

## **Report on the compliance, with Energy Community *acquis* and European best practices, of the 2018 electricity distribution tariff methodology adopted by ANRE**

### **I. The 2018 draft methodology**

On 22 November 2017, ANRE published on its website the draft methodology on calculation, approval and application of tariffs for electricity distribution service and invited comments from the stakeholders.

On 30 November 2017, ANRE submitted to the Secretariat a draft methodology on calculation, approval and application of tariffs for electricity distribution service.<sup>1</sup> ANRE requested the Secretariat's comments on the draft.

### **II. Exchanges with ANRE**

On 21 December 2017, the Secretariat submitted its initial comments to ANRE.

On 9 February 2018, a meeting took place at the ANRE headquarters in Moldova between representatives of ANRE (from both the technical and management level), representatives of the Secretariat, EU delegation to Moldova, and an international tariff expert. During the meeting, all the comments above (as well as the comments of the other experts) were discussed, and representatives of ANRE committed to implement the proposed changes.

On 12 February 2018, ANRE sent to the Secretariat an amended version of the methodology on calculation, approval and application of tariffs for electricity distribution service. The second draft implemented most of the comments and recommendations of the Secretariat and tariff expert. However, a few issues remained open.

As a result, on 15 February 2018, the Secretariat shared its comments on the second draft of the methodology and requested a conference call the following day.

On 16 February 2018, following a conference call between representatives of ANRE and of the Secretariat, a third draft of the distribution tariff methodology was prepared.

In an email to ANRE on the same day, the Secretariat confirmed that the third draft was in accordance with the Energy Community *acquis* and European best practices. However, this confirmation of the Secretariat was only preliminary, as it was given upon revision of a draft in English, and on a working version of the annex (weighted average cost of capital (WACC) formula and parameters). The Secretariat announced that the final confirmation would be issued after the review of the Romanian version of the distribution methodology upon its publication in the Official Journal of Moldova.

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<sup>1</sup> ANRE also sent the Methodology on calculation, approval and application of regulated prices for the supplier of last resort and for the universal electricity supplier, on which the Secretariat did not comment.

### III. Adoption of the methodology

On 22 February 2018, the methodology for calculation, approval and adjustment of tariffs for electricity distribution was adopted by ANRE in a public meeting.<sup>2</sup>

On 9 March 2018, the methodology for calculation, approval and adjustment of tariffs for electricity distribution was published in the Official Journal of Moldova.<sup>3</sup>

### IV. Assessment

In the Secretariat's assessment, the distribution tariff methodology is compliant with the Energy Community *acquis* and best European practice in the field.

This methodology is the result of extensive and fruitful exchanges between the Secretariat and ANRE.

Initially, the Secretariat identified several problematic provisions in the draft methodology. Below is a summary of the most important provisions which were discussed by the Secretariat and ANRE's representatives between November 2017 and February 2018:

1. Certain provisions of the draft methodology introduced both monomial tariffs (calculated in relation to the quantity of electricity distributed) and binomial tariffs (calculated in relation to the capacity). Using these two different measures would not lead to the same result, so it is advisable that a regulator chooses between one type of tariff or the other.

Upon discussions with the Secretariat, ANRE rectified this. The adopted methodology only uses monomial tariffs.

2. In the Secretariat's view, the provision addressing the regulatory asset base (RAB) should have addressed only the assets relevant for tariff purposes, and not all the assets in the accounting books of the operators. Also, the Secretariat suggested to avoid any suspicions that ANRE may decline without justification to accept re-evaluation reports submitted by operators. In order to avoid confusion, and to protect ANRE's independence and discretion at the same time, the Secretariat suggested adding a sentence saying that in all cases when the re-evaluation is made by a licensed international audit company, ANRE may only challenge it for justified reasons.

Upon discussions with the Secretariat, ANRE rectified this, and added the suggested wording.

3. Article 26 remains a problematic provision, mostly because of the corresponding provision in the electricity law (article 87(3) in which the Moldovan Parliament is instructing the regulator on how to calculate or cap the losses.). Until the electricity law will be amended, the Secretariat insisted that the methodology is from the start compliant with Energy Community *acquis* and European best practices. In the Secretariat's assessment, the initial version of Article 26 of the draft methodology breached the principle of regulatory independence and did not conform with the principles of incentive-based regulation. Therefore the Secretariat proposed deleting the cap on losses from the draft methodology and adding the following language at the

<sup>2</sup> ANRE Board Decision no 64/2018 dated 22 February 2018.

<sup>3</sup> Official Journal of the Republic of Moldova No 77-83 from 9 March 2018.

4. end of Article 26: "In all cases, the gains resulted from increased efficiency shall be equally divided between each respective operator, on one hand, and its consumers, on the other."

Upon discussions with the Secretariat, ANRE added the suggested wording. However, changes in the electricity law may be needed in order to fully rectify the problem.

5. With regard to the working capital, article 29 of the draft methodology envisaged that if a distribution system operator would use its own equity, it would be penalised by ANRE by a reduction of the regulated income. This approach is very strict, as best practices grant an operator the right to decide how to finance its needs, in order to optimise its costs. The Secretariat suggested a slight change in the language to make the provision more flexible, still allowing ANRE to reduce the income of the operators in the following year, but without making it compulsory.

Upon discussions with the Secretariat, ANRE added the suggested wording.

6. With regard to the balancing of the costs, one provision of the draft methodology forced the operators to strictly use the costs by destination, which interferes with the management of the company, as the management and not the regulator knows better how to allocate the money between different activities.

Upon discussions with the Secretariat, ANRE removed this wording.

7. The Secretariat noted that one provision of the draft methodology gave ANRE the right to reduce the tariffs by up to 10% for the non-observance of the minimum values of the quality indicators. The punishment is very high and, as per the principles of incentive based tariff regulation, the emphasis should be placed on the gains to be obtained when operators are efficient, and not on the penalties.

Upon discussions with the Secretariat, ANRE removed this wording.

8. Regarding the WACC formula and its parameters, the Secretariat repeatedly stated that it is very important that the parameters reflect the realities of the Moldovan market, which was generally the case in the second draft methodology. The Secretariat invited ANRE to continue to have negotiations and discussions with the operators, conducted in good faith, so that the final WACC formula is one that is internationally accepted and in line with the best practices, and that the final result is a fair one for operators and consumers alike.

The final WACC formula and the WACC parameters reflect best practices in the field.

In conclusion, in the view of the Secretariat, the adopted methodology for electricity distribution tariffs is in line with Energy Community *acquis* and European best practices. The Secretariat also acknowledges ANRE's willingness to accommodate the Secretariat's suggestions.

Whereas the adoption of this distribution tariff methodology was undoubtedly a significant step in the right direction, the Secretariat would like to recall at this point

that further efforts are needed, especially regarding amendment of the Law on Electricity which, as stated above, contains provisions which undermine the regulator's independence.

Also, the Secretariat notes that article 39 of the adopted methodology states that changes in the regulatory framework in Moldova will be taken into account by ANRE for the annual adjustments of tariffs. The Secretariat, while not contesting ANRE's right to adjust tariffs, would like to stress that any such adjustment should be made based on objective reasons, free from any political interferences, and respecting the principles of predictability and stability of the investment environment, as well as the international agreements Moldova is part of.