

Energy Community Dispute Resolution Forum

Gas Natural Fenosa vs Moldova

(Sailing in Troubled Waters)

September 27, 2018

gasNatural
fenosa





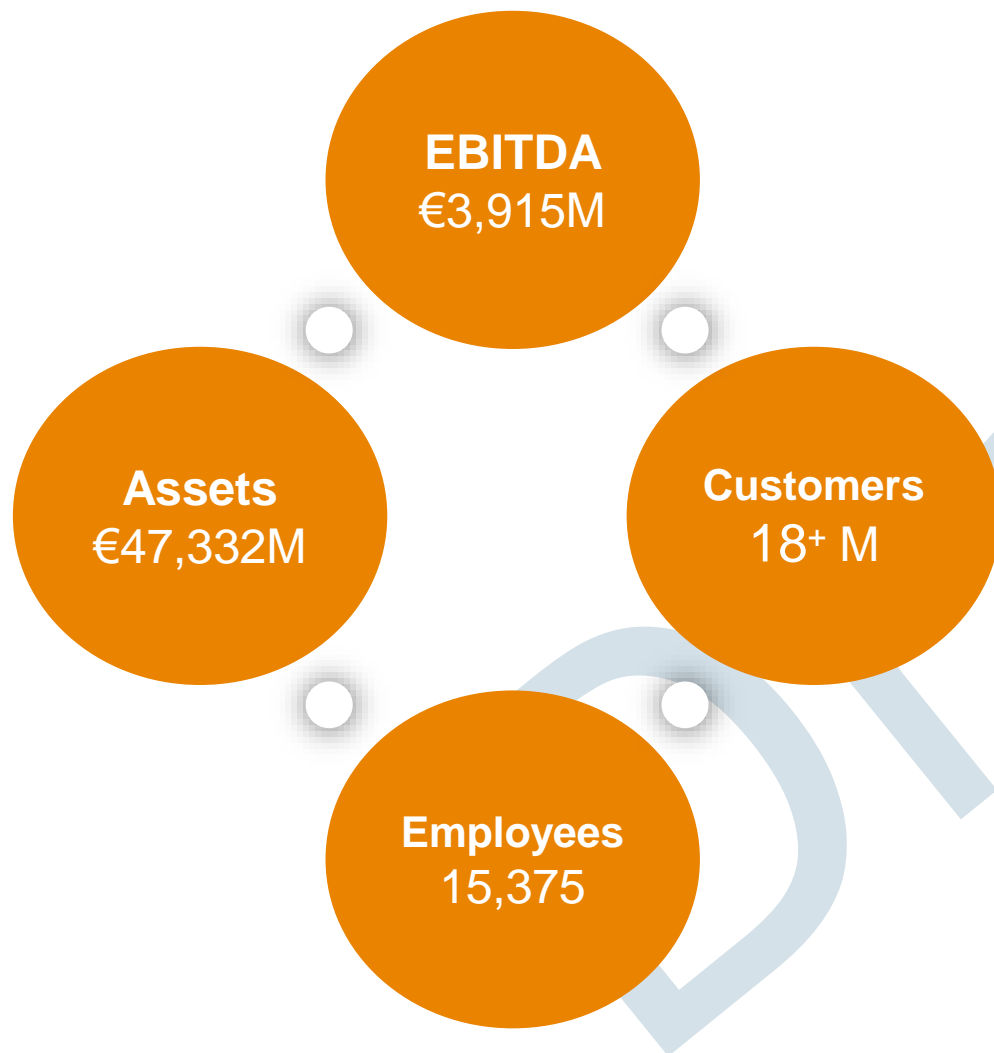
Gas Natural Fenosa

in the World in Moldova

gasNatural
fenosa



Gas Natural Fenosa in the World

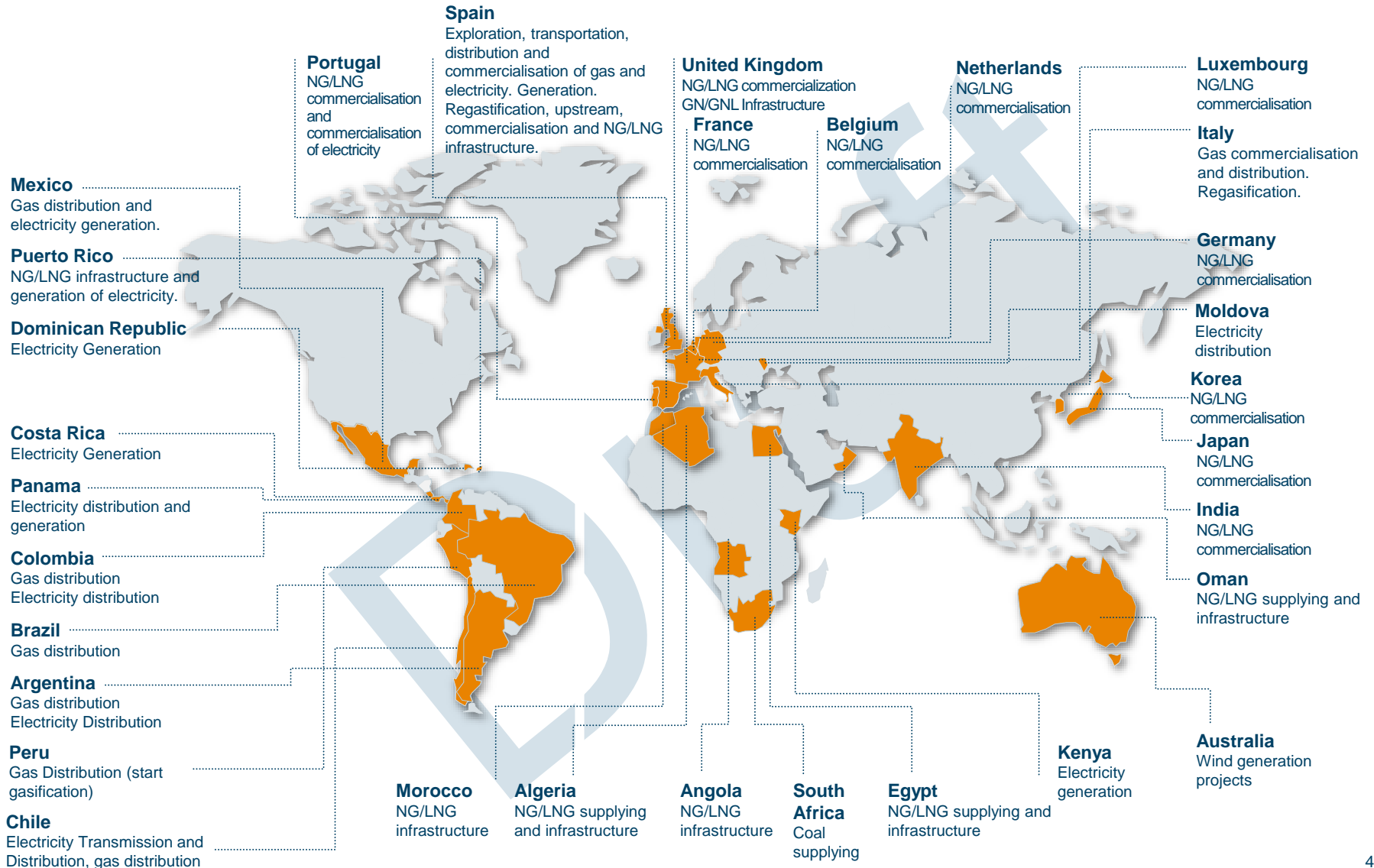


Leading
multinational
group in the
gas and
electricity
sectors

Note: Figures as of December 31, 2017.

Gas Natural Fenosa in the World

Presence in 30+ countries



Gas Natural Fenosa in Moldova

In Moldova since the privatization process in 2000

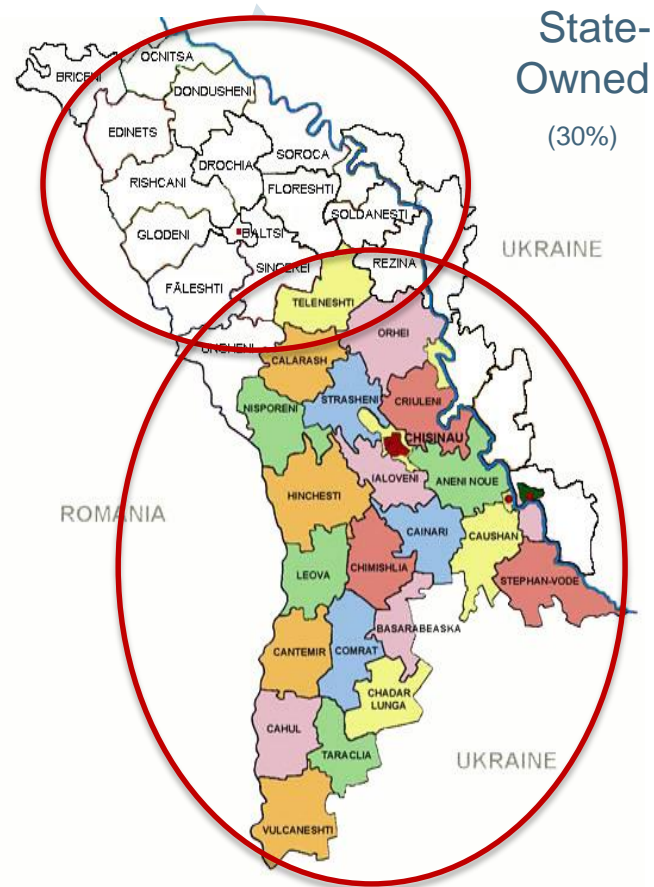


Customers: 889.078

Sales: 2.704 GWh

Network: 35.142 km

**Transformation facilities:
9.111 (2.032 MVA)**



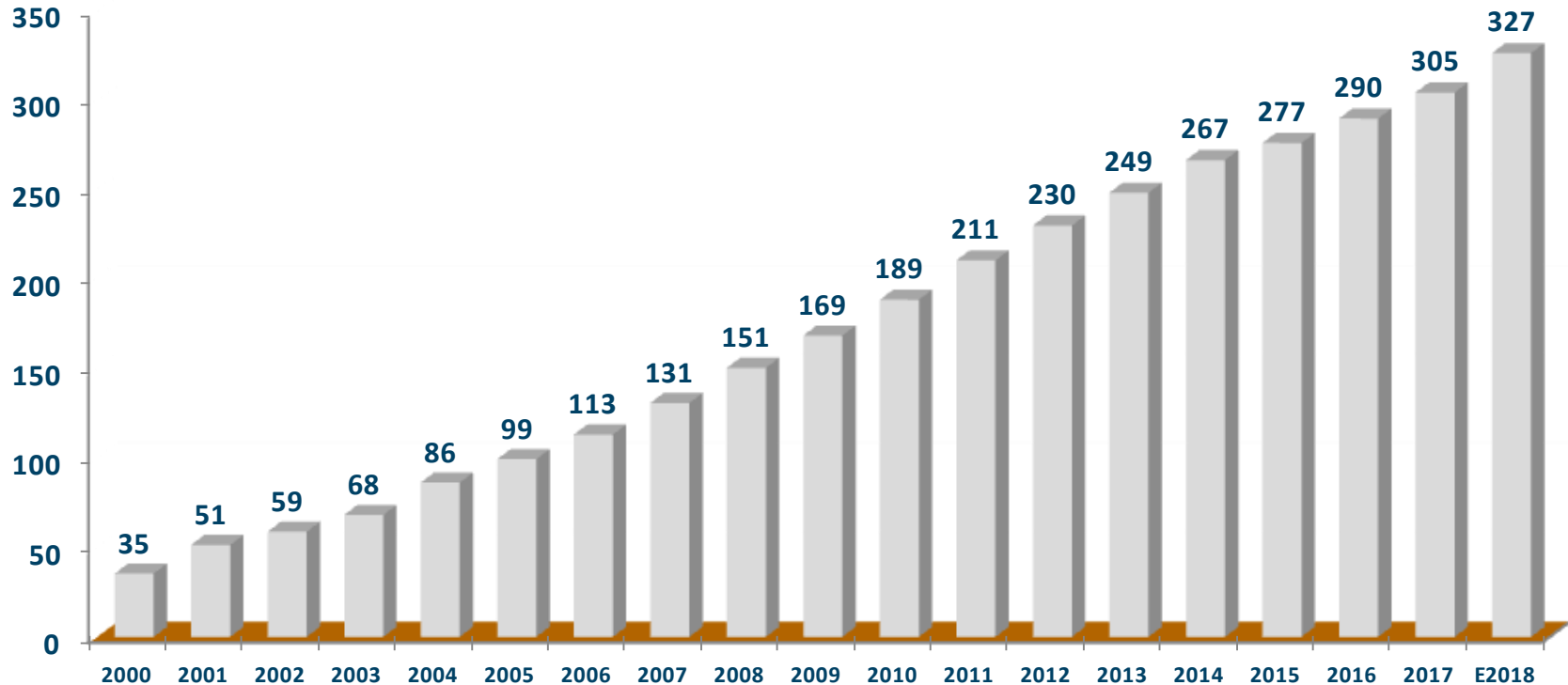
Gas Natural Fenosa

(70%)

Note: Figures as of December 31, 2017.

Gas Natural Fenosa in Moldova

Cumulative Investments (Million USD)



More than 80% of the Investments have been allocated to the renewal of power lines and the modernization of electricity facilities

Gas Natural Fenosa in Moldova

Number of Employees

Employees

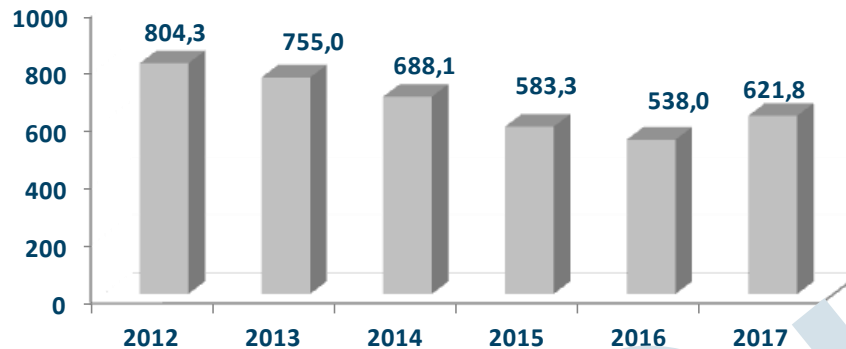


Productivity reached via the introduction of international best practices

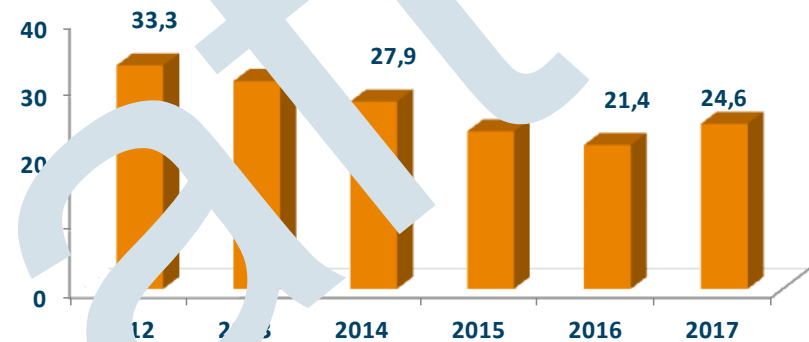
Gas Natural Fenosa in Moldova

Operational expenses

OPEX per km of network
(USD)



OPEX per customer
(USD)



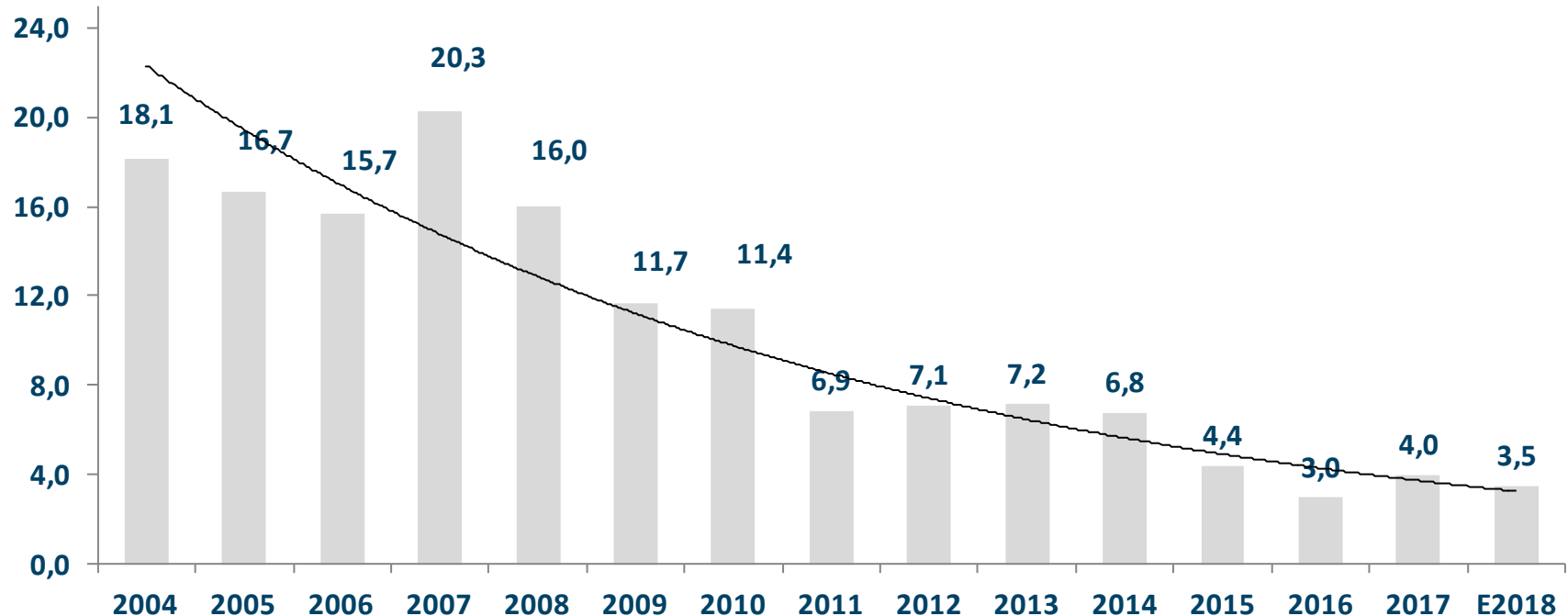
23% Improvement in Operational Costs per km of network
Reduction of 26% in costs per customer

Gas Natural Fenosa in Moldova

SAIDI (*System Average Interruption Distribution Index*)

2001: 4,700 hours

SAIDI(h/client)

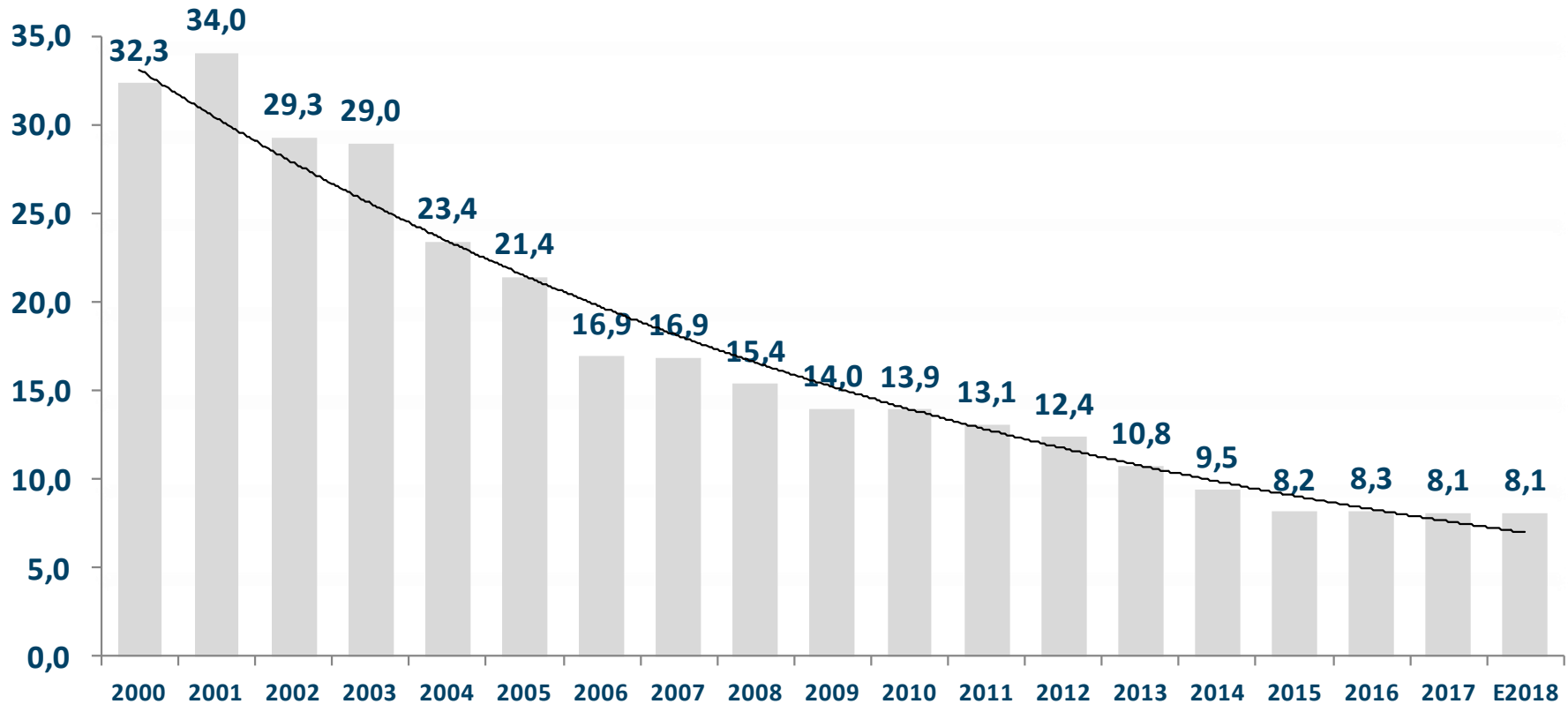


81% improvement in Quality of Supply (*average interruption time per customer*)

Gas Natural Fenosa in Moldova

Energy Losses (%)

Losses %



Reduction of 75% in energy losses

Gas Natural Fenosa in Moldova

Cash Collection

Cash Collection (%)



Collection ratio consolidated at 99-100% level

Dispute and Settlement

gasNatural
fenosa



Dispute and Settlement

Tsunami in formation



Dispute and Settlement

Tariff Deficit

The Tariff deficit reached €75M as of December 2015

- Collapse of local currency in November, 2014, due to a crisis in the banking sector. This led to an equivalent increase in the price of power.
- Delay of the regulator to adjust the tariff to cost-recovery level until November 2015 (since May 2012).

The insufficient tariff caused a shortage of financial resources in the sector, compromising its sustainability and investment capacity.

Risk of power interruptions: State wholesale energy providers sued GNF for delayed payment, and menaced to cut the power.

Government not proactive in recognizing and solving this situation.



Dispute and Settlement

Problem solving

In August 2015, GNF launched arbitration proceedings against Moldova in ICSID.

In the mediation stage, the Energy Community Secretariat (ECS) was involved as mediator.

In February 2016, a MoU was signed among MoEI, ECS and GNF.

TO THE REPUBLIC OF MOLDOVA

GAS NATURAL SDG SA (GN) and its subsidiary GAS NATURAL INTERNACIONAL (GNI), formerly named UNIÓN FENOSA INTERNACIONAL, S.A. (UFI), all these companies having Spanish nationality, belonging to the group Gas Natural Fenosa (hereinafter jointly referred to as "GNF Group"), and with official address at 77, San Luis Avenue, in Madrid [Spain], address this **formal written notification** to the Republic of Moldova, under the legal coverage established in article 26 of the Energy Charter Treaty (ECT), signed in Lisbon on December 17, 1994, based on the following:

ALLEGATIONS

FIRST.- PRELIMINARY

- This letter constitutes a formal notification of a dispute concerning issues covered by the ECT in force, on the terms provided in Article 26 of the above-mentioned International Treaty.

MEMORANDUM DE ÎNTELEGERE

Acest Memorandum de Înțelegere, este încheiat la 24 februarie 2016 de către Gas Natural Fenosa, un grup de companii stabilit și existent în conformitate cu legile din Spania, având sediul social la adresa Plaza del Gas nr. 1, Barcelona /Spania, înregistrată în Registrul Comerțului din Barcelona ("Gas Natural Fenosa") și Ministerul Economiei al Republicii Moldova, în calitate de autoritate guvernamentală și cu participarea Dl. Dirk Buschle, Directorul adjunct al Secretariatului Comunității Energetice pentru Centrul de Litigii și Negociere al acestuia ("Facilitatorul").

I. Context

În condițiile în care, la 7 februarie 2000, Gas Natural Fenosa și Republica Moldova au semnat Acordul de Cumpărare a Acțiunilor ("ACA") pentru procurarea acțiunilor Rețelei Electrice de Distribuție Centru SA, Rețele Electrice SA (Mun Chișinău) și Rețele Electrice de Distribuție Sud SA, ulterior reorganizate în ICS RED UNION Fenosa SA;

In June 2016, a Settlement Agreement was signed. It recognized a deficit of €82M as of December, 2016, to be paid via tariff in 4 years from 2017 (€20.5M per year).

ARANJAMENT
pentru regularizarea recuperării devierilor tarifare încheiat între Gas Natural Fenosa și
Ministerul Economiei al Republicii Moldova

Ministerul Economiei al REPUBLICII MOLDOVA	GAS NATURAL SDG SA
Semnătura:  Octavian CALMIĆ	Semnătura:  Antofei PERIS MINGOȚ
Titlu: Viceprim-ministru, Ministru al economiei	Titlu: Director pentru Companiile de Distribuție de Gaz și Electricitate
ÎCS "RED UNION FENOSA" S.A.	ÎCS "GAS NATURAL FENOSA FURNIZARE ENERGIE" S.R.L.
Semnătura:  José Luis GOMEZ BASCUAL	Semnătura:  Galina POROHONCIUC
Titlu: Administrator	Titlu: Administrator
FACILITATOR	
Semnătura:  Dirk BUSCHLE	
Titlu: Director Adjunct Secretariatul Comunității Energetice	

Dispute and Settlement

Problem solving

In July 2016, the regulator approved the detailed mechanism to payback the tariff deficit.

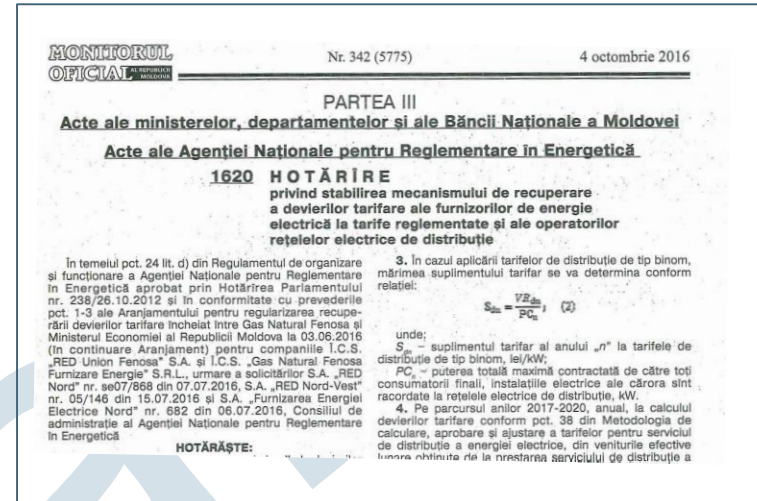
In October 2016, IMF included a condition in its Program requiring the Regulator to effectively adjust the tariff to recover the arrears.

The Agreement stabilized the energy sector by solving a severe economic and social issue.

GNF committed to:

- Extend four years the period of recovery of the deficit, to reduce the impact to the consumers.
- Cancel the outstanding debts to energy suppliers (\$14M), eliminating the risk of power interruptions.

Stability of the regulatory framework is to be guaranteed during the recovery period through the involvement of ECS as supervisor of the fulfillment of the Agreement.



Dispute and Settlement

Surfing the Waves



Dispute and Settlement

Fulfilment of the Settlement Agreement



In July, 2016, while transposing Directive 2009/72/EC, without consulting with stakeholders, the Parliament, via the Electricity Bill, modified the regulatory framework, affecting several tariff parameters like recognized energy losses and cost of extended lifespan of an assets.

In February 2017, against the advice of ECS and disrespecting its term of validity, the distribution methodology was amended.

- The recognized energy losses were reduced
- The cost of extended assets lifespan was cancelled
- The return on assets (WACC) was diminished



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Email: office@energy-community.org
Web: www.energy-community.org

Vienna, 11 April 2017
DfVr08bu4011-04-2017

Reference: Implementation of the Settlement Agreement dated 3 June 2016

Your Excellency,

I am addressing you regarding the recent discussions about the newly-adopted electricity tariffs for April 2017 – March 2018.

As you will recall, the Secretariat was involved in the discussions regarding the amendment of the electricity tariff methodology. Our goal was to ensure that principles stemming from European law such as transparency, proportionality, non-discrimination, predictability and cost reflectivity are respected. To the extent these principles are respected, ANRE has the discretion to adopt tariffs as they consider appropriate.

At the same time, I would like to remind you of the commitments undertaken by the Moldovan Government in the Settlement Agreement with Gas Natural Fenosa dated 3 June 2016. Gas Natural Fenosa claims that the recently-adopted methodology breaches the obligations stemming from the Settlement Agreement, and that they are contemplating various options to mitigate any potential damages. We would like to ensure that the conflict does not escalate and that predictability and stability are safeguarded in the Moldovan energy market.

To this end, I suggest a meeting, at your convenience, with the Ministry and Director General Kopaci of ANRE, to discuss and agree on the underlying principles of the newly-adopted electricity methodology.

I look forward to the continuation of our good cooperation. Should you have any questions, please do not hesitate to contact me.

Yours sincerely,

Dirk Buschle
Deputy Director and Legal Counsel of the Energy Community Secretariat

H.E. MR. OCTAVIAN CALMAC
MINISTER OF ECONOMY
THE REPUBLIC OF MOLDOVA

Bank: Raiffeisenbank
IBAN: AT861200051510825
BIC: RBAUW333

In March 2017, while setting 2017 Tariff, the regulator unexpectedly applied a €6.2M penalty for investing in 2015 below the legal minimum.

The impact in 2017 of these adjustments was € 20.6M



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Mr. Sergiu Ciobanu
Mr. Octavian Lungu
ANRE
Str. Columna 90, Chisinau
Republica Moldova, MD-2012

Vienna, 16 January 2017
DfVr08bu4016-01-2017

Dear Mr. Ciobanu,
Dear Mr. Lungu,

Thank you for consulting us on the intended amendments of two important ANRE decisions on the methodologies for determination, calculation and approval of the electricity distribution and regulated electricity supply tariffs (ANRE Decision 497/20.12.2012) as well as the methodology on calculation and determination of regulated gas supply tariffs (ANRE Decision 678/22.08.2014).

We have reviewed the proposed draft decision. We noted with concerns that, in relation to the methodology for electricity distribution and regulated electricity supply tariffs there is the intention to modify it before the expiry of the regulatory period of five years (Article 2, ANRE Decision 497/2012). Respecting the regulatory period is required to ensure a stable, predictable regulatory framework for the companies and investors.

We acknowledge that some changes in the wording of the methodologies may have been required to align them with the terminology used in the Electricity Law 107/2016 of 27.05.2016. However, the Electricity Law grants 24 months after its adoption to align the regulations with the primary legislation (Article 96(2) of the Electricity Law 107/2016). We have difficulties understanding the rush in amending key regulatory provisions during the five year regulatory period, especially as they impact severely the profitability of the companies due to changes in calculations of WACC, debt/equity ratios or calculation of network losses for the purpose of tariff determination.

In this respect, I recall the commitments taken by the Republic of Moldova to settle the dispute with Gas Natural Fenosa by a legally binding agreement of 3 June 2016 which I facilitated. This Agreement includes the commitment to include in the calculation of electricity distribution and supply tariffs every year until 2020 the financial deviations suffered by Gas Natural Fenosa (extended to state owned electricity distribution and supply companies by ANRE Decision 201/2016). ANRE's attempt to change the methodology seems to put that agreement at risk.

For all of the above, we strongly advise you to put the review of these methodologies for electricity and gas on hold, ideally until the finalisation of the five year regulatory period ending in March 2018 but in any event until an open discussion with all stakeholders has taken place, in particular Gas Natural Fenosa being party to the Settlement Agreement concluded in June 2016. The Secretariat will take part in such a meeting as facilitator, please do propose appropriate dates.

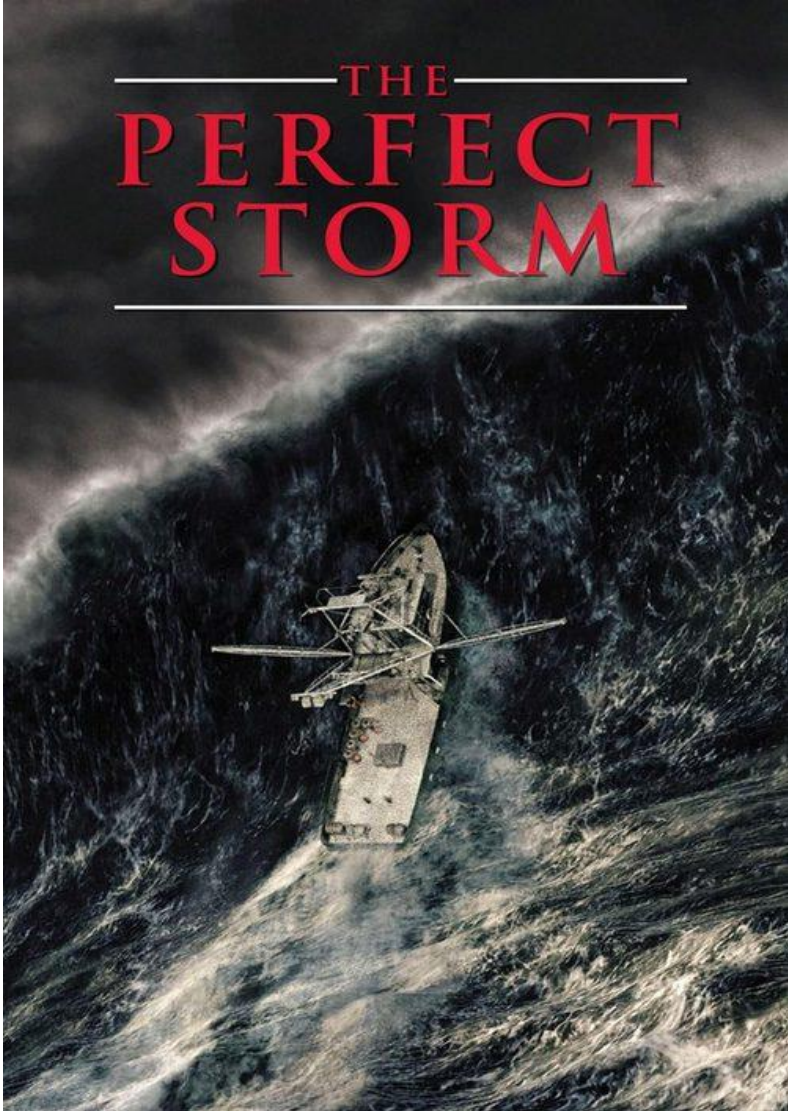
Sincerely yours,

Dirk Buschle
Deputy Director, Legal Counsel
Energy Community Secretariat

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BIC: RBAUW333

Dispute and Settlement


Bigger is Better



Dispute and Settlement

Problem solving

In May 2017, ECS opened dispute settlement proceedings against Moldova for breaching the Treaty establishing the Community, after reviewing the complaint filed by GNF.



Barcelona, May 5, 2017

Mr. Janet Kopac
Director of the Secretariat of the
Energy Community

Mr. Dirk Buschle
Deputy Director and Legal Counselor of the
Secretariat of the Energy Community

RE: Letter of Complaint of Gas Natural Fenosa versus the State of the Republic of Moldova

Dear Mr. Janet Kopac,
Dear Mr. Dirk Buschle,

By the present letter of complaint, Gas Natural Fenosa group, owner and operator in the Republic of Moldova of a distribution company and a supply company, would like you bring into the attention of the Secretariat of the Energy Community several recent facts that have occurred in Moldova in relation to the energy sector, which we are going to describe briefly next.


We believe that these facts constitute a basis for opening an infringement proceeding before Moldova based on the non-compliance with the Treaty establishing the Energy Community ("The Treaty") signed by Moldova and in particular with the objectives of creating a predictable regulatory framework, ensuring a stable investment climate and respecting the principles of non-discrimination and transparency. These principles are covered in the Treaty and in Directive 2009/72/EC.

Background

Gas Natural Fenosa (GNF) is an international energy group based in Barcelona, Spain. Gas Natural Fenosa operates in the gas and electricity sectors and today is present in 30 countries around the world, providing energy services for around 20 million clients and with a power generation installed capacity of more than 15,000 MW.

Gas Natural Fenosa is active in the Republic of Moldova since year 2000, when three state-owned electricity distribution enterprises were privatized. In 2008, these three Utilities merged into a single company: ICS RED Union Fenosa S.A., which is the subsidiary of Gas Natural Fenosa that distributes electricity in Moldova, serving almost 70% of the total electricity demand of the country. Since the privatization, Red Union Fenosa has cumulative invested more than US\$ 290 million, mainly in the electricity grid modernization. As mandated by the electricity law due to the transposition to the legal body of Moldova of Directive 2003/54/EC and Directive 2009/72/EC, and also as established in the Treaty establishing the Energy

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Vienna, 13 November 2017
MD-MC/O/ko03/13-11-2017

Subject: ECS-9/17 - Opening Letter


EXCELLENCY,

Please find attached the Opening Letter in reference to Case ECS-9/17.

Sincerely Yours,



Janez Kopač
Director



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new assets which would lead to an unnecessary increase in the tariffs. Under the first scenario, the tariffs would not allow the operator to recover the costs of the investments made into the networks. The second scenario is putting an unnecessary burden on the consumers and is therefore inefficient. Both scenarios do not correspond to the principles of cost-reflectivity and cost-efficiency, as defined above and as protected by Articles 37(1)(a) and 37(8) of Directive 2009/72/EC read in conjunction with Articles 2 and 6 of the Treaty.

IV. Conclusion

Based on the above preliminary legal assessment, the Secretariat preliminarily concludes that Moldova fails to comply, in the instances described above, with Articles 35(4), 35(5), 37(1)(a) and 37(8) of Directive 2009/72/EC read in conjunction with Articles 2 and 6 of the Treaty as well as with general principles enshrined in Articles 2, 6 and 94 of the Treaty.

In accordance with Article 13 of the Dispute Settlement Procedures, the Government of Moldova is requested to submit its observations on the points of fact and law raised in this letter within two months, i.e. by

1 February 2018

to the Secretariat.

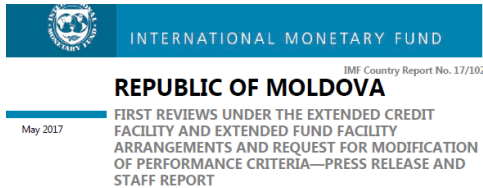
It is recalled that, according to Article 11(2) of the Dispute Settlement Procedures, the purpose of the procedure hereby initiated is to establish the factual and legal background of the case, and to give the Party concerned ample opportunity to be heard. In this respect, the preliminary procedure shall enable the Republic of Moldova to comply of its own accord with the requirements of the Treaty or, if appropriate, justify its position. In the latter case, the Republic of Moldova is invited to provide the Secretariat with all factual and legal information relevant to the case at hand.

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Bank	RefFin@ecmc.com
BAN	ATFA2002000151102825
BIC	RLNWITWW

Dispute and Settlement

Problem solving



In December 2017, another condition was set so that the new methodology would be developed in agreement with ECS and in consultation with WB.

In April 2017, a condition was included in the IMF Program requiring the agreement of ECS to any amendment to the tariff framework, which could affect the recovery of the arrears.

Table 2. Moldova: Prior Actions and Structural Benchmarks Under the ECF/EFF

Measure	Timeframe
Prior Actions for Board Consideration of the Review	
Energy Sector	
6 Increase the district heating tariff by an estimated minimum of 5 percent to allow for adequate investments and current payment obligations, subject to an agreement between ANRE and World Bank. (MEFP 113)	New
7 Increase the 2017 electricity tariffs that would maintain cost recovery and include the first tariff supplement, as a part of gradual repayment of the recognized financial deviations accumulated by electricity distribution companies. The base tariff adjustment will be made based on the existing methodology. If the base electricity tariff is adjusted based on amendments to the existing methodology, such amendments should be coordinated with, and not opposed by, the Energy Community Secretariat. (MEFP 113)	New

Table 9. Moldova: Proposed Prior Actions and Structural Benchmarks Under the ECF/EFF

Measure	Timeframe
Structural Benchmarks 1/	
Energy sector	
10 Develop, approve, and publish a new tariff methodology, in line with the new Energy law, and in agreement with the Energy Community Secretariat, and consulting with other stakeholders, including the World Bank, electricity distribution companies and CSO.	New Mid-February 2018



Macro-Financial Assistance to the Republic of Moldova
Grant and Loan from the European Union of up to EUR 100 million

MEMORANDUM OF UNDERSTANDING

between

THE EUROPEAN UNION

and

THE REPUBLIC OF MOLDOVA

and

THE NATIONAL BANK OF MOLDOVA
as the Beneficiary's Financial Agent

In November 2017, a condition was included in the EU Program to strengthen the tariff framework and comply with ECS recommendations.

ENERGY SECTOR REFORMS

Action 8

With a view to strengthening the governance and regulatory framework of the energy sector, including the independence of the National Energy Regulatory Agency (ANRE) and addressing the recommendations of the review of ANRE carried out by the Energy Community Secretariat, the Parliament will adopt the new Law on Energy.

Dispute and Settlement

Problem solving

In February 2018, the regulator approved a new electricity tariff methodology, in close coordination with ECS and in consultation with WB.

In June 2018, the 2018 tariff was set in accordance with the new methodology.

During the discussions, the parties have reached an understanding on the amendments made in 2017 regarding:

- The return on assets
- The Regulatory Asset Base
- The penalty for lower investments in 2015.

With the involvement of ECS and the international community, and the renewed approach of the regulator to recover the dialogue, important steps have been taken to resolve the dispute in place that since 2015 between Moldova and GNF. The last open point pending resolution is the determination of the OPEXs to be transferred to tariff.

Final Comments



- ❑ Three years of disputes have damaged both the reputation of GNF in Moldova and the image of Moldova among international investors.
- ❑ Acting in an unilateral way is not a better option than consulting with interested parties and reaching compromises.

❑ Importance to balance:

- Short-term: Lower Tariffs
- Long-term: Financial sustainability, investment capacity (quality of service), Predictability and Business Climate



Final Comments

- ECS has been an essential tool to find reasonable solutions accepted by both parties.

So...
If you want to
Surf on Big Waves,



...better have
ECS
on Board !

Thank you !



Muchas gracias

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Profitability of GNF in Moldova

- **The authorities claim GNF has a huge profit in Moldova**
 - ✓ For the first 10 years of operations, GNF companies in Moldova had negative accumulated Net Income
 - ✓ The cumulated Net Income since 2000 is 3.5 billion Lei, out of which, 729 million Lei (>20%) correspond to Tariff Deficit (accounts receivable yet to be collected)
 - ✓ GNF Group invested in Moldova US\$ 80.7 Million ⁽¹⁾ in years 2000 - 2003. Pay-back was reached in 2013. The internal rate of return is < 10% including residual value ⁽²⁾
 - ✓ The tariffs approved to the two state-owned distributors are 36% and 59% higher than the tariff applied to GNF

Notes

1: Purchase Price US\$ 27.3 M + Capitalized loans from GNF US\$ 59.2 M + EBRD shares US\$ 2.3 M

2: Moldova Country Risk Premium: Average 2000-2016: 10%; Current 2017: 9.25%. Moldova is B3 rated.