Bank BNR and the Competition Council.

However, the implementation of the law and the manner in which the law is interpreted to actually appoint the new leadership and the regulatory committee proved to be more important than the law itself – as it usually happens in Romania. The process to select should have been **transparent, truly competitive and allow the most competent people with best possible reputation, including abroad, to be selected**. In fact, given ANRE's past record of media scandals in 2007-2009, with political appointees in key positions who were in conflicts of interest or owned shares in the regulated industry, this time the

selection process should have been exemplary.

Thus, to avoid any public suspicion that the future members of the regulatory committee were **already "known beforehand"**, meaning that the "selection" is just a charade that only naïve fools believe in, the law itself should have been more specific on certain aspects. It should have specified:

- a deadline by which the Parliament committees publish the detailed methodology for the appointment of the members of the regulatory committee; and
- the minimal rules for the process, such as the fact that the openings would be announced publicly and for a reasonable time to allow any suitable candidate to apply; the competence criteria would be better defined for each position; the fact that the selection process would be fully transparent and the committees would publish the methodology, criteria for grading and ranking the candidates and, for each candidate, the reason for selection or rejection at the end of the process. Also, the candidates for the executive leadership of ANRE should be examined also on the management plan, to see for example how they intend to rebuild the long lost capacity of ANRE after many qualified staff left when salaries dropped by 70%.

In brief, the general public and the EC expects from the selection of ANRE's leadership nothing short of the transparency that is expected also from the selection of chief prosecutors these days.

Competitive selection is crucial to allow the regulator's independence from both politicians and the regulated industry. Failure to do so transforms ANRE into an even worse institution than before the law was approved. Now, the regulatory committee would have little capacity to understand and challenge proposals from the regulated industry to ensure that the interests of other stakeholders (e.g., consumers or

taxpayers) are respected. If regulators are not fully competent, but appointed on political loyalties only, this is a recipe for disastrous rumors that would simply destroy the little credibility that ANRE has left – and credibility is very important for ANRE to actually regulate an industry. Indeed, many would suspect or even publicly accuse that regulations in reality may come “from elsewhere” or “from the deep pockets of foreign investors to whom we sold our last crown jewels”, to be simply endorsed without opposition. Of course, that would be in exchange for bribes from these “sharks”, which then are further distributed fairly among parties proportional to representation in the committee, to finance the political campaign, for example. Even if not true, such slanderous accusations would stick to the reputation of the regulator for a long time – and ANRE’s capacity to enforce its regulations without credibility becomes Mission Impossible.

In fact, to avoid this trap, there is **no reason why we couldn’t learn from the big headhunting exercise that takes place this year with the IMF and Emergency Ordinance 109/2011 for the competitive selection of management and boards of the state owned companies.** After all, in SOEs the problem was the same – managers and board members were appointed based on party loyalties instead of minimal competence criteria and a fair competition. And whatever finally starts to work well in SOEs (indeed, after long delays) should have been successful for the headhunting in regulators such as ANRE as well. The key is to select right from the beginning excellent headhunters, with sound reputation, and who would not want to get involved in a rigged process. Then, one would need to prepare the terms of reference for members of the regulatory committee (if needed, one could ask around in

other regulators or even in the newly formed ACER for advice). The headhunters would then place advertisements, including in international newspapers like The Economist and select a shortlist of candidates from which the Parliament, as the body to which ANRE now reports, would select based on an interview. The whole process must be made very public, which takes minimal effort: publish criteria for selection and scoring, allow anybody interested from the general public to attend the interview meeting, and publish results of all interviews, for successful and non-successful candidates.

The executive members (president, VPs) must also have a management plan; regulators in general must show first of all their advanced competencies in CV experience but also the number of publications concerning the sector and regulation. **The most critical skills are knowledge of the market operation and the functionality of the regulated industry.** The job of regulatory committee members is not simply to check and endorse regulations made by others: the regulatory committee must prepare the **regulatory road map** (strategy of regulation), looking at the sector, understanding the problems, proposing a list of regulatory objectives in discussion with the Consultative council (which represents all stakeholder interests and views) to solve these problems, and ensure that all regulations proposed and endorsed

Before the Parliament’s decision on October 23 to appoint non-transparently, non-competitively the regulatory committee of ANRE, we were willing to give better scores.

by ANRE meet one or more of the overarching objectives of the regulator. The regulatory committee must check that regulations have the desired effect, by checking the implementation results and considering amendments only if the regulation does not work; and they must explain, in

the annual report of the regulator, how well the regulator performed compared to what it intended to do in that particular year. Did ANRE improve

consumer choice? Did it support the reduction of CO2? Or was security of supply enhanced by a regulation that removed a barrier to investment in generation? These overarching objectives must be matched by regulations on which ANRE is accountable to stakeholders. But to do that, regulators must **have the in-depth knowledge to make sophisticated assessments of impacts and see the big picture.**

One big discussion in the past 3 years has been the financial independence versus the irresponsible waste of resources if the regulator and its people cannot be made properly accountable for their decisions. The **regained financial independence** can lead to additional issues if it is not matched by increased accountability. In the past, ANRE's good salary level made it very tempting for politicians to appoint people in key positions in ANRE based only on political affiliation, which then backlashed in public scandals and was followed by the subordination of ANRE to the Government to keep such developments "under control". Now this is why the so-called financial independence should not be divorced from a form of intelligent, flexible budgetary control: ANRE must publish not only its budgets and execution, but do independent audits, and salaries of key people such as regulators should be approved by the body ANRE reports to, the Parliament, who should also check how ANRE sets its license fees, so that the regulator does not abuse discretion over its own financial matters.

In the end, the true independence of the regulator will be tested by the capacity of the regulatory committee to **challenge proposals**: from politicians; from the regulated industry, from other stakeholders, from interest groups to whom members might be exposed to. But how can one challenge if they are not more competent than anybody else? A member of the committee must understand not only the regulation that is proposed, but:

- what are the main risks inherently contained in the proposal, coming from the individual interests of the proponent; and
- the regulatory committee member must also think what are the alternatives to any proposal.

For example, there's nothing wrong that the distribution companies propose adjustments of the tariff methodology for the next regulatory period, 2013-2017, or that an electricity producer proposes an amendment to the market rules. However, the regulator must understand that all of these initiators have own interests, in many cases very legitimate, that might clash against the other stakeholders' equally legitimate interests. For example, the distributor may want to increase a tariff as much as possible, in conflict with the goal to keep prices at an affordable level for consumers; and the electricity producer may simply want to make sure that new entries from possible competitors are avoided. Politicians in their turn make even more blunt pressures: they can threaten to replace regulators for failure to comply with their own political agenda, unless the regulators have been selected in a process that is so transparent and appreciated by the public that the replacement of people selected in that manner would cause a public outrage. In short, the regulator must understand which of the provisions in the proposals are biased towards the interests of the proponent, and be able to challenge every parameter with arguments, knowing very well the alternatives for sound regulation.

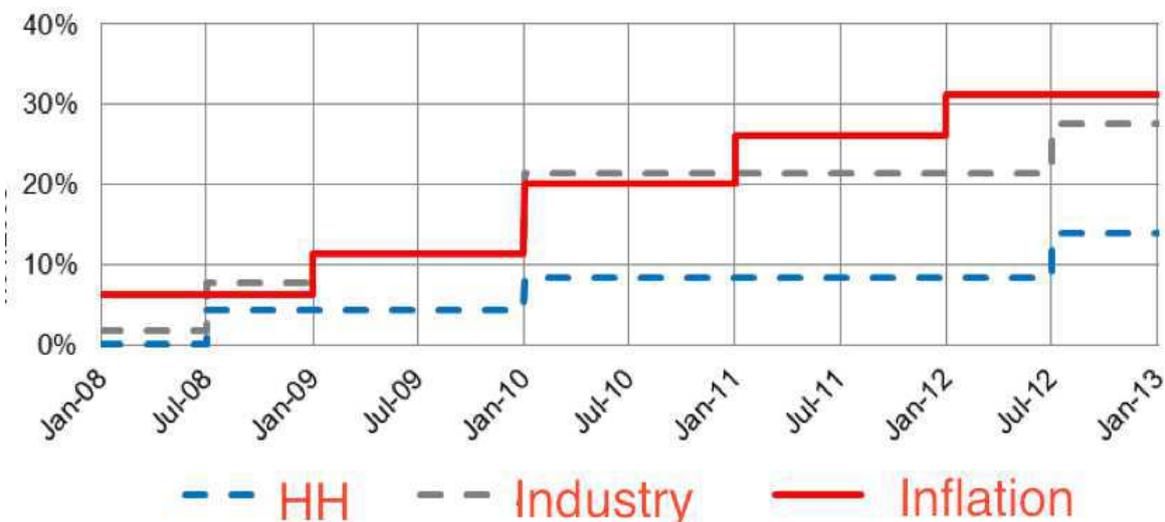
The process by which the Parliament decided to appoint the members of ANRE's regulatory committee has met in fact **none of the good practice standards**. Two CVs of reputable, technically competent candidates have been dismissed without justification; there was no public discussion on the applications of various candidates, the process of selection was completely non-transparent, with no criteria except

political support and no applications from outside the Parliamentary groups were possible, on the contrary. This is of course no different than what happens in Romania with other institutions, such as the public TV, the Cultural Institute or the insurance regulator. However in this case, the European Commission is particularly sensitive. The EC has been promptly informed and considers sanctions for Romania as the process was a blatant violation of the principles agreed beforehand; not to mention that the EC is simply at its wits' end after Romania needed a year and a half after the deadline for transposition to prepare a reasonable draft. The sanctions considered by the EC are from official letters expressing disapproval of the process to infringement procedures that could be launched as soon as in two weeks. The main concern is that, if the regulatory committee is not made up of people with competence beyond dispute, and if party or group loyalties prevail, the regulator would **not be able to function like an objective, independent mediator of all stakeholder interests**. In that respect, the next logical question is what's the point to still **have** a regulator if a regulator cannot function properly.

Again, Romania's particular case might be a source of inspiration for EU institutions. Sure – now the European energy regulator is not empowered to take over functions of national energy regulators, as member states have opposed the idea when the negotiations on the 3rd Energy Package took place. And maybe it would need an amendment of EU Treaties to empower ACER to become a supranational body like ECB before national regulators can be dissolved and replaced, though EU recognized that in some member states the regulators were the bottleneck for the development of EU's internal market on energy. But who knows? Maybe we continue to prove totally incapable to set up a well functioning regulator and let it work decently, judging from past experience. If there is little chance that the energy regulator would ever be capable to arbitrate sensibly among legitimate stakeholder interests, when the regulatory committee has little competences in energy and might be subject to increasing pressures, EU oversight may be the key.

What if, in the medium term when all EU bureaucratic work and legal fluff can be reasonably sorted out, EU simply decides to dismantle ANRE and transfer all energy regulatory functions to ACER?

Growth of electricity prices below inflation: political pressures to keep prices low (CEZ, 2012)



Expert Forum (EFOR)

Maybe this could be an issue for consideration at some point in other countries as well if the implementation of the 3rd Package does not solve the issues with national regulators that the 3rd Package was made for? Just like in the case when EU officials said they are thinking to set up an EU general prosecutor because Romania made it clear that this was an urgent thing to do, we could set yet again the first example, and push ACER to take on some roles that it was not initially supposed to cover, in a few years and after all legal amendments at EU level

can be made, to respond to all the surprises that only mischievous little countries like ours can prepare.



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Scorecard ANRE

	2004	2010	2011	2012*	2012**	2013	2014	Immediate measures (end-2012)	Mid term measures (by 2013-2014, to reach target)
GOVERNANCE									
Independence								Par: redo proper selection of members of the regulatory committee	Par: control only through approval of ANRE's Report, careful dismissal
Budget and subordination								Par: analyze financial reporting of ANRE	Par: check financial statements in Report
Change in leadership								Par: proper selection of reg committee members	Par: replace leadership if Report is rejected
Informal political pressures								Par: proper selection of reg committee members	Par: no pressures for low prices; ANRE: implement liberalization calendar
Relations with regulated sector								Par: proper selection of reg committee members; ANRE: observe law	ANRE: no inappropriate relations to cos (shares, nepotism) by implementing law
Accountability									
Reporting and confirmation of leadership								ANRE: report on activity at 2004 level and full audited report on finances	ANRE: performance and financial reporting
Reporting and confirmation of leadership								Par: change members of reg committee only on performance	Par: change management only on performance by report
Accountability to consumers, industry, public								Par: reg committee. ANRE: respond adequately to complaints, consult with Consultative Council	ANRE: full reporting on activities targeted to different audiences
Financial and auditing								ANRE: publish audited financial statements	ANRE: publish audited financial statements
Ethics and enforcement								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)
Publish decisions (regulations + decision-making process)								ANRE: publish reg committee decisions and link decisions to objectives	ANRE: all decisions on objectives, monitor deadlines, explain delays
Proper consultation								ANRE: public hearings or e-comments on all major decisions	ANRE: launch e-debates on all major decisions, publish all comments
FOIA responses								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
Consistency and justified amendments								ANRE: publish justifications for all amendments to Orders; work program on objectives	ANRE: full work program on objectives, explain deviations or changes
Adaptability to environment changes								ANRE: full debates on changes (tariffs)	ANRE: identify and launch debates on changes in environment, e.g. private participation in generation
SUBSTANCE									
Tariffs									
Economically sound								ANRE: implementation liberalization program; debates on 3rd regulatory period	ANRE: revise tariff policy, enhance competition, liberalization calendar
Economically sound								ANRE: adequate cost pass through	ANRE: review tariffs for networks (distribution; transmission - tranzit, zonal tariff)
Periodic reassessments								ANRE: change of tariffs only on fundamental changes in environment, full implementation of own regulations	ANRE: announce in time reassessments of tariffs and debate
Monitoring markets and licensing									
Enforceability of decisions								ANRE: clarify and enforce regulations; energy market monitoring	ANRE: refocus its activity on markets, not tariffs
Enforceability of decisions								ANRE: better sanctions, including for SOEs	ANRE: Enforcement code with full procedures
Transparent criteria for licensing/withdrawal								ANRE: enforcement guidelines	ANRE: Enforcement guidelines
Consumer protection, management of complaints against industry								ANRE: respond to complaints with clear justifications, enforce sanctions on those in breach	ANRE: Consumer rights

* October 15
 ** October 23
 * Achievable target
 Unsatisfactory
 Moderately satisfactory
 Good
 Best practice
 N/A or no evidence

Reason for changes in 2012 (full explanations in Report):

- Independence:** ANRE could have been depoliticized if the law had been followed; the process to appoint people in Parliament session indicates there is no intention to de-politicize the energy regulator, which breaches the spirit of the Directive and is not in the public interest. ANRE becomes financially independent.
- Accountability:** The Consultative Council will be reinstated; ANRE reports to Parliament; but the breach of good practices at the appointment will render reporting to Parliament equally irrelevant; ANRE is not audited
- Transparency:** ANRE responds to FOIA requests, but the quality of responses on the most sensitive issues is not very good; public reports do not contain information about politically sensitive matters.
- Predictability:** Tariffs follow methodologies, but ANRE does not consistently apply its own regulations (cost pass through or changes to tariffs based on the formula)
- Tariffs and prices:** Non-implementation of cost pass-through for regulated supply, the deferred revenues issue, delays in debating the 3rd regulatory period (ex. distribution of electricity and gas)
- Market monitoring:** There is no effective monitoring and sanctioning of SOEs and no analysis of controversial decisions of Government.