



The Single Energy Market: Europe Takes the Third Step Forward, We Take Another Step Back



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March 3, 2010 marked the expiration of the one and a half year period of time given to EU member states to transpose into their national legislation the directives of the EU Third Energy Package for the single market in natural gas and electricity. The goal of the Package is to speed up the construction of a competitive energy market, first at a regional level, then at the level of the entire Union, even as many member states have difficulties with or even openly oppose the liberalization of their national energy markets. Ever true to form, Romania, rather than moving forward, is rushing backward, while its laws today are somewhat worse than they were yesterday.

I. Europe: Liberalizing energy markets and the Third Energy Package

Europe has been trying to build a single, competitive energy market for over a decade, including in the two sectors that were until recently dominated by national players with monopoly power: electricity and natural gas. The end goal, in the medium and long term, is to build a single energy market that gives consumers choice, including purchasing from transnational suppliers, and in which prices converge toward the same level. This is very important for competition in all energy-intensive industrial sectors and for success in building a real EU single market: if producers of all manner of goods have access to cheaper energy in a certain country for reasons not pertaining to economic efficiency, they will have an unfair competitive advantage with respect to competitors in other countries.

Transforming these energy markets initially dominated by national monopolies into competitive markets means, briefly:

- a) separating activities that lend themselves to natural monopolies (transport and distribution networks) and gas warehousing capacity from those that could become competitive (production, supply);
- b) reducing concentration in the latter and creating conditions for competition;
- c) interconnecting national markets to regional markets and then, in the longer term, to a common market at the level of the entire Union;
- d) building regulatory authorities (national and European) in charge of promoting competition and price regulation for natural monopolies.

The process of liberalizing energy markets in the European Union was achieved in several steps, on the basis of existing constraints and impediments from some of the member states wishing to maintain the *status quo* (e.g. France, where the natural gas and electricity markets are still dominated by state giants EDF and GDF). Liberalization began with the approval of certain Directives at the end of the 1990s for the internal electricity and gas market, followed by a new wave in 2003. Everyone has gained from these first steps toward liberalization: household consumers (since 2007) as well as industrial consumers (since 2004) now benefit from an

increasing freedom of choice between energy suppliers and competition between producers and suppliers in the energy markets, as competition pushes prices down to a relatively low level and ensures that better services are offered and investments concentrated where demand is greatest, ultimately leading to greater supply security¹. To all these may be added greater contracting transparency and, implicitly, greater protection in the face of potential abuses by suppliers.

Despite these positive results, the liberalization process at the EU level is far from being over. In 2006, an investigation² by the European Commission showed that the liberalization of energy markets, on the basis of Directives 54 and 55 from 2003, face difficulties for two main reasons:

- a) producer controls over transport networks, which block competitors' access to the market;
- b) the lack of independence by some national energy regulators, which leads them often to be politically influenced. When regulators are not politically independent, this leads to certain state energy companies being advantaged or to a delay in the liberalization of markets for final consumers out of a fear that prices will rise by too much, which has electoral costs.

How are other states faring with respect to energy market liberalization?

The situation varies greatly from country to country. Some states (Nordic countries) have truly liberalized markets, while France and the southern states have fallen behind in terms of the rhythm of reforms since implementing the old directives, and this situation is more serious in the case of the gas market than in that of the electricity market (Fig. 1). Hence the proposal of a third package of reforms, approved in 2009, which attempt to stimulate liberalization and accentuate the removal of administrative barriers to liberalization identified in the 2006 investigation.

¹ A summary of the benefits of liberalization and obstacles in the way of more competitive markets observed until now can be found at the following link:

http://ec.europa.eu/energy/gas_electricity/legislation/doc/20110224_non_paper_internal_nergy_market.pdf.

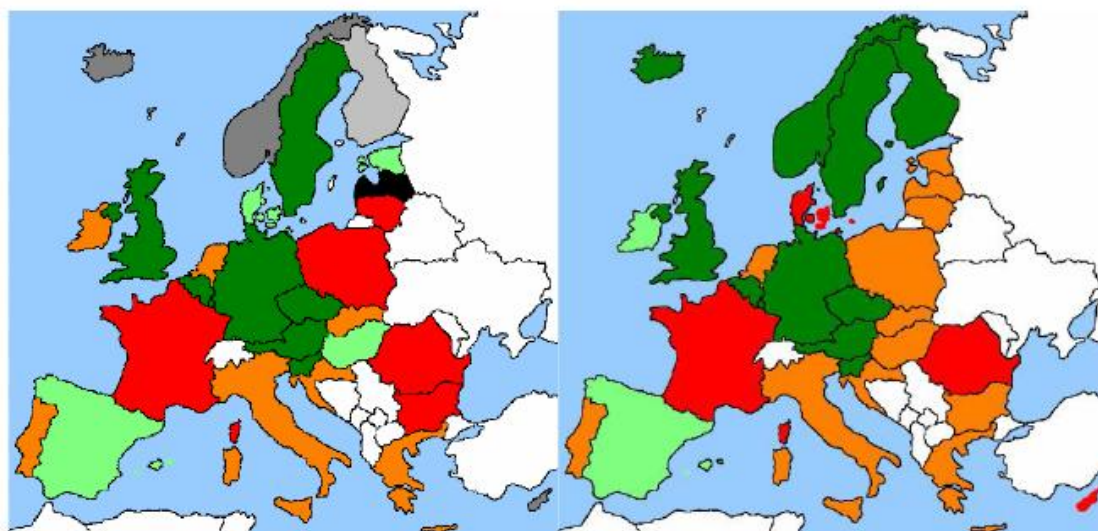
In short, where markets are interconnected, price convergence was observed in the last few years, especially in the North- and Central-West European markets, where prices have begun to follow changes in the real economy (falling during the crisis); energy transactions grew; gas prices fell in 2009 as a result of new LNG terminals, which put competitive pressure on traditional gas suppliers.

² The commission drafts annual reports in which it follows the stage in which the implementation of liberalization directives of the common electricity and gas market finds itself:

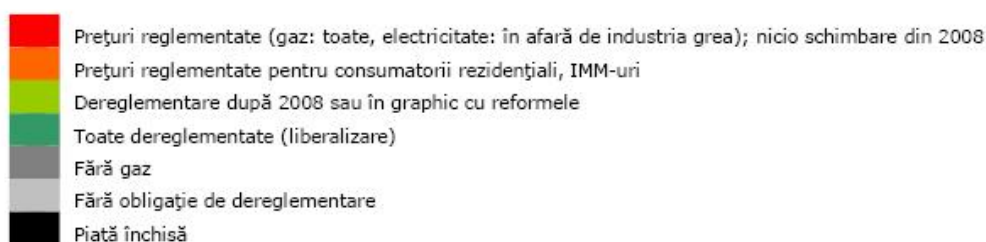
http://ec.europa.eu/energy/gas_electricity/legislation/benchmarking_reports_en.htm.

In 2006, detailed analyses were done of each individual member state; these analyses showed the necessity of having supplementary regulations for the elimination of barriers to the liberalization of the internal energy and gas market.

Fig. 1: The implementation of Directives from the Second Package (2003) in EU member states by 2010



Piețele de energie – gaz și electricitate, pe drumul spre reformă, dintre țările membre ERGEG. România a rămas în urma celor mai mulți membri UE, prin menținerea prețurilor reglementate și abandonarea oricărei reforme din 2008. Situația este îngrijorătoare mai ales în sectorul energiei electrice, unde celelalte țări își liberalizează piețele mult mai repede decât în sectorul gazului. Date ERGEG, 2010.



Translation: Energy market – gas and electricity, on the road to reform, among ERGEG member countries. Romania lags behind most EU members by maintaining price regulations and abandoning efforts at reform after 2008. This situation is especially worrisome in the Romanian electric energy sector, while other countries have liberalized their markets much faster than in the gas sector.

Source: Romanian Academic Society, on the basis of ERGEG 2010 data

Why did the EU come up with a new energy package?

As a result, the Third Energy Package (Directives 72 and 73 of 2009) introduces several new directions with respect to the preceding normative acts for the European energy market:

1. Increasing the independence of transport network operators.

Transport networks must be independent of producer interests in order to assure that all producers have nondiscriminatory access to the market so as long as they meet certain minimum technical standards for connecting to the network. In many member states, especially where the electricity and gas sectors are still vertically integrated, a producer that possesses a transport network can block access by competitors, either by not permitting connection or by imposing prohibitive fees with the pretext of the existence of

congestion. It is preferable (though not obligatorily in the case of the two directives) that the independence of transport networks from production be achieved through an effective separation of network ownership ("*ownership unbundling*").

An acceptable alternative would be to create an independent transport operator, without separate ownership, but with clear mechanisms (managerial and legal independence) for ensuring nondiscriminatory access to the network by other producers. In other words, it is imperative that the same persons do not control both a producer and a transport operator. Transport operators must have managerial autonomy and sufficient resources (financial, human) to ensure their independence. Moreover, the management of transport operators must be named and replaced by a supervisory body, created specially for this purpose, which would also have the role of making important decisions regarding network assets, the approval of investment and financial plans, and the distribution of dividends; and the naming of a compliance officer (also approved by the national regulator) to monitor the implementation of a plan created by the transport operator by which nondiscriminatory access to the network is ensured for any producer that meets technical criteria. The supervisory body for electricity and gas transporters proposed in the two directives is to be made up of members named by stockholders and, potentially, by union representatives. Obviously, this alternative is more complicated than separate ownership.

Aside from the question of independence, but partially related to it, transport operators need to ensure physical access by as many producers as possible to the network. The transport operator must make 10-year investment plans which need to take note of estimated consumption and forecast production, as well as community plans for the interconnection of national networks, as a major barrier to the integration of national markets into a single market is the limited capacity for cross-border transactions. The plan is monitored by the regulator, which has the power to use different mechanisms to obligate the transport operator to make investments as part of the program; in addition, transport fees must be approved by the regulator precisely on the basis of this plan.

2. *Nondiscriminatory access by consumers and suppliers to distribution networks.*

In the case of distribution networks, the directives propose measures similar to those regarding transport networks, described above. Despite this, the attention given to distribution networks in the two directives is limited, as the main problem observed in practice by the Commission in the 2006 investigation was access to transport networks, where the most frequent problems related to congestion arise and the influence of producers and suppliers is most felt as a barrier to a competitive market (as the transport network is the infrastructure of the wholesale market).

3. For gas, a problem similar to that regarding the transport network is related to *warehousing capacity*, which in some member states is owned by one of the producers,

without the other gas producers having access due to discrimination. Although warehousing capacity is not a natural monopoly like transport and distribution networks, the problem in most states is the dominant position of a single warehouse operator, usually also the dominant producer. To resolve the dominant position problem, here again separation (preferably also of ownership) is proposed for warehouse deposits by producers.

4. *Increasing the independence of regulatory authorities.*

The package of directives proposes to isolate regulatory authorities from influence by political decisionmakers, and/or by the regulated industry. It is also meant to encourage an increase in the capacity of national regulators to encourage competition in national gas and electricity markets (for example, by promoting market mechanisms – well-constructed taxes – investments in transport networks where existing capacity restrictions or congestion might affect competition between producers; and ensuring prices that stimulate investments and access by as many producers as possible to the market). The independence of the regulator is ensured by the mechanism of naming and replacing the management (fixed term); decisionmaking responsibility; own sources of financing, independent from the state budget, to insulate the regulator from political influence.

5. *Creating a supranational energy regulator (ACER)*, meant to supervise national regulatory authorities and coordinate/harmonize existing regulations at the national level in order to increase cross-border competition. Initially, it is meant to produce integration in regional energy markets in order to increase competition; in time, as the capacity for the interconnection of national networks grows, it is meant to stimulate regional markets to integrate into a single market across the EU.³

Besides these new ideas, the directives accentuate certain aspects that came up in older versions of the directives, yet which were not implemented sufficiently quickly by member states. Foremost among them are the following:

6. *Accelerating the pace of market liberalization, including for household consumers.* The new directives stress the adequate definition of a few terms to separate social protection from market mechanisms in order to avoid distortion in the energy markets. Thus:
 - They stress that the concept of the vulnerable consumer must be defined in national legislation on the basis of the conditions in each member state and which must take into account the level poverty that would not allow access to energy (“*energy poverty*”) and the interdiction on disconnection during critical moments. In terms of the level of poverty which would not permit access to energy, this must be resolved through social measures, within the social policies of each member state and NOT through mechanisms that distort the energy market (for example NOT through regulated prices at below-market levels).

³ Romania wished to host this new agency, but it lost the competition to Slovenia. However, a Romanian holds the position of vice president of CA.

- *Consumer protection* DOES NOT mean smaller (regulated) prices for certain categories of consumers, but rather the right of consumers to be informed about their own level of consumption, sources of energy, prices, alternative offerings by other suppliers, and the possibility of resolving disputes by submitting complaints about abuses by suppliers. Energy prices must stimulate investments (especially for the development of networks, including interconnections between national networks), energy efficiency and the promotion of renewable energy via market mechanisms, all of which in time produce convergence of national prices toward a single EU-wide price.
- The *public service obligation* refers to the fact that states must ensure economic services of general interest, such as consumer protection, supply security, quality, environmental protection, and energy efficiency, all without reducing competition below a level comparable to that in other member states, as much as possible. Economic services of general interest are an obligation of the state before the citizen. Thus, the state may oblige private companies to offer the public certain services if these are considered economic services of general interest, something achieved by regulating private companies or by offering special subsidies. For example, to assure universal services, member states may define an electricity / gas supplier of last resort, which can only disconnect consumers in exceptional circumstances.

II. What member states should and should not do

Member states are obliged to transpose the provisions of the two directives into national legislation and have at their disposal about a year and a half (the deadline passed on March 3, 2011). Of course, the directives simply offer objectives: not all of the states have the capacity to apply immediately all of the articles of the directives, and the Commission can begin the infringement procedure against those states that do not comply within the specified timeframe. This is especially the case with states that continue to have vertically integrated companies, as France does, or with other states that still give special treatment to certain categories of consumers, as in the case of lower prices for household consumers. For this reason, no less than 25 states had the infringement procedure applied to them in 2009, under the old directives 54 and 55 from 2003. In addition, experience shows that even when the infringement procedure is applied, the Commission does not always go all the way, taking to court only some of the states that violate certain provisions of the directives. In other words, the Commission sets priorities when it comes to the imposition of penalties against member states that do not fulfill their obligations.

Even if it does not always go all the way when it comes to imposing penalties, the Commission still wants to see progress made in the direction of a single energy market. Therefore, as many states will not be in conformity with the new directives from the start, the first to be penalized and those with greatest chances of appearing before the European Court of Justice are those in which the Commission observes a lack of intention or political will to apply the Community rules. So much the worse will it be for states that actually go against the reforms, and, unfortunately,

this is the case with Romania. It must be mentioned that Romania and France are the only countries in the entire Union that in the last 3 years have taken no steps toward the liberalization of their electricity and gas markets, while Romania has even taken steps backward.

III. What Romania is doing

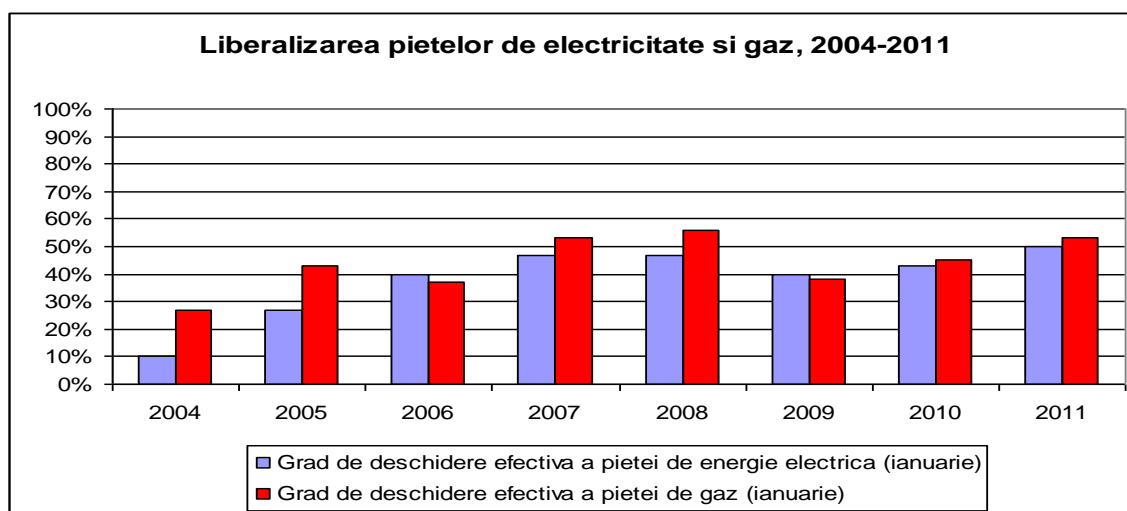
Up until the end of accession negotiations with the European Commission on Chapter XIV Energy, Romania had remarkable performances on the road to liberalizing its energy markets. From the beginning of the 2000s, in the electricity as well as gas markets monopoly activities (transmission, distribution) were separated from production, and then from supply; the market began to open up to competition, and the electricity market even saw a rather well-performing exchange, OPCOM, which after 2005 became one of the very first in Europe in terms of liquidity of transactions (currently ranked 8th). OPCOM could have even become a regional energy market in 2009 through connection to Hungary and, later, to Austria, but this has not happened yet.

For gas, things have developed more slowly, although even in this case the market reached a 50% level of effective openness as of 2007. Real competition in the electricity market could have appeared, yet only in the case of electricity production privatization, which would have made private producers compete against each other, as was the direction of the reforms begun in the first half of the 2000s. Similarly, real competition on the gas market would have appeared if the internal price of gas had not continued to be artificially regulated at a level far below that of the market (on average, the price of imported gas is 40-50% higher than that of domestic gas). In addition, the ANRE regulatory agency, set up at the end of the 1990s and revitalized in 2004, was for a long time a model for the construction of similar regulators in France and Germany. Yet what started well ended badly: once the external pressure for reform disappeared, these were blocked, and we began to regress.

Instead of continuing privatization to encourage competition and investment, the discussions currently being carried out relate to the creation of integrated electricity champions; continuing liberalization is excluded from the outset, with social protection the pretext, even though the main beneficiaries are certain companies rather than household consumers. Certain firms, such as producers of chemical fertilizers (especially Interagro and Azomureş) sometimes benefit from cheap domestic gas through special laws (OUG 54/2009 și L332/2009). Similarly, even in the deregulated electricity market, which could be competitive, a part of the contracts are given out at below market prices, as in the case of the famous Hidroelectrica “insiders” contract. Regulator ANRE has deteriorated constantly since 2005, becoming more and more politicized and involved in nepotism scandals; and the uninspired attempt by the Government to smooth over the scandals by bringing ANRE under the control of the prime minister, including by placing ANRE financing in the state budget, had no other effect than to produce a reduction in the salaries of

competent employees, the mass departure of specialists, and the complete loss of the regulator's independence to continue liberalization as politicians' exerted populist pressure to keep prices low in electoral years. In other words, Romania has regressed, and not as much out of concern for the protection of the consumer as due to poor governance.

Fig. 2. The liberalization of gas and electricity markets did not surpass 40-50% of the market after 2007



Translation: Liberalization of electricity and gas markets, 2004-2011

-Level of effective openness of the electricity market (January)

-Level of effective openness of the gas market (January)

Source: ANRE, 2010. Even according to official figures, the liberalization of electricity and gas has been blocked. In reality, the competitive market is much smaller. In the gas market, anyone can opt for a "basket", which makes the level of openness of the market in reality zero. On the energy market, circa 80% of long term contracts are negotiated bilaterally outside of the exchange, at below market prices ("insider" contracts representing 15 TWh out of 45 TWh in total consumption, meaning almost a third); in other words, the truly competitive segment of the electricity market represents just 20-25% of the total market.

Who wins and who loses from the delay in gas price liberalization

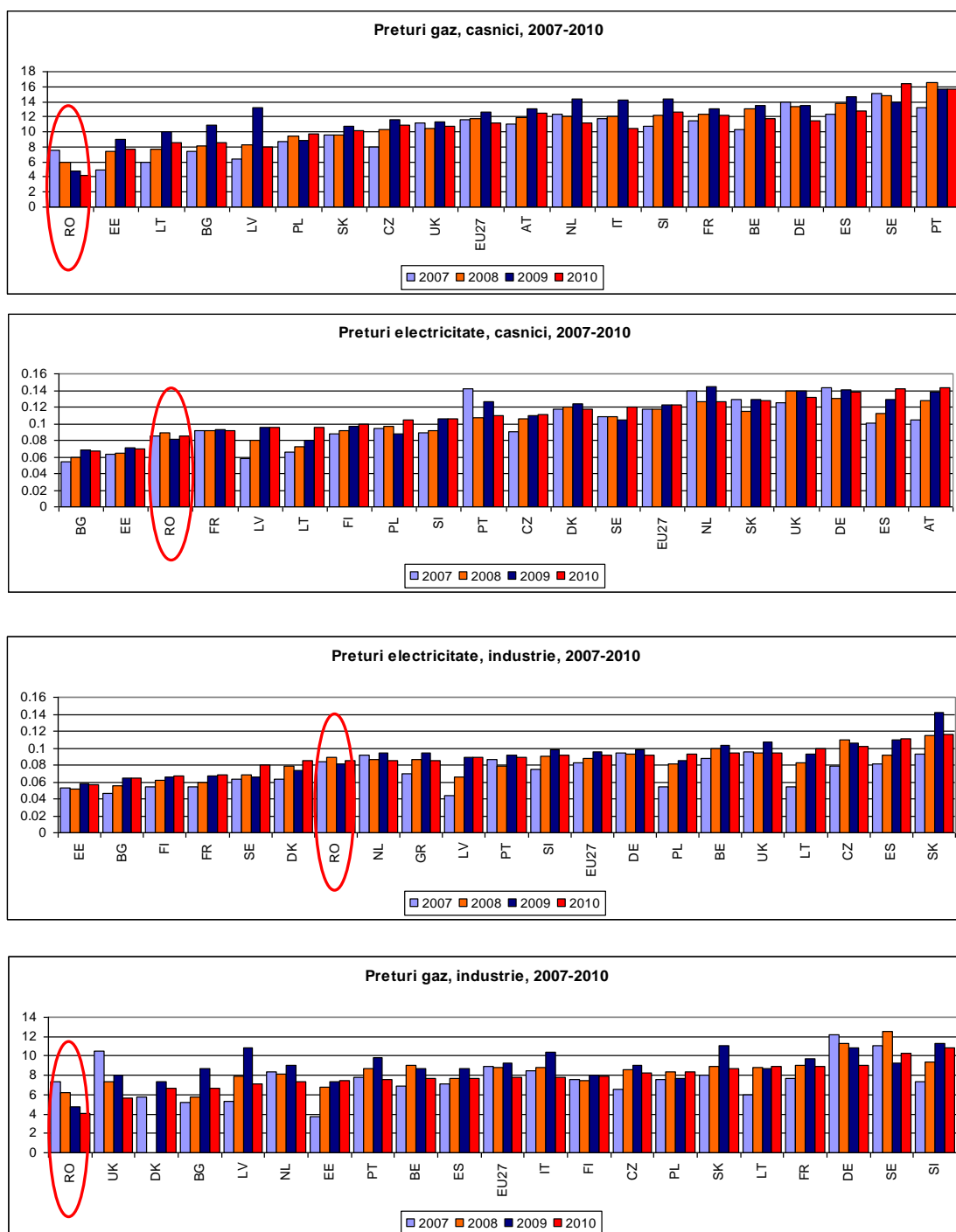
The biggest winners from the delay in gas market liberalization are companies that receive “cheap domestic gas”. Until the liberalization of gas prices (i.e., bringing domestic gas prices to parity with imported gas prices, which should have been completed by 2008), practically all consumers are able to receive gas at the “basket price”. The “basket” is an average of domestic and imported gas prices, weighted by the relative quantities of domestically produced and imported gas. To keep prices low, the state manipulates Romgaz prices and forces Petrom to sell at the same price; as imported gas prices cannot be controlled, basket prices are kept low by lowering the price of domestic gas and/or increasing the quantity extracted in Romania.

In addition, with the crisis as a pretext, from July 2009 to October 2010 interruptible consumers with consumption above 1 million cubic meters/day had the option of acquiring gas exclusively from domestic sources. The criteria were met by a few fertilizer producers, among which were Interagro and Azomureş, as well as other industrial consumers, such as electricity producers. Fertilizer producers alone consume as much as the average amount of gas imported in a year (c. 20% of Romanian gas consumption). By way of comparison, 20% is how much all household consumers in Romania consume.

Who pays for this price subsidy for end consumers? In the first place Romgaz, which supplies domestic gas at reduced prices instead of selling it at the market price (the import price); in addition, Romgaz doesn't even get paid. A loser to a smaller degree is Petrom, which has discovered different methods for avoiding the basket for a part of the gas it extracts. Overall, it is estimated that total losses from the sale of domestic gas at below market prices are circa 2 billion USD annually. A special case is that of EON and GDF, formerly Distrigaz, which in 2010-2011 faced regulated consumer prices, which ANRE set without fully recognizing their cost of acquisition for the gas.

Thus, EON and GDF sell gas at a regulated price composed of fees for distribution, transportation and warehousing plus the price of gas, regulated by the basket method. To keep prices down, ANRE stopped updating the composition of the basket in Q4 2009, using calculation parameters of 20% imported gas at a price of 290 USD/1000 cubic meters and an exchange rate of 1 USD = 2,9 RON, while the price of domestic gas was circa 160 USD/1000 cubic meters. Although EON and GDF are obliged to continue selling at the basket price, in reality Interagro, Azomureş and the others consumed part of the domestic gas, reducing the amount available from stocks, while the conditions under which EON and GDF bought the gas changed radically: today, circa 40% of gas is imported, at a price of almost 400 USD and an exchange rate of 1 USD = 3,2 RON. In other words, the two private distributors are forced by the state to sell at a loss: in 2010 alone, the losses of the two reached 400 million RON, while in the first two months of 2011 their losses were over 100-120 million RON.

Fig. 3: Energy prices, household and industrial consumers



Translation: Gas prices, household, 2007-2010; Electricity prices, household, 2007-2010; Electricity prices, industrial, 2007-2010; Gas prices, industrial, 2007-2010

Source: Eurostat, 2010. Romania has the lowest gas prices in the EU, and they are falling, especially for industrial consumers, which have benefited from “cheap domestic gas”; electricity prices are kept low for the population, at the expense of industry; prices on the open market (for industry) are higher than those in liberalized markets like Denmark, Sweden or Finland.

When the deadline for transposing the new EU directives into national legislation expired (March 3, 2011), Romania had not adopted any legislative changes nor organized a single real and transparent debate on the new electricity and gas laws. Moreover, the public perceives a total lack of transparency and an attempt to avoid at all costs any transparent discussion about the new legislation. Thus:

- According to the public information available on the site of the Chamber of Deputies, for several months Parliament's commission for industries and services has discussed a minor amendment to the electricity and gas law. It is impossible that such an amendment (increasing five-fold the penalties for violation) would require weekly debates since May 2010 with the frequent participation of the Ministry of Economy, ANRE and ANRM (the regulator for mineral resources). In reality, the debates seem to be about the Energy Prosecutor's Office, something which, however, seems to be well hidden from the public eye. Thus, there is a great risk that the entire discussion will remain in quasi-secrecy until the final version of the law appears as a major amendment in the decisional chamber in order to avoid public debate along the way.
- At the same time, because of the expiration of the deadline for transposing the directives into national legislation, just a few days before the expiration of the deadline (February 28) the Ministry of Economy posted a proposal for a government emergency ordinance ("OUG") for the transposition of directive 73 (gas) on its website, leaving 7 days for public debate. A similar proposal for the transposition of directive 72 (electricity) appeared in a final form ("Legea") in March, with a period of time for debate that was just as short. Both proposals belong to ANRE and, as will be seen, are not in conformity with the directives. It is quite probable that these two normative acts will be introduced in Parliament in the proposed form as amendments to the existing legislation, nullifying the debates from up until now in the commission for industries and services.

III.1 Transposition of the directives on gas and electricity (ANRE's legislative proposals, in public debate on the website of the Ministry of Economy)

In short, the proposals do not adequately translate the most important elements of the Directive in relation to:

- a) ANRE's independence and competences;
- b) Separation of storage of gas production (Romgaz);
- c) Carrier independence and ensuring professionalism and independence of management of Transgaz and Transelectrica ;
- d) Market liberalization and adequate definition of consumer vulnerability.

Instead, the OUG and the Law also contain many details that should be included in the secondary legislation, instead of requiring the amendment of the primary legislation too frequently (for example, is determined the amount of sanctions for violations, this being also the pretext for the debate in Parliament on the old laws of electricity L13/2007 and gas L351/2004).

Both proposals, however, miss entirely the spirit of the directives, which is to build a functioning competitive market, with regulations as limited as possible and geared toward boosting competition in those segments that may become more competitive (production, supply). Also, in the proposed legislation the regulator's functions are not aimed at an active promotion of competition, but rather a passive role of the regulating authority. Even the fact that in both proposals for the normative acts the prices are grouped together with regulated rates suggests a lack of understanding of the market mechanisms for the functioning of the electricity and gas sectors and an outdated vision regarding the role of the energy regulator.

Thus, even some of the key definitions are unsatisfactory. For example, the vulnerable consumer, as defined in both normative act proposals, refers to all household consumers regardless of poverty, which is explicitly prohibited by the Directive (in the Directive the vulnerable consumers are only those whose degree of poverty does not allow them access to energy and the consumers who cannot be disconnected because they offer some services of public interest, such as hospitals, schools). In connection with these consumers defined inadequately as vulnerable in OUG, for gas is still used the term "regulated price", a concept that goes against the spirit of the directive (to build a functioning market). In reality, the directive does not allow regulated prices, but the protection of the vulnerable consumer in the broader context of social protection made by each member state (income support for poor people) plus a ban on disconnection in certain circumstances. Directives clearly specify that measures to protect vulnerable consumers will not prevent the effective opening of the market; but regulated prices distort the market.

Similarly, the public service obligation is insufficiently well defined. It should, after directives, refer to safety (security of supply, regularity, quality, price); environment (including energy efficiency, boosting renewable and measures to protect against climate change); furthermore, Member States may also include issues related to poverty and the prohibition of disconnecting consumers in some critical moments (these two are directly connected with the correct definition of vulnerable consumer, for them the insurance of access can be done through the existence of a supplier of last resort and through income support). The obligation of public service should not impede, in any way, the effective opening of the market- however, at electricity, and at gas prices we talk about prices regulated for households.

As explained above, there are four key points of the new directive: the regulator's independence and ability; the independence of the transportation networks; the independence of the gas storage operator; and the establishment of European energy regulator. At the same time, there is a need for continued liberalization of the energy markets, more aggressively than in previous versions of the Directive. Here's how these issues are addressed in the proposed normative acts in debate:

III.2 ANRE

With regard to the regulator, the wording of the OUG acknowledges the complete politicization of ANRE, a matter for which Romania has received since June 2010, a particularly harsh warning from the European Commission (an explicit threat to start infringement procedures if these problems are not remedied pending the entry into force of the Third Energy Package). The only change for the better about the situation today is the financial independence of ANRE (own income, e.g. licenses) and exemption from the law on the unitary payment (in 2009-2010, following the decrease of the number of governmental agencies and the screening in the uniform pay law, employees lost nearly 70% of revenues, which prompted a mass departure of the specialists left). The change for worse in the already bad situation that is nowadays consists, basically, in the fact that the ANRE president will win more power than before, provided that he gets along with the Prime Minister, which, in the Romanian context is the key of the final politicization. In other words, instead of OUG improving ANRE in accordance with the trend of the new European directives, Romanian law is regressing; OUG proposals on gas and electricity law have much weaker provisions on the governance part of the ANRE regulator than the electricity law in 2007 or the gas law in 2004, as amended. True, the law proposal for the transposition of the Directive on electricity may correct some of the major loopholes of OUG, though without changing their essence.

Management of the regulator: ANRE has a president and vice-presidents appointed by the prime minister and the number of the vice-presidents is reduced from 7 to 1. ANRE will be coordinated by the Prime Minister, which means political subordination (the only acceptable choices would have been for the ANRE management to be accountable to a collective body, even the Cabinet or, preferably, the Parliament, as is the case of CNVM). As in previous legislation (L13/2007), ANRE makes its own rules of organization and operation, which will be approved by the President of ANRE. ANRE salaries are also decided by the President: within 30 days after the approval of the two laws, the President decides the pay scale. This method will ensure staff loyalty. ANRE elaborates, approves and applies the organizational and functional regulations, and the remuneration of the Advisory Board and Regulatory Committee, by decision of the ANRE President, which means both bodies, will become virtually dependent of the ANRE president's will. The president issues orders, decisions, approves tariffs.

In terms of leadership mandates, in OUG (gas) is left to be understood that mandates of the President, the vice-president and the regulatory committee should be fixed term, but is not specific on what term. The electricity bill stipulates that the President's mandate is for 6 years and that of the regulators for 7. Compared to the previous legislation (L13/2007), the conditions for revocation of the leadership are more relaxed (for example, besides death, resignation, etc., the mandate may be terminated by "cancellation law", whereas previously there was only for non-mandate). In OUG, the final criminal conviction does not automatically lead to dismissal, as in L13, but only if it is a criminal activity strictly related to ANRE; but in the electricity law it returns to this, and there is a broader mention of any criminal conviction. Neither OUG, nor the law, do specify anything about the possibility of withdrawing the mandate not met.

A positive think is the fact that it specifies the leadership and regulators' ban to hold shares in the regulated industry, which happened in the past, and was promptly fined by the press.

Regarding the decision making, in the proposed OUG is not specified how decisions anywhere in ANRE are taken, except for the mentioning "To approve the regulations issued by ANRE is set up a Regulatory Committee (Art. 11 al 1)". OUG does not specify how to approve the rules (majority vote?). It is also not clear who initiates legislation, which makes the annual ANRE regulations, who verifies that the regulation plan is meet. Indeed, in the law transposing the Directive on electricity it is said something more clearly, that the orders and decisions are issued by the President and are debated in the regulatory committee, where they shall be adopted by a majority vote, but it remains unclear who will start these regulations. In both normative acts, the Advisory Board's role is very weak (Advisory Board is a body that had, even before, a more formal role, but still there was some consultation, particularly when at the leadership of ANRE there was any will for it). The Advisory Council no longer has the guaranteed level of representation L13 (employers, unions, local authorities, professional organizations, consumers of gas and electricity), but should only be composed of people from different specializations; it is stated that they should have a good reputation, but they will not be selected by any criterion anyway competitive. The nomination proposition is made, as before, by the ANRE president and the appointment by the Prime Minister. In addition, the fact that the ANRE president decides the staff's salaries leads to the risk that directors will approve only regulations pleased by the ANRE president.

Furthermore, from the vague formulation from the two normative acts it remains the risk that the members of the Regulation Committee are, as until now, directors from ANRE (gas, electricity, market/rates, etc). This perpetuates the possibility of the existence of a conflict of interests, observed in practice (*I issue regulations on gas, you, electricity director, approve it so that I will approve yours as well*).

As regards the quality of the regulations, ANRE will continue to "approve prices" (both in OUG for gas, as well as in the electricity law) even though this is contrary to the directives and principles of functioning market, instead of just regulating only the methodologies for prices. The vision over the regulations which can be issued by ANRE is, whole retrograde, in accordance with the old idea, closer to central planning than the market economy, that ANRE should regulate "prices and rates." References to the issues related to energy efficiency, the usage of alternative fuels (biogas), renewable energy, free competition, promoting the interconnection are sketchy, and appear where the text is simply translated literally from the directive; this does not show the understanding of the spirit of the directive by the issuer of the two proposed normative acts, ANRE. For example, for electricity, consumers who did not opted to change the provider can stay at a regulated price; for gas, nothing is done to eliminate the "basket" (gas prices being regulated as a weighted average price between import volumes and domestic production). This would have been done for example by giving a deadline to repeal the Joint Order MEC / ANRGN / NAMR on which the "cart" is built.

As long as there is the concept of a regulated price, it is understood that the basket methodology is keep indefinitely. This happens while the European Commission warned us that the method of

gas chimney (which requires internal manufacturers to put on the market a certain quantity of gas at a regulated price) equals an export ban and is a grave breach of the directive. In practice we see otherwise that is not allowed not to move gas in both directions on the new gas pipeline Arad-Szeged, i.e. to domestic producers Romgaz and Petrom, is practically forbidden to sell gas for export. Ironically, we respect this principle by designing a possible future pipeline to Moldova, where Romania's strategic interest is to import gas from Russia via Moldova, but also to help Chisinau when needed, so gas should flow in both directions (see more details in the CRPE report "How we used the window of opportunity. The outcome of a year to revive the Romania-Moldova relations "). So where we have a direct interest we respect the principles of the Directive, although Moldova is not the EU and so we can not talk about her involvement in the common energy market, unlike Hungary.

III.3 Transport operator independence

Most of the formulations from the two normative acts proposals are meaningless or do not represent a transposition, being direct translations from the directives 72 and 73. For example, in Romania there is no "integrated enterprise" to contain the carrier in the gas sector. Full articles are translated from the two directives which explain what means the lack of control of one or more persons over the carrier and a manufacturer, but without giving a concrete solution to the problem that will apply to Romania. For example, the fact that the appointment of AGA and CA members both for carriers and state producers is done by the same departments and people from MEC is a violation of the directive. It is true that the fact that at least there will not be the same persons in AGA and AC at carriers and manufacturers is a good thing, but the Commission should be asked whether this minimal solution is acceptable. But to meet the Commission's requirements without discussion, the easiest way would be to divide the property (e.g. Romgaz transfer at the Ministry of Finance, while Transgaz remains at the Ministry of Economy; and the same for electricity producers and Transelectrica).

The independence of the management

OUG and the Law do not transpose the Directive's provisions regarding the independence of the carriers (Transgaz and Transelectrica) nor the nomination and revocation criteria of the management and AGA. Thus, Romania seems to choose not to separate property, a simple solution that could be applied by keeping the MEC for transport operators and the future gas storage companies and transfer the other companies from the production sector to the Ministry of Finance – but for the more complicated alternative (additional mechanisms to ensure the independence of product carriers). For this alternative, the directives mention the need to establish a Supervisory Body for transport operators, to ensure their independence from the interests of producers, but these Oversight Bodies are defined neither for electricity nor for gas. According to the directives, this Body should be the one who nominates the transport company management (management and Transgaz and Transelectrica CA), and the decision of the

Supervisory Body for management should be verified by ANRE to ensure independence of transmission of any illegitimate interest, the replacement of the management during the period being also made only by these two Bodies. The compliance officers, who should ensure verification of the independence and third party access to networks, are not defined either.

III.4 Gas storage separation

As in the case of carriers, the directive is translated, but without detailing the means by which this will apply in Romania (in essence, it is about Romgaz's impossibility to continue to control the storage facilities; currently Romgaz holds gas deposits and intends to do more, for example in the proposed partnership with Gazprom for the landfill at Mărgineni). The directive says that a separate company for storage must be established, independent from a producer and CA and AGA members should not be linked with CA and AGA members of any of the manufacturers. Again, the simplest solution for Romania would be to divide property by keeping the company at MEC and transferring Romgaz to the Ministry of Finance.

III.5 Opening electricity and gas markets

There is no specific reference to consumer protection understood as the freedom to choose their supplier (the possibility of changing in three weeks is mentioned, but much less specific than in those two directives, which have both an annex with what safeguards should be for the consumer). For electricity there are still talks about regulated market and competitive market, without the existence of a concrete timetable for opening the markets. Moreover, it is also understood that a domestic consumer, for example, who opted to change the supplier, can always go back to regulated prices, which are entitled to those who do not opt for exercising eligible rights. Similarly, the timetable for liberalization of gas market is not completed, and the definition of vulnerable consumers, in a much broader sense than presented in the Directive (including **all** household), makes liberalization not take into account households at all, whether they are in a class of poor consumers or not. A worrying aspect of the liberalization of electricity and gas markets is the fact that in neither of the two proposals for legislation is caught even the schedule negotiated with the IMF and DG ECFIN for the new stand-by loan agreement (of course even if this calendar existed, it does not mean that DG Energy / DG Competition could not initiate an infringement procedure, but at least this would have shown the intention of the Romanian state to continue the liberalization of both markets and it would have reduced the risk of sanctions).

IV. What Romania ought to do:

As we have seen, Romania is among Europe's last country in the pace of reforms, slowing down after the 2008 liberalization of energy markets (Fig. 1). As a result, it must recover quickly also the arrears it made in implementing the old Directives, and to implement urgently the new legislative Package.

IV.1 Strengthening the independence and capacity of the regulator

For ANRE the acceptable solution for meeting the new Directive is the recovery of the capacity of the national regulator in the field of energy (ANRE), not only by returning to the old form for funding from its own funds, but also de facto political independence and effective accountability of the regulator. For example, even when the previous laws (especially L. 13) specified quite clearly the conditions under which the ANRE management may be replaced, in reality changes were made by breaking the law, and in 5 years there were no more than 5 ANRE presidents. Similarly, during election years, gas prices were kept artificially low by more or less direct pressure from politicians (see Figure 3). A concrete example of such a practice that is as current today and it was before is the MEC release from 2nd of March⁴: *"The view of the Ministry of Economy, Trade and Business is that in this period, natural gas prices **should not increase**. We also believe that **there is no reason that natural gas prices on the population will be increased in future**. Romania's only institution authorized to issue decisions on the price of natural gas is the National Regulatory Authority in the Field of Energy (ANRE)."* Such an expression is in fact a clear instruction by MEC to ANRE that the price increase is undesirable.

In the same time, the returning of the funding sources to ANRE without a proper control of the quality of regulations and without a real accountability of the regulator will immediately lead to new scandals of bad government, nepotism, waste of public resources, as happened in the last 2-3 years. That is why ANRE should be held accountable by:

- Establishing clear objectives and develop annual plans for transparent regulations and which result from consultations with specialists;
- Annual Activity Reports, approved by the Parliament (or at least the whole Cabinet) and published, in which the ANRE management presents the accomplishment of the objectives for the past year;
- Change of management can be made during the mandate if it does not perform the tasks (by rejecting its annual report to Parliament);
- Publication of an annual audit, financial, to answer for the money used and for the procedures for internal control mechanisms in risk control activities (e.g. licensing)⁵.

IV.2 Transport operator independence

⁴ http://www.minind.ro/presa_2011/martie/2_mart_comunicat_pret_gaze.pdf

⁵ For a detailed analysis of the capacity and governing of the regulator: http://www.sar.org.ro/art/publicatii/policy_briefs/cetateni_pentru_energie_prima_evaluare_a_anre-531-ro.html

Regarding the independence of the carriers, Romania broadly fulfilled the requests of the old directives and now the problem is only when transposing the new rules. The issue becomes very important for the electricity market where, for the first time in 2011, private producers appear, who are likely to have network access problems. As a priority for Romania, increasing independence of carriers is less important than the reforms for the regulator, but even here taking appropriate measures would show the political will of the Romanian Government to continue reforms in liberalizing the electricity and gas markets.

Transgaz and Transelectrica are considered companies with better corporate governance than other state companies, not solely because both are listed at the stock market BVB and they need to fulfill certain criteria of this market regarding corporate governance. However, there were suspicions over the years of political influence and politicization of management (e.g., frequent replacement of managers at each election cycle). One solution would be to increase the share of the private sector in the shareholding of the company, by putting on the stock of some minority stakes, which is Government's intention and was negotiated with the IMF and the European Commission. In the same time, establishing a supervisory body for each of these carriers, which will name the management on the principles of the Directive, would avoid suspicions of politicization and influence of those who control and the companies in the electricity and gas production (Ministry of Economy).

To avoid bureaucratic complications, Romania can legally separate the property of carriers Transelectrica and Transgaz from the property over the state producers (Romgaz; Hidroelectrica, Nuclearelectrica, Turceni, Rovinari, Craiova, Termoelectrica, Elcen etc). A possible, but not recommended, solution could be the transfer of Transelectrica and Transgaz to another Ministry (for e.g. the one of Transport and Infrastructure). This solution would not be desirable because the Ministry of Economy is responsible for energetic security, and the carriers are the ones who put it into practice ensuring permanently the equilibrium between supply and demand, including through the equilibrium markets and through the dispatching function.

But a better option, which would definitely be accepted by the European Commission, would be the transfer of all state companies which operate in a competitive market (the electricity and gas production sector) to the Ministry of Public Finances. This second option of controlling state companies by the Ministry of Finance is not unusual; it is used in France for example.

Corporate governance of public companies and their property

One aspect that must be explained regarding the state companies is the purpose for which these companies exist and are state property. What is the mission of these companies: to maximize profits? Safety supply, a very important product for society, or told otherwise, the obligation of public service? The existence of a monopoly, which can not be effectively controlled through regulation? Or is there a joint goal? In general, state companies could be divided into two broad categories: companies operating as a monopoly in one area that cannot be competitive – e.g., railway infrastructure; or companies operating in a competitive environment, possibly with some regulatory restrictions – e.g., Nuclearelectrica and Hidroelectrica.

For the first category, the network industries, this can be detained by the line ministers that also do the regulation framework, much more stricter for monopol. In the second category, companies could be oriented to maximize profits and thus of dividends which are distributed to the state budget, under regulations made by ministries; how dividends go to the state budget, this is the reason why companies should be at the Ministry of Finance. E.g., Nuclearelectrica is subject to safety regulations for use of raw materials and radioactive waste. Hidroelectrica benefits from facilities paid from the budget or which have positive externalities (e.g., dams built before 1989 which are used for flood control or irrigation, thus producing economic services of general interest). Such regulations may however be regulatory constraints which can be applied without this meaning that the two companies are unable to maximize profits given the constraints. There is no reason why Nuclearelectrica or Hidroelectrica could not be transferred to the Ministry of Finance, other necessary regulations being made by line ministries (Economy, Environment, Agriculture, etc.).

As mentioned, if the state decides to keep at MEC all the companies is also necessary to establish Supervisory Bodies to ensure the depoliticization of the two carriers, the approval of compliance plans to ensure non-discriminatory third party access to networks, and especially ensuring that carriers' management remains apolitical. This is especially important as the network is congested in a certain area and there the carrier may raise difficulties of connection, possibly blocking the access for new producers.

To avoid the physical access problems which would limit competition on the electricity and gas markets, but also to eliminate other potential distortion in market competition, ANRE must assure that:

- a. all necessary additional transport capacity is provided where significant new investments are expected (e.g. wind power in Dobrogea) and
- b. production incentive scheme for renewable energy does not benefit from a too generous support scheme, which could lead to building an excessive production capacity, for speculative reasons (according to some specialists, Law 220/2008, which is now examined

by the Commission seems to give a too large number of green certificates for wind energy production and should be revised).

IV.3 Separation of storage of gas production is one aspect in which Romania must comply and this can be done by separating Romgaz gas deposits, keeping the new companies at MEC and transferring ownership of Romgaz to the Ministry of Finance. As in the case of carriers, Romania can comply relatively simply to Commission requirements.

IV.4 Liberalization of electricity and gas markets is a remnant that Romania had even before the introduction of the new directives and for which we have already received an infringement in 2009 (although, along with other 24 member states). Liberalization should not necessarily be unpopular and painful for the population (households):

- First, **liberalization must proceed urgently from those industrial customers who continue to receive energy at a regulated price or in conditions not related to market mechanisms**, and then to consumers. The largest distortions in energy markets in Romania are due to contracts with the "smart guys" and cheap gas for some consumers who frequently receive state support. The growth of competition in energy markets should start with them. Hidroelectrica and Romgaz should sell competitively to who gives more, not at regulated or below market prices. If the Romanian state gives reliable signals that it will address this problem (which already worries DG Competition), the Commission may grant agreement for a longer period for the liberalization of domestic consumers. Moreover, if Romgaz and Hidroelectrica would maximize profits, the Romanian state would earn extra money for the budget to support households in social protection schemes.
- Then, **they should adequately define the vulnerable consumers**, as to not include in this category all household. It is necessary to identify from the domestic consumers group the ones who really need social support, under the form of income support, and the simplest way would be for those defined under the same criteria to be the ones who receive the minimum income support. There are more problems for which the small, regulated, prices are not an adequate solution of social protection:
 - this mechanism distorts energy markets. When in regulated quantities the "cheapest" energy usually enters, sold at cost plus, it results that for eligible consumers it remains only the more "expensive" energy. For example, the regulated electricity consumption contains "cheap" nuclear energy (75% of Nuclearelectrica); hydro (20%, the rest being ticked by the "smart guys") and heating cost (a part of the Turceni, Rovinari, Craiova production). On the competitive market remain the less profitable producers. Similarly, the "basket" includes all domestic production of cheap gas. Basically, whoever wants to change his supplier of electricity or gas, has more expensive alternative, which hinders market opening;

- small electricity and gas prices do not stimulate energetic efficiency, because the waste is not sufficiently costly;
- protecting through small prices makes a category not benefiting from support to be the most deprived category, meaning those who do not have any access to electricity and gas;
- from small prices benefit exactly those who consume most, the most probable to be rich persons.

In conclusion, Romania should not do everything at once; but the Commission will not accept the reforms in the liberalization of markets to not even be started. The Government should give clear signals for reform, starting with the issues related to the good governance of the sector. This includes independence and accountability of the regulator; abandoning the subsidy practices for companies or sectors through preferential contracts and laws, which drain state companies of electricity and gas; and using these additional resources from the budget to support those groups that really need welfare.

V. Summary of conclusions and recommendations

Romania not only does it not align with European requirements regarding the liberalization of electricity markets and gas, but even goes backwards. Although European laws are becoming stricter with directives from the third energy package (which should be transposed by 3rd of March 2011), we did not respect even the principles from the previous 2003 directives. The main problems in the legislation proposed by Romania in the last minute are related to:

- **independence and responsibility of the ANRE regulator, which must assure the effective competition on the market.** ANRE should be more active in monitoring and sanctioning the contracts of “smart boys”, in warning MEC that the establishment of integrated companies permanently removes competition from the electricity market, or that special laws about supply of “cheap gas” by some branches have anticompetitive effects. ANRE should also not keep prices artificially low for electricity and gas, for industrial consumers and households which are not poor, especially during elections. But for ANRE to be able to do these things, it must be politically independent, accountable for its work to Parliament, in front of the public, consumers and the regulated industry. This is not happening because ANRE remains politicized, subject to the Prime Minister, with a management in which the advisory role of stakeholders disappears completely, and will not answer for the money used and the quality of its regulations to those who are affected by it;
- **there is no clear separation of the interests of state producers from state carriers;** this will become even more important as from 2011 appear also the private electricity producers (Petrom-Brazil). Also, there is no separation between the storage operator

from the state gas producer Romgaz, a necessary thing to limit the company's dominant position in the storage part. In other words, as long as there is no separation of interests of network state producers there is a risk that private producers are disadvantaged in the market. In addition, if the carriers will be politicized instead of acting transparently and being closely monitored by ANRE, there is the risk that some private producers, on the contrary, can be favoured when connecting, detrimental to their competitors, defending a new form of ticking;

- **the regulation of the prices continues, at low level and without economic basis**, for electricity, but mostly gas. Although this appears to be in favour of the consumer and an effort for supporting households, in reality the main beneficiaries are the companies with special relations with the state, the inefficient producers in the chemical industry, metallurgy, ferrous metallurgy and some intermediaries. Low and unjustified economical prices lead, on the long term, to major energetic security risks, because the investors in the sector of electricity and gas production are not interested in investing in Romania with the risk of not getting their money back. In the same time companies, especially state ones, lose enormously from the low prices. For example, in the gas market are lost approximately 1.7 billion USD by selling gas at around 40% of the import price; and Hidroelectrica lost 220 million EUR in 2009 from the contracts with smart guys.

Instead of going further with these damaging practices for the energetic sector, Romania should firstly assure the independence, the depoliticization and the accountability of the regulator, so that it has a real capacity to penalize including the state for its anticompetition practices. State-owned production companies should be transferred to the Ministry of Finance to increase their profitability and hence of the dividends received from the state budget. All measures from the energy sector and the legislation transposing the directives must be done through a real debate with all stakeholders affected, consumers, investors, public, experts, rather than approving ad hoc various measures that favour the status quo and the current illegal interests from the domain.

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- energy
- infrastructure
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