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How can one make institutions work in transition countries, after external pressure is gone? Watching them frequently and putting them under the spotlight helps, we think.

Watch the watchdogs: Romania's experience



- **We monitored for three years the Romanian energy regulator and published the results**
- **The public now knows what the energy does and is supposed to do**
- **Our recommendations included in the law**

In transitional countries aspiring to EU integration, the construction and survival of institutions is no easy task. When Western institutions are copied these are not fully internalized, but perceived as foreign objects to be dismantled when Brussels and Washington does not pay attention. What's more: Western models might need some adaptation in our countries, where corruption is much higher, so on top of the Western model we need to build much stronger controls, tougher rules, different safeguards.

Our Romanian experience on energy regulation suggests from where one could start. In our energy watchdog project, we found that what we copied from the West works very well, but only as long as the West is watching. Local specificities, such as the ingenious ways to steal from state-owned companies and create preferential rules for well-connected political clientele,

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indeed require additional regulatory safeguards on top of what works well elsewhere. And when there's no pressure from outside, one needs to coagulate the domestic stakeholders to move things forward – not easy, when local players can also be corrupt or fully satisfied with the status quo. There are indeed many entry points for change in unpredictable environments, but one needs to adapt rapidly.

For all these reasons, NGOs and journalists play a critical role in making things work and articulating all these forces and opportunities for reform. Hence, the need for a brief practical guide on how to monitor energy sector reforms, push for better regulation, and with some initial ideas to mobilize stakeholders so that the progress grows roots.

1. What we did in Romania

We picked the energy (gas and electricity) sector, mainly as a pilot, with the intention of later scaling up to other sectors. Energy also has the advantage that all EU members and neighbors in the Energy Community have to follow the same rules, including to create similar regulators; separate competitive from natural monopoly activities; and eliminate barriers to competition.

The project concept (an external evaluation of the energy regulator) was among the winners in an international anticorruption competition, Global Integrity Impact Challenge, in 2009. It was then refined and proposed for financing by the organizers of the competition to the Partnership for Transparency Fund, which agreed to finance and also continue with a follow-on project (under the newly established Expert Forum), once the first two evaluations had been completed.

The project focused first on the regulator itself, which was easier to monitor and compare to other energy regulators, given the relatively numerous attempts to compare all EU regulators. We evaluated the energy regulator ANRE in October 2010, April 2011 and October 2012. These dates were selected because of particular events of importance to the energy sector regulator (approval of law, appointment of members of regulatory committee etc.).

Then we looked at the broader sector, assessing particular problems that pose specific challenges for the ex ante regulation

of competition and indicate some areas in which the regulator should be stronger, such as competition among dominant state-owned enterprises which sometimes do not maximize profits but rents to managers.

Specifically, we looked at the legislation affecting the energy sector (e.g., the laws transposing the 3rd Energy Package, but also legislation concerning SOEs and other legal and regulatory initiatives that interfered with the functioning of the energy market, such as competition legislation); examined the behavior of state owned companies, distortions induced by them in the market by concluding contracts with favoured and measured the money lost from some companies as corruption; prepared an analysis of the energy market and competition issues in cooperation with the Competition Council; analyzed the "draft energy strategy by 2035".

We used external peer reviewers for enhanced quality and credibility. Peer reviewers were experts with top credibility in Romania and foreign specialists from a broad range of specializations: engineers, economists, competition specialists, lawyers. This contributed to a clearer picture of the energy sector and its dysfunctions, and the extent to which these are caused by regulation or other factors; plus we gained reputation among stakeholders, including among foreign international financing institutions and the EC. As a result, our recommendations have been considered when the Parliament and Government drafted the new legislation concerning the energy regulator (implementation is the issue).

The context

In Romania, the electricity sector is made up of 6-7 companies that are state-owned, practically a monopoly of 85% of the market; several small renewable players, who have recently entered the market and which have a 5-7% market share; and the remaining 8-10%, a private gas-fired plant with a special regime because of distortions in the gas market. In gas, there are two producers, one state-owned and one private, which sell regulated quantities at regulated domestic prices. On both electricity and gas there are very many suppliers who buy energy from producers and sell to the end-consumer. The two sectors are about 50% liberalized – meaning, half of the market is made up of fully regulated consumers, whereas the other half can pick freely their

suppliers. Gas and electricity is transported from producer to consumer through transmission and distribution grids, which are fully regulated as natural monopolies.

So the energy regulator in Romania faces two challenges: to liberalize electricity and gas markets; and to ensure that the few dominant market players actually compete with each other as if this were a competitive market indeed. Both mean that the regulator must be independent from the industry, including from the Government, which owns regulated companies and where politicians want to ensure reelection by keeping energy prices down, below economic levels.

The regulator

In 1998, Romania set up an energy regulator, ANRE, decent even by Western standards. ANRE developed in a rather innovative way in the first years, when there was precious little experience with energy (de)regulation and liberalization for competition elsewhere at the time, given that many EU countries had big state monopolies. ANRE's functioning in practice was imperfect because the state-dominated energy sector was plagued by corruption and heavily distorted by all sorts of subsidies.

However, the regulator "on paper" made sense and even influenced France and Germany when they designed their own regulators. After 2005, because salaries were good, the regulator became a destination for sinecures. In 2009, after numerous scandals, the Government reduced drastically the regulator's independence by taking away its own revenues, limiting the payscale, and most of the remaining qualified staff left. We monitored ANRE since 2010 advocating for greater independence but only if it is matched by increased accountability and professionalism.

The methodology

We looked at both regulatory governance (the rules under which the regulator functions) and regulatory substance (the quality of regulations). Some specific areas of interest (e.g. financial independence of regulator or the manner in which distribution tariffs are computed) were determined also based on discussions with the panel of peer reviewers. The main focus was thus on regulatory governance (80%) with a test of several key aspects of

regulatory substance (20%), meaning assessment of the actual decisions (e.g., such as the effects of proposed market and monitoring rules, tariff structures or licensing methods, where an ex-post evaluation is possible; and test on whether the regulator's policy makes economic sense).

Where possible, we compared ANRE with regulators from other countries, using also the information from existing benchmarking exercises (EU, ERGEG, IERN etc.). There are strong limitations in such benchmarks, mainly because these are self-assessments of regulatory bodies with possibly biased results; plus they are based on what is written in the law, whereas the practice might be very different. Also, energy sector structure and role of regulator vary among countries. Therefore, we compared ANRE with itself across time. This has the advantage that it focuses on items that are relevant to ANRE and seeks incentives for change within the regulator itself.

However, we still selected 1-2 good practice regulators with which ANRE could be compared on transparency (e.g., completeness of website information) or substance (quality of regulation). We used mostly the case of Ofgem (the UK regulator), a best practice model in terms of adaptability to challenges, quality of services provided to its stakeholders, public perception, and transparency.

Data collection methods:

We did desktop research of legislation, media articles, reports and benchmarking exercises done by regulatory agencies in Europe, data from statistical sources (national, Eurostat, World Bank database).

We also had interviews with key national and international specialists in energy. The questionnaire and indicators used are based on a questionnaire developed with inputs from the Board and are adapted from World Bank and Inogate (EU). We also did tests on transparency – requests for information sent on FOIA (L544), made by us as organization, by other individuals and by journalists, to test how ANRE responds to all such requests.

Definition and testing of indicators

We used mostly qualitative indicators, which were adapted from World Bank and Inogate handbooks. They are used to fill in the Scorecard table assess the relative

performance of ANRE now, with its own performance in 2004 and a performance target. The “green” indicator is the “ideal” for ANRE, considering the existing energy sector environment in Romania.

Regulatory governance:

All reports have a governance and a substance section. The governance assesses governance rules and procedures on which ANRE operates. This concerns the legal framework (ANRE’s statutory documents, secondary legislation, laws regarding the energy sector etc.), but also the application of these rules in practice.

1. Independence

The target (benchmark) level is:

- the regulator has a distinct legal mandate fully applicable in practice, there are good prerequisites to keep the regulator free from political (ministerial) pressures and pressures from the regulated sector; it makes final decisions within its authority domain
- the regulator must not be subordinated (formally or informally) to one single person in the Executive or to the ministry owning energy companies, and the subordination and accountability of regulator must be clearly defined
- Regulator must have the possibility to fully control market rules and price setting for regulated market components without pressures from ministerial level (including informal pressures, such as “guidelines” for pricing); also, licensing and monitoring of market must be free from outside pressures
- must have budgetary authority (from own revenue sources)
- there must be an appeals process to create pressures on the regulator to make decisions that would not be reversed, e.g. to make sure the regulator is not influenced by one company from the regulated industry
- Executive leadership must be fixed-term, technical staff to be selected on competitive terms, appointments and removals of staff to be based on objective criteria – competence, interest etc.
- Regulatory Board and Consultative Council must be appointed by clear rules

that ensure independence of individuals from regulated sector and political pressures

- The regulator must have highly trained staff in appropriate numbers to perform its functions and avoid contestations
- The organization structure and resources are adequate to perform its functions without pressures from government (but also without excessive expenditure).

2. Accountability

The benchmark level:

- the regulator must prepare annual reports of activity (in addition to energy market monitoring), to be discussed and approved in Parliament, and available to the stakeholders in due time. Second best practice: the report can be approved by the Cabinet of Ministers, but NOT by one person in the executive, such as the PM
- there must be clear, legal rules according to which regulator must respond to requests and inquiries from stakeholders, and these rules must be enforced in practice
- if judicial courts overrule decisions systematically, the regulator must take action to correct decisions, regulations etc.
- responsibilities must be clearly defined among various regulatory bodies (ANRE, Competition Council, Consumer Protection, etc.) and clear, structured and formalized relationships must be established among these bodies on issues needing coordinated approach (e.g. tariffs and competition on electricity market etc); there are no areas that remain not regulated when they should be (regulatory gap). The regulator is preventing the market dominance (e.g., is properly informed and consulted when Government attempts restructuring of state-owned energy companies that might have an effect on regulatory effectiveness)
- regulator must give proper accounts of money spent, and financial accounts externally audited
- regulator must be accountable for performance (preferably audited externally), according to clear performance indicators, based on which

the management can be reappointed and / or removed, and these rules apply without exception

- the regulator must have an ethics code, which must be applied in practice (e.g., avoidance of conflicts of interest, transparency of assets and wealth for dignitaries beyond the normal requirements for any public institution, rules of conduct in sensitive situations etc)
- the regulator and staff must not exercise their powers with discretion, but only within approved rules and good practices (a quality assurance system to be in place)
- the processes by which the regulator makes decisions must be clear and consistent in time, both those formally in law and informal processes, to avoid decisions that discriminate in favor of one market player (this item is also under regulatory predictability)
- the regulator must be able in practice to enforce its rules and decisions and effectively supervises investment programs, service quality standards etc (e.g., the penalties on companies must be proportional to faults, there must be adequate remedies, and good responses to requests for clarifications from regulated sector. These items also contribute to ensure decisions are not arbitrary)

3. Transparency

Benchmark level:

- all decisions publicly disclosed, including with justification, to be accessible to the public and stakeholders; in case of “emergency” decisions or frequent amendments to previous regulations, the “emergency”/ amendment must be clearly justified and reviewed ex post. This includes also the information on the items discussed in Consultative Council and Regulatory Committee
- rules are applicable to all in the same category (no discrimination), rules are published ahead of time
- stakeholders are properly consulted on decisions, not only informed ex-post, and there are no exceptions to consultation / transparency rules

- regulator publishes reports on activity and performance, and on the energy market, on the website, to be publicly available to stakeholders (to be benchmarked with another EU regulator)
- Regulator answers promptly and adequately on requests for information based on FOIA (L544), on even sensitive issues (tariff structure; eligibility of consumers, access to networks, regulated market tariffs and “pool” structure; financial statements, auditing etc.)

4. Predictability

Benchmark level:

- regulatory decisions must be consistent in time, and there are periodic revisions of tariffs and responses to changes in environment
- regulatory decisions are properly explained and justified (e.g. in good “substantiation notes”, which have to be of proper quality and publicly disclosed)
- Regulator learns from past experience (e.g. if decisions are systematically challenged, regulator must review them; the regulator monitors the impact of regulation in time, adapts in a flexible manner to changes in environment, ensures that regulations are not overburdening). However, amendments to previous legislation must not be extremely frequent and must be justified by a feedback from the environment.

Regulatory substance:

The regulatory governance section examines the performance of ANRE in a selected number of decisions and orders. Since we did not want to make the regulator’s evaluation report about the sector in general, we chose certain aspects of policy as examples of good or poor regulation; and focused in each of the 3 evaluation reports on a different aspect (first – electricity and gas regulated prices; second – non-implementation of a regulation on full cost pass-through for regulated supply in the case of gas; and third – distribution tariffs, as ANRE is supposed to draft the methodology adjustments for the third regulatory period, 2013-2017).

1. Tariff design

Benchmark (target) level:

- The tariff setting mechanisms must not endanger financial viability of regulated companies (e.g. tariffs are cost recovery)
- Tariffs must direct company operations towards increasing economic efficiency and quality standards levels (tariff levels, tariff structures, automatic and non-automatic cost pass-through mechanisms; tariffs avoid cross-subsidization. Economic prices must be separated from social policies.) Prices and tariffs must be non-discriminatory (no favoritism) and with no cross-subsidies.
- Prices structures to remain stable and predictable, published in due time, consulted with regulated industry and policy makers
- Limit regulatory intervention to minimum, not to overburden the industry (“proportionality” principle: costs of intervention do not exceed benefits, regulations are proposed where there are market failures, for consumer protection, energy security etc.)
- Tariffs must be consistent with clear strategic goals, defined in advance (such as energy efficiency; social tariffs should gradually be replaced by social assistance systems for access to energy)
- Regulator must perform periodic reassessments of costs / regulatory review to check whether the base for approved tariffs remains the same
- Regulator benchmarks itself to “best practices” in similar countries to check consistency and appropriateness of regulation
- Regulator enforces always its rules, decisions, orders on the market players (eg penalties, revocation of licenses etc)
- Regulator criteria for licensing and authorizations is transparent, non-discriminatory, allows quality of supply, does not overburden companies
- Third party access to networks, including cross – border interconnectors, is non-discriminatory, in law and practice
- Revocation of licenses and authorizations is based on clear, objective criteria (e.g. poor quality, interruptions, financial bankruptcy), without undue interferences from political level / pressures from regulated sector
- Regulator has clear formalized rules to handle consumer complaints and observe them adequately (e.g. how many complaints and are they resolved quickly in comparison with other countries)
- Regulator monitors and enforces the implementation of criteria in privatization contracts, monitoring in due time investment and maintenance programs, and quality standards
- Regulator monitors quality of service standards (are they comparable with EU standards – e.g. interruptions?)
- Regulator issues / monitors clear rules for investment programs and connection obligations of the network companies (regulated third party access to grids)
- Horizontal coordination – regulator coordinates in a formalized, structured manner with other regulators on consumer protection, market competition on electricity / gas markets, environment policy
- Regulations respect property rights, do not restrict investments / access on the market to a company, do not unduly affect one company

2. Monitoring & licensing

Benchmarking (target) level:

- Regulator receives systematic data from the energy market and information on request from regulated companies, and demands most information in standardized formats

The same methodology was used on all three reports (the second and the third being mostly updaters). The reports were presented in conferences with stakeholders and press, and widely publicized in the media. We also published a series of other energy-related policy briefs, keeping the public opinion interested on energy.

2. Sustainability

Though some improvements were noticed, the question is how to ensure sustainability of the exercise after the current donor (PTF) ends its support. We approached energy companies and associations and minority shareholders in state-owned companies to jointly do projects and public advocacy on issues of general interest, such as good governance in the energy sector, level play and proper representation of all interests. This was extremely difficult, as companies did not want to get involved very visibly, and some companies also might have their own vested interests in keeping the status quo. We managed however to:

- ensure (co)financing from other donors (UK embassy) specifically for energy-related reports or events
- got support from energy companies to organize some public events (companies paid the event, we moderated the debates and ensured that the debate is not biased pro the opinion of the company)
- ensured support from consultancy (economic, legal) companies for expert peer reviewing of other energy reports that we prepare

The project also supported us in developing our own expertise in energy sector governance and develop connections with all stakeholders, including donors and EC, and we are asked to present in major energy conferences our position on various energy policy issues.

This also helped in keeping the topic on the public agenda and some of the recommendations in our second report were included in the new law on ANRE (e.g., subordination of ANRE to Parliament, manner of appointment of regulatory committee, reporting to Parliament etc.;

however, the implementation has not been appropriate, which makes it indeed only a partial success).

3. How can EFOR help abroad

Many issues we encountered are similar across all countries in the region (weak regulator, very corrupt state-owned companies, abuse of dominant position by the state; anti-competitive behavior on certain market segments; non-implementation of some regulations because of political pressures). If other NGOs in the region are interested in starting similar watchdog projects (regulator then scaled up to sector monitoring), we can become partners.

Our panel of experts (peer reviewers) have extensive experience in countries in the region, some of them even having worked at the setup of these regulators. In addition, all energy regulators should develop in a quite similar manner, as they are required to follow a certain blueprint in EU's 3rd Energy Package, to which all EU members and members of the Energy Community must abide.



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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								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.