

SAR POLICY BRIEF No. 49

After having lost its top position among EU regulators, ANRE still has an opportunity to make a big comeback now, says SAR

HERE'S THE DEAL:

Give ANRE back its powers and ask for better governance

The EC threatens Romania with an infringement on the energy regulator, while the government seems to have a point in its attempts to control ANRE, if we just look at recent media scandals. What to do? We suggest a win-win solution: the Government must give ANRE independence, but only in exchange for clear commitments from ANRE on accountability, transparency, regulatory quality and predictability.

If there's one area in which we could be among the top performers in Europe, we risk reversing all reforms, for fear not to lose our laggard position we are so accustomed to. So we said in our Annual report three years ago, and unfortunately we were right. Electricity and gas were those sectors; reforms in the two were indeed stalled; we witnessed some steps backwards, with the never-ending saga of "integrated energy companies"; and ANRE, one of the key institutions in the energy sector and once a best practice regulator in the EU, has in the meanwhile been stripped of its independence, core competencies and funding.

Is there a chance that ANRE could be restored? We definitely believe so. We performed a detailed independent analysis of its regulatory governance



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and substance in our “Citizens for Energy” project. This Brief summarizes our main findings and focuses on key, urgent recommendations that have to be implemented urgently. There is no time to lose: ANRE’s recently weakened position has prompted a **strong reaction from the European Commission, and indeed we would get an infringement in March 2011** if no corrective actions are taken immediately. Unlike other infringements, this time the EC definitely means business: Romania is the only country in the EU where such a major setback in regulatory independence ever took place.

The main concerns of the EC are related to the effects of new legislation (L329 and HG1428 of 2009). By these, ANRE was subordinated to the General Secretariat of the Government, and its revenues were transferred to the state budget. The EC is also worried by previous practices, such as the frequent changes in presidents, and by the loss of qualified staff as a result of salary cuts (50% in the Unitary Pay Law, 25% temporary reduction of pay until end 2010).

But at the same time we understand the concerns of the Government regarding ANRE after recent scandals, and that the inclusion of ANRE in the new legislation was partly caused by a public pressure to curb practices signaled by the media. The press wrote on countless occasions about excessive salaries, cases of nepotism and other governance-related issues in ANRE. We also understand the extraordinary measures needed to cut the deficit, including by slashing the public sector wages. However, the energy regulator indeed needs to regain its independence to be in line with EU’s common energy policy, and the EC will have a tough stance on that. We propose a deal that is in the benefit of both the Government and ANRE, not to mention the energy

sector and the interests of the general public: **the Government must give ANRE back its independence, while in exchange ANRE commits increased and proven accountability, transparency, regulatory predictability, and quality of regulation.**

ANRE must not be subject to political pressures; but remain accountable in a transparent way for the resources it uses and the powers it has

1. The Government’s part:

The regulator’s independence from the Executive is a must because the government, more specifically the Ministry of Economy,

owns a large part of the regulated industry (electricity and gas producers, distributors, transmission grids). Excessive government control also leads to populist pressures in electoral years, as we witnessed in the year 2008 of Parliamentary elections, when prices for gas to households dropped substantially (by 22%). This happened despite the fact that Romania still keeps low regulated prices for domestic gas production and should have reached import price parity in 2008 (see Graph).

To achieve independence, the regulator’s leadership must be appointed 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. But ANRE has recently been subordinated to the General Secretariat of the Government, and its funding now flows through the state budget. What is worse, even before the new legislation, ANRE had no less than five (5) presidents between 2005 and 2010, despite strict conditions under which presidents and the regulatory committee could be replaced before the expiry of their fixed-term (5 year) mandate. The replacement was not linked to a measure of non-performance, such as the rejection of the Annual activity Report. It is unclear why it must be so: we have other good governance examples in the Romanian

Government did...	ANRE did...
replace presidents and leadership mid-term make statements about "keeping low the prices during the crisis", both for residential and industrial only formally endorse budgets (bureaucracy without control) not make mandatory verification of budget executions not make ANRE accountable for performance (eg market opening)	not react adequately to media accusations allow members of regulatory committee to own shares in regulated industry (gas, transmission grids) increase budgets and staff without keeping up in terms of quality with other EU regulators not publish financial statements or means to reduce expenditure not increase tariffs for regulated consumers to make switching worthwhile

regulatory framework (e.g., CNVM; which reports directly to Parliament and its top management is changed only if annual reports are rejected).

The Government must:

- **repeal immediately** HG1428, exclude ANRE from L329, and return license fees to ANRE as own revenues for budgetary autonomy
- commit to **not changing presidents mid-term except in case the Annual Reports are rejected** by the entire Cabinet of Ministers
- amend Energy laws to make appointments of ANRE's management, regulatory committee and consultative council **on competence criteria**, and nominations to be endorsed by full Cabinet (not by a single person, such as PM or deputy PM); enforce the new rules
- **refrain from informal pressures on the regulator**, such as statements on "keeping low the energy prices to end-users"
- the Cabinet must use its **statutory powers** to enforce good governance practices in ANRE: monitor execution of budgets, reject Annual reports unless they contain:
 - o external audits of financial statements and internal processes
 - o means to address governance issues signaled by the media (accusations of nepotism,

shareholding in regulated industry, nepotism or employing relatives of management of regulated industry); and, of course

- o evidence of good quality regulation / performance

By the approval or rejection of the Annual report, the Government would have full control on the critical governance aspects that caused the initial problems. Indeed, the Government would actually have much better control than it ever had. On the contrary, in the current arrangement (direct subordination to GSG), there is no guarantee that ANRE's financial resources would be better used or that other governance issues are immediately resolved.

2. ANRE's part

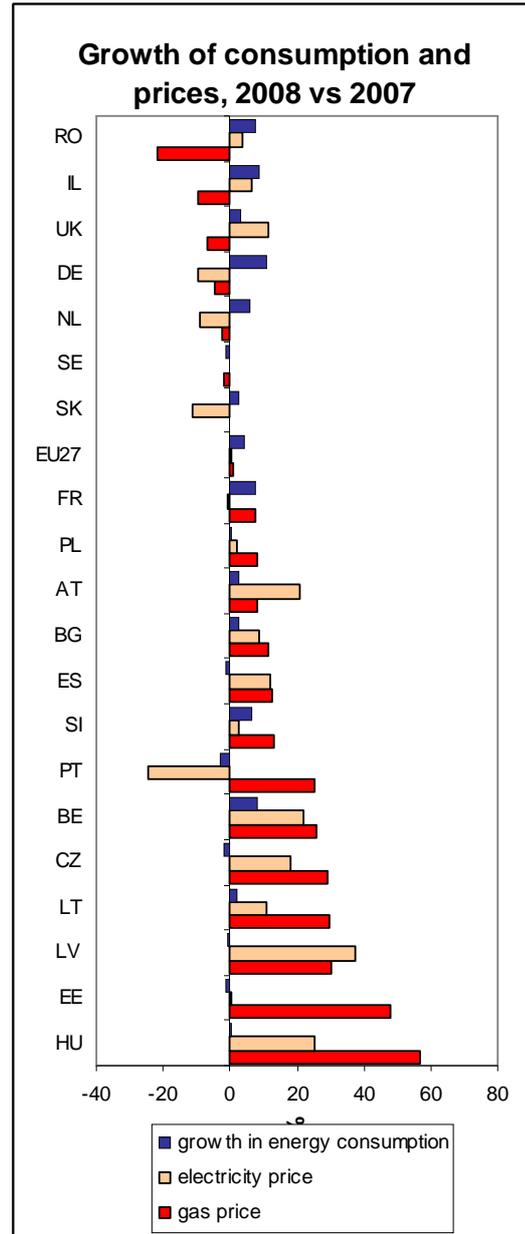
Regardless of whether media allegations are factual or not, the agency must mitigate the risks any regulator is naturally exposed to (influence from regulated industry, mismanagement of assets and powers, or simply lack of motivation or capacity to adapt to changes etc.). Unless it does so, ANRE loses its credibility, which "justifies" brutal interventions from the Executive to correct deviations.

Several actions must be **immediately undertaken by ANRE**, and their enforcement must be checked by Government in the authority's Annual Reports:

- introduce and enforce an **Ethics code** to supplement legislation on integrity applicable to public institutions. Its focus should be

on the items that are frequently in the media (nepotism etc.) and providing timely, adequate response. The code must **define unacceptable practices**: e.g. explicitly forbid shareholding in regulated industry, employing relatives of management of regulated companies; define limitations of activities that can be performed at the same time (consultancy) etc.

- **ensure external financial and process audits, with published results.** ANRE must also publish ways to reduce costs and risk mitigation measures for the critical business areas (e.g., the processes and controls involved in the issuing of licenses, invoicing, cash management etc.)
- **report on actual regulatory performance and quality,** instead of duplicating the information on Orders issued and market monitoring reports. ANRE must revert immediately to the performance monitoring done in 2004 Reports and in the medium term improve both regulatory quality and reporting on achievements, following European best practices (e.g. Ofgem):
 - o the activity focus must shift **from tariff setting to enhancement of competition and effective consumer protection**, plus renewables / green energy
 - o tariff structures must be **reviewed not to distort markets** and allow effective competition in both wholesale and retail markets. E.g., the regulator must ensure no cross-subsidization between “captive” and “eligible” consumers in gas and electricity, which prevents users from switching suppliers

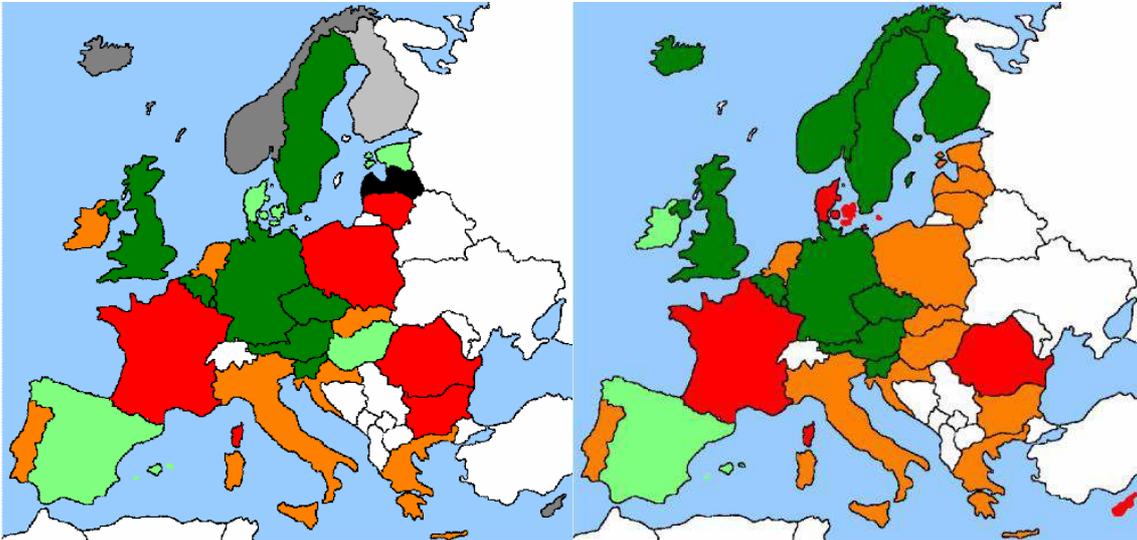


Political influence on prices for households. In 2008, an electoral year, despite the growth of household energy consumption, prices dropped substantially from an already low level in the EU; this happens while at the same time domestic gas prices are kept well below import parity. Source: Eurostat, 2010.

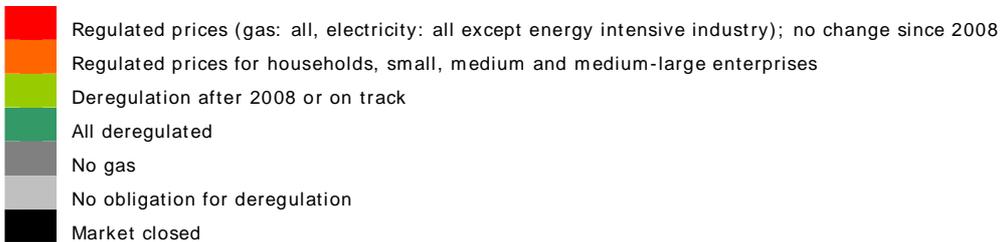
- o provide evidence of **adequate responses to consumer enquiries and complaints**
- o provide evidence that **rules are enforced**, to avoid situations like the ENEL scandal (e.g. by timely monitoring of the privatization contracts instead of delayed sanctioning of a possible breach 3 years earlier)

- **maintain predictability of regulatory regime**, e.g., by refraining from the temptation to easily

sanction deviations by changes in approved tariffs in the middle of the regulatory period.



Energy markets – gas and electricity, on track for reform, in the ERGEG family. Romania lags behind most EU members, by keeping regulated prices and not pursuing any reform since 2008. The situation is particularly worrying in electricity, where other countries liberalize markets much faster than in gas. Data from ERGEG, 2010.



Scorecard – Benchmarking ANRE to itself

	2004	2010	2011*	2013*	Immediate measures (by 2011, 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)	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	Govt: social protection, if any, completely outside prices
Relations with regulated sector					ANRE: no inappropriate relations to cos (shares, nepotism)	ANRE: no inappropriate relations to cos (shares, nepotism)
Accountability					ANRE: report on activity at 2004 level and full audited report on finances	ANRE: performance and financial reporting
Reporting and confirmation of leadership					Govt: change management only by Cabinet decision, on performance	Govt: change management only by Cabinet decision, on performance
Accountability to consumers, industry, public					ANRE: respond adequately to complaints, accusations in media	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					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		TBD			ANRE: respond in full to all FOIA requests	ANRE: respond in full to all FOIA requests
Predictability					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, impact on regulatory framework of changes of sector structure)	ANRE: identify and launch debates on changes in environment, e.g. private participation in generation
SUBSTANCE						
Tariffs					ANRE: eliminate distortions on tariffs	ANRE: revise tariff policy to enhance competition, eliminate regulated prices for producers & consumers
Economically sound					ANRE: review tariffs for regulated consumers; abandon social tariff	ANRE: review tariffs for networks (transmission - tranzit, zonal tariff)
Periodic reassessments					ANRE: change of tariffs only on fundamental changes in environment, not as crisis response (ENEL)	ANRE: announce in time reassessment of tariffs and debate
Monitoring markets and licensing					ANRE: clarify and enforce regulations	ANRE: refocus its activity on markets, not tariffs
Enforceability of decisions					ANRE: better sanctions, do not replace with change in approved tariffs	ANRE: Enforcement code with full procedures
Transparent criteria for licensing/withdrawal					ANRE: start work to streamline Enforcement guidelines	ANRE: Enforcement guidelines
Consumer protection, management of complaints against industry					ANRE: respond to complaints with clear justifications, enforce sanctions on suppliers in breach	ANRE: Definition of vulnerable consumers; consumer rights

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

Explanations for changes in scores between 2004 and 2009 (full explanations in Detailed Assessment):

- 1. Independence:** ANRE lost budgetary autonomy and was subordinated to GSG; presidents were changed mid-term despite the provisions of the laws. There were increased political pressures on prices before elections and on silent approval of the two integrated companies (without a published impact assessment of the new challenges to regulate a market with two dominant companies).
- 2. Accountability:** The quality of reporting has decreased, currently the annual reports do not provide enough details on the performance of the regulator. Strong negative image in the media in recent years. Conduct Code prepared in 2004-2005 abandoned.
- 3. Transparency:** Poorer annual reports on website, less information on regulatory performance, less connection between regulatory activities and broad objectives.
- 4. Predictability:** Consistency of regulation was enforced by external conditionality and PRG project of the World Bank (expired in 2009); discussions in 2010 to amend tariffs on distribution in the middle of the regulatory period as response to ENEL debate.
- 5. Tariffs:** Methodologies were set in place in 2004, before the end of the negotiations on Chapter 14 Energy with the EU for Romania's accession. Agreements reached then (to phase out social tariffs by 2007, to reach import parity for domestic gas prices) were not complied with. Tariffs allow cross-subsidization despite the explicit interdiction in the energy laws in 2007.
- 6. Monitoring markets and licensing:** evidence Romania is not in compliance with consumer protection guidelines, breach of ANRE's own orders. ANRE has not been able to enforce the regulations agreed upon in the privatization contract with ENEL

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Established as a think tank in 1996, the Romanian Academic Society (SAR) aims to further the ideas of freedom, democracy and good governance in Eastern Europe. Starting with our own country we seek to raise the public awareness level of policy issues, contribute through research and advocacy to informed policy formulation and assist administrative reform through performance assessment. We believe that countries can do more or less out of their European accession process and our goal is to help improve their performance in this process so that integration brings a maximum of benefits. Finally, we are confident that both Europes – the old and the new one – will meet each other in an enlarged European Union where civil society will be a crucial actor.



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