Structural Deficiencies, Regulatory Policy and National Regulator Malpractice in the Electricity Sector in Bulgaria

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Introduction

In response to repeated disputes between players in Bulgaria power sector, and to worrying signals of repeated regulatory failure and delayed liberalization, the Institute for Market Economics had undertaken analytical efforts to review the practices of the State Energy and Water Regulatory Commission (SEWRC), the national regulator. This report summarizes these efforts.

Independent regulatory agencies in the energy sector have been the subject of numerous studies, mainly focusing on factors that are key to ensuring adequate, efficient and impartial/non-discriminatory regulation. Such factors typically include political, corporate and financial independence, impartial and objective expertise, and a regulatory framework that sets the ground for binding decisions which are difficult to overturn. These and several other factors have been included in both European and national law regulating the energy sector in Europe.

Although the legal and regulatory framework in Bulgaria is generally in line with the good practices outlined by the European law, by and large they remain on paper and are not put into practice. **In recent years it has become an established practice for the Bulgarian Regulator to openly violate European and national law, its own Ordinances, and even long-term contracts and obligations.** The following report aims to outline some of the deficiencies in the regulatory process and the outright malpractice on behalf of the national regulator in the electricity sector, without claiming to be exhaustive.

These include:

- questionable independence of the regulatory body with signs of borderline coordination of its decisions with the executive body of the government;
- lack of expert staff and in-depth knowledge of the system;
- unpredictable market environment;
- insufficient efforts for creating a stable market environment (some regulatory decisions go as far as to inhibit the creation of such an environment);
- non-cost-reflective regulatory decisions; the use of cross subsidies both as a tool in the government's social policy and as financial support for uncompetitive companies;
- lack of transparency regarding the Regulator's decisions (there are even examples of Draft Ordinances and Regulatory Rules that have undergone public discussions but are later adopted with a different content);

- discriminatory treatment of market participants;
- arbitrary regulatory decisions and even regulatory failure.

Independence of the Regulator

Article 35, Paragraphs 4 and 5 of Directive 2009/72/EC concerning common rules for the internal market in electricity stipulates that member statesshall **insure the independence of the regulatory authority** both from public and private entities. The national provisions in response to this stipulation find their place in Bulgaria's Energy Law in a single line in Article 10, line 2 "The commission [SEWRC] is an independent specialized state body - a legal entity with headquarters in Sofia". As EC's report from May 2013 points out this **"does not explicitly spell out the more detailed independence requirements which the Third Energy Package establishes".**

According to Paragraph 5, line b) of the above-mentioned directive, "in order to protect the independence of the regulatoryauthority, Member States shall in particular ensure that […] the regulatory authority [...] has adequate human andfinancial resources to carry out its duties."

In view of this provision, the EC's report from May 2013 concludes that **"the financial and human capacity of SEWRC is inadequate"**. The entire staff of the commission numbers 128, of which the specialized administration includes 78 people (13 of these being in the ElectricityDirectorate and 14 - in the Economic Analysis and Customer Relations Directorate). No steps have been taken with regard to either recommendation.

In its September 2013 audit report the Bulgarian National Audit Office (BNAO) summarizes that during the period 01.01.2007 - 30.04.2013substantial personnel turnover took place in all structural units of SEWRC. An illustration of this trend is given by the case of the Legal Directorate, where no less than 50% of all 2007 employees quit their jobs. The situation in 2010 and 2011 was similar. In 2008, 9 out of total 10 employees quit. Within the other directorates, the turnover rate is the highest in the Directorate for Regulation and Control of the Natural Gas Sector in 2010 - 44% of actual employees. In the Heating Directorate the highest turnover rate – 38%, is registered in 2008. In the Electricity Directorate, 27% of all employees quit their jobs in 2010. After the establishment of the Directorate for Regulation and Control of Electricity & Heating Sectors, the turnover rate is 5 percent.

The Commission's report also draws attention to the high staff turnover, "which makes building a strong internal expert knowledge challenging". Furthermore in the period February-December 2013 SEWRC saw the change of 5 Chairmen and several members of the Regulator. These turnovers in the managing body of the SEWRC, as well as the fact that the Chairman and members of the Regulator are elected and can be dismissed by the Council of Ministers without any further sanction or possibility for appeal, **put into question the Bulgarian regulator's independence which is in direct violation of both EU and national law**. This concern is reiterated in a report of the World Bank,highlighting that **"the decision to decrease prices was pre-announced by the State officials and followed a change in the Energy Law allowing price decreases"**.

Furthermore, the criteria for selecting members of the Regulator can be described as insufficient.

Article 11 and 12 of the Energy Law introduce broad and vague criteria for the eligibility of the members – "experience in the energy sector" of at least 3 years. The other criteria, such as 10 years of working experience and university diploma, are not related to the person's expertise.

As already mentioned **Article 35,** Paragraphs 4 and 5 of Directive 2009/72/EC stipulates that member states shall **insure the independence of the regulatory authority** both from public and private entities.

However, the current SEWRC Director (appointed in mid December 2013) served at the time the head of the Bulgarian Energy Holding which is a state-owned company. The Holding company is the sole owner of: Mini Maritsa Iztok; Maritsa Iztok 2; Kozloduy NPP; Natsionalna Elektricheska

Kompania (NEK); Electricity System Operator (ESO); Bulgargas, natural gas monopoly; Bulgartransgas; and Bulgartel. The appointment raises the question of the independence of the head of the Regulator.

General and Specific Objectives of the National Regulator

Article 37 of Directive 2009/72/ECoutlines the duties of national regulators, which include:

- fixing or approving, **in accordance with transparent criteria**,transmission or distribution tariffs or their methodologies;
- ensuring that there are **no cross-subsidies between transmission, distribution, and supply activities**.

The Energy Law in Bulgaria goes a little further and Article 31 stipulates that in exercising its powers for price regulation SEWRC abides by the following principles:

- prices are non-discriminatory, based on objective criteria and are determined transparently;
- prices are cost-reflective with regard to economically justified expenses for core activities;
- prices provide an economically justified rate of return on capital;
- prices for different customer groups reflect the cost of supply of energy and natural gas to these customers;
- ensuring that there are no cross-subsidies between activities, subject to licensingand customer groups;
- equitable allocation of the cost of feed-in tariffs on consumers.

Separately, Article 36 of Directive 2009/72/EC stipulates the general objectives of the regulatory authority, which include:

- ensuring that **system operators and system users are grantedappropriate incentives**, in both the short and the long term,to increase efficiencies in system performance and fostermarket integration;
- helping to achieve high standards of universal and public service in electricity supply, contributing to the protection ofvulnerable customers.

The regulatory framework set by the SEWRC has been broadly in line with these general principles. For example, the Price Regulatory Framework for Bulgarian Electricity Distribution Companies, which has been in place since the privatization of the Electricity Distribution Companies (EDC) in the country, outlines the regulatory criteria for a 13-year period divided into three regulatory periods – 3-5-5 years. It also envisages that the main price-setting factors, including technological costs, remain unchanged during each regulatory period.

Unstable Regulatory Environment

However, **the price-setting decision of the SEWRC for the July 2010 – June 2011 price period (3rd year of the 2nd regulatory period) is in direct violation of the aforementioned requirement**. With its decision SEWRC sets the approved technological costs for the three EDC at 15%, which was calculated on the basis of the actual losses of only one company without taking into consideration the specifics of each individual company. As a result the principle of non-disctrimanatory treatment, the logic behind the regulatory policy until that moment, as well as the legal framework[1], have been breached. In 2011 a three-member panel of the Supreme Administrative Court (SAC) repealed the newly approved level of technological costs and in 2012 a five-member SAC panel confirmed the ruling. Nevertheless, the approved technological costs remained at 15% in the period July 2011 – March 2013.

[1]Bulgarian Energy Law, Article 23, Paragraph 1, Line 5

On 28 February 2013, the parliament amended the Energy Law, the amendments gave a green light to the SEWRC to violate its own ordinance. In particular, they made possible that the Regulator was henceforth granted the option to change the regulated electricity prices during a price period by:

- changing the energy purchases from producers for the needs of the regulated market;
- changing the technological costs of generation, transmission and distribution companies;
- changing other pricing elements.

These amendments are clearly in direct contradiction to the objective of creating appropriate incentives to increase efficiencies in the system and achieve high standards of universal and public service. They are also unpredictable, not transparent and lack the necessary justification as well as impact assessment. The amendments create an unpredictable regulatory environment and cannot facilitate, in any way, the achievement of high standards of services in the sector. Nor can they create the appropriate incentives to increase efficiencies in the system – in fact they act in exactly the opposite way, by providing disincentives for investment in efficiencies. Furthermore the amendments destabilize the overall investment environment in the country for two reasons:

1) they violate the Price Regulatory Framework for Bulgarian Electricity Distribution Companies, according to which the technological costs for the EDC are set once for each regulatory period, and are determined according to a formula within the said regulatory framework;
2) the addition of "other" pricing elements opens the door to regulatory arbitrariness given that it is subject to interpretation.

The unilateral decision by the SEWRC to reduce the technological costs in the price period July 2010 – June 2011 as well as the amendments to the Energy Law granting the Regulator the mandate to alter the regulatory approved level of technological costs at any time have financial consequences for the EDC.

The regulatory approved level of technological costs were reduced to 15% since July 2010 which, without a doubt, has contributed to the deterioration of the financial position of the companies.

As the Regulator reports in its Motives regarding its price decision from 05.03.2013 although the approved level of 12% return on capital in 2012 the actual ROC of CEZ is 8%, EVN – 9% and Energo-Pro – 3%. This decision is followed in 2013 by by three consecutive reductions in less than 9 months: 12% - since March 2013; 10% for CEZ and EVN and 11% for Energo-Pro – since August 2013; 8% for CEZ and EVN and 9% for Energo-Pro – since December 2013. **Without a doubt, the three consecutive reductions in the approved level of technological costs from 2013 will have an even larger negative impact on the financial position of the companies.**

These decisions lack an analysis of the specific situation of each company and do not take into account the reported levels of technological costs in networks with similar specifications. For example the Energy Community Regulatory Board gives a snapshot of technological costs in other countries in the region which are around 50% higher than the approved 8% level in Bulgaria.

While the Regulator is granted additional powers, **the SEWRC creates a regulatory vacuum** due to the lack of Instructions of the State Energy and Water Regulatory Commission for the Pricing of Electricity Distribution through the Distribution Networks, Regulated by Using the Revenue-Cap Regulation, for the third regulatory period.

This lack of explicit instructions is in direct violation of the regulator's own rules. The only instructions available are related to the capital structure of the companies (which should consist of 50% equity and 50% debt) and are included in the Instructions of the Regulator for the second regulatory period.

Another clear example of creating an unstable investment environment is the decision of the SEWRC for the third regulatory period August 2013 – June 2015 according to which the Regulator cut down the investment programs of the three EDC to € 0.

Cost-reflectivity of regulated prices

As the European Regulators' Group for Electricity and Gas has stressed on numerous occasions, competition in the energy sector is in the interest of customers, while price regulations hinder the smooth functioning of the market. Similarly the Energy Community Regulatory Board has reiterated the negative consequences of price regulation and has drawn attention to a more specific issue – the fact that regulators can set prices at non-cost-reflective levels[2]. Nevertheless such regulatory policies persist in Bulgaria and, as different studies have highlighted, the resulting financial distress, imposed on energy companies (for example, but not limited to, Natsionalna Elektricheska Kompania (NEK)) and the endangered viability of the whole sector, have been sure to follow.

One example of costs, which are systemically undervalued by the regulator, is the compensation for the feed-in tariffs for electricity from renewable sources.

- **The liabilities for purchasing energy from RES**, which have been recognized by the SEWRC, but have not been included in the final electricity prices, **sum up to € 162 mn[3] as of July 2012**.
- **During the July 2012- June 2013 price period these liabilities increased by just over € 221.9 mn**, including 26.5 mn leva related to the purchase of high efficiency cogeneration.
- In September 2012 SEWRCmodifiedthe compensatory mechanism, which was supposed to alleviate the costs for purchasing electricity from RES. It introducedprovisional fees for access to the electricity transmission and distribution networks paid by wind- and photovoltaic-powered electricity producers with feed-in tariffs. However, the Supreme Administrative Court repealed the access fees and ruled that the proceedsfrom these fees be restored to the energy producers.
- **The total amount to be restored, that has not been included in the consumer electricity prices for the August 2013 – June 2014price period, is more than € 98.2 mn.**
- In 2013 amendments to the Energy Law further modifiedthe compensatory mechanism for purchases of electricity from RES. The changes include the omission of green, high efficiency and unrecoverable expenses surcharges (9.36€/MWh) fromthe transmission fees and their transformation into a so-called public obligations price (8.37 €/MWh), which is applied to sales from suppliers in the regulated market, grid operators and suppliers of last resort. This was forecasted to lead to a deficit of nearly € 255 mn, which the regulator sought to balance with an additional financial inflowfrom the auctioning of greenhouse gas emission quotas pursuant to the Environment Protection Law. Initially the projected additional resources to be generated from the sale of greenhouse gas quotas amounted to € 255 mnfor the July 2013-June 2014 pricing period.However, proceeds from the auctions reached just € 43.8 mn in H2 2013 and the State Budget forecast for H1 2014 pins them at € 20.6 mn, **leaving a deficit of € 190.8 mn.** The reported proceeds for the first five months of 2014 reached as high as € 24.9 mn which can lead to a smaller deficit, but a deficit nonetheless.

Bottom line: **the deficit in the system solely from undervaluation of resources to cover the costs for purchases of electricity from RES with feed-in tariffs is projected to reach € 659.4 mn by the end of June 2014**.

In its price decision for the August 2013 – June 2014[4] price period SEWRC decreases the price for access to the transmission grid by 57.4%. In a statement by ESO, sent to SEWRC at the end of 2013,

[2]Vulnerable Household Customers - An ECRB Contribution to a Common Understanding (2009) andTreatment of thevulnerablecustomersinthe Energy Community (2011)

[3]The official fixed exchange rate of 1.95583 leva = € 1 has been used in all calculations; all values have been rounded to the fist decimal place

[4]The beginning of the price period was delayed by 1 month due to the Regulator's inability to come to a decision about the regulated prices

the company proposes that the Regulator return the price for access to the HV grid to its former level and at the same time – reduce the price for transmission through the HV grid, thus leaving the sum of the two prices, which is paid by the final consumers, unchanged. The company further elaborates that a decrease in the price for transmission would stimulate exports, but will lead to a financial loss for the company. However, the projected losses from lower transmission price are to be compensated by the increased price for access to the grid. **Yet, despite this statement, the Regulator approves a lower price for transmission, but keeps the price for access at its August 2013 levels.**

The financial result of ESO for 2013 equals a net loss of € 2.4 mn, which is considerably better compared to the previous year's net loss of € 19.5 mn. However, this is accompanied by an increase in the liabilities to related parties – € 14.6 mn, commercial liabilities –€ 16.5 mn and tax liabilities – € 2 mn. In other words, the financial result in 2013 is better compared to the previous year but if the additional increase in liabilities by € 33.1 mn total is added to current company costs, ESO's situation in 2013 appears to have worsened substantially.

The interim statement of ESO for the first six months of 2013 where data appear to be consistent with previous-year results, suggests that the deterioration of ESO's financial situation in 2013 has taken place in the second half of the year. This goes to show that SEWRC's decision from August 2013 to reduce the access price collected by ESO by 57.4% has had a negative effect on the company. Along with this, the green energy, high-efficiency cogeneration and unrecoverable costs surcharges to the transmission price were also reduced, which promoted exports and overall grid load. Yet, the load needs to be almost doubled in order to compensate for the loss of revenue, which is clearly impossible.

The situation in the first quarter of 2014 is even more disturbing since at the end of last year the regulator also reduced the transmission fee by 57.2%. As a result in the first three months of 2014 the revenues of the companyamount to € 47.9 mn, compared to € 62.4mn for the same period of 2013, which represents a reduction by approximately 25%. The financial result is not surprising – a net loss of € 6.9 mn in the first quarter of 2014 compared to anet profit of € 15.2mn in the same period of 2013. The addition to the increase in liabilities to related parties –by € 8.6 mn, and other liabilities – by € 19.3 mn paints an even grimmer picture. On this background, the decrease of commercial liabilities by some € 1 mn is hardly reassuring.

Although the Energy Law grants the SEWRC the right to recognize and approve all costs related to the operation of a company, the Regulator is not obliged to do so. As there are no guidelines, methodology or any kind of objective and transparent criteria related to the methods used by the SEWRC in approving such costs, this creates an environment for arbitrary decisions.

As a result is has been a regular practice for the SEWRC to undervalue the operational costs of the Electricity Distribution Companies(EDC) during the second regulatory period. It follows from these decisions that in order to continue their operations the companies have to fund themselves the difference between the approved level of operating costs and their real level. Another consequence of these decisions came to light after the SEWRC conducted its Regulatory Audit of the three Electricity Distribution Companies as it concluded that the reported operating costs of the companies were above the approved regulated levels. From this follows, the Regulator argued, that the companies are inflating their expenditures to unjustified levels and hiding profits and evading government taxes.

Another problem arises with respect to the approved amortization costs which, again, are undervalued during the second regulatory period so much so that their levels are even below the reported amortization costs during 2003. This means that the SEWRC refuses to approve amortization costs on new assets acquired as a result of the investment program of the EDC, which is a direct violation of the Energy Law (Article 31, Line 2 and Article 23, Line 9), the Ordinance on Electricity Prices (Article 13, Paragraph 4) and the Instructions of the State Energy and Water

Regulatory Commission for the Pricing of Electricity Distribution through the Distribution Networks, Regulated by Using the Revenue-Cap Regulation for the second regulatory period.

In its price decisions the SEWRC constantly refuses to approve the additional costs for End Supplier Companiesarising from their legal obligations to balance the supply from producers of electricity from RS and high-efficiency cogeneration of thermal and electric energy connected to the distribution grid and the demand from final consumers, which have not chosen to participate in another balancing.

In their public appearances[5] members of the SEWRC have stated that balancing costs attributed to End Supplier Companies will not be included in the final electricity prices for the regulated market.

Cross subsidies

Cross subsidies in the sector had been a common practice until the privatization of at least a part of the electricity system in the country. However, some of these malpractices have persisted and continue to distort the operations of the system. **An audit by the Bulgarian National Audit Office (BNAO) of the SEWRC, covering the period 01.01.2007 - 30.04.2013 and published in September 2013[6] shows that price distortions are still to be seen, allowing for, but not limited to**:

- cross-subsidizing of electricity and heating prices for domestic consumers at the expense of non-domestic consumers;
- illegitimate subsidizing of heating prices from heat and electricity cogeneration;
- low tax burden on energy products.

One example of the systemic defects of the regulated Bulgarian energy sector is the **cross subsidy between domestic and non-domestic consumers**. This is done via the energy price component since grid service fees (access, transmission and distribution) are the same for all consumers connected to a certain grid, domestic or otherwise. The comparison of the weighted average price of electricity for domestic and non-domestic consumers connected to the low-voltage grid after the March 2013 price changes shows that this defect is expanding. **As of 30.04.2013, the price charged to domestic consumers was 3.43€c /kWh, or by 2.46€c/kWh lower than the price charged to non-domestic consumers connected to the low-voltage grid.**

The aforementioned average prices were calculated on the assumption that domestic and non-domestic consumers use double-tariff electricity meters and the daytime/night-time consumption ratio is 70:30.

Lack of transparency

The same report by BNAO also notes that **the Regulator's activities with regard to changes of rules, methods, instructions and other documents take place non-transparently**. There is no timely announcement of intended changes or presentation of the amended normative act to the attention of interested parties. On publication of the new document, amendments therein go unspecified which makes comparison of new and old texts difficult. Rationale of the changes is not provided and there is no opportunity for objections; interested parties remain unaware of amendments and cannot provide opinions thereon. This is in contrast to the requirements for justification, stability, openness and coordination set forth in the Normative Documents Act.[7,8]

[5] http://www.standartnews.com/mneniya-intervyuta/nyama_prichini_da_poskapne_tokat-238793.html
[6] http://www.bulnao.government.bg/bg/search/download/6420/Doklad_DKEVR_0913.doc
[7] Normative Documents Law,Article 26, Paragraph 1
[8] AR № 8 -letter № E-05-00-42/03.04.2013 and AR № 4 – Expert opinion statement № 1 – q. 11 and q. 12

These conclusions are reiterated in a report by the Supreme Administrative Prosecutor's Office (SAPO) regarding the SEWRC[9]. It draws attention to the fact that there are no guidelines, procedures or rules for determining the price for preferential purchase of electricity from RES. The methodology for determining the surcharges for the purchase of green energy is unclear. The SAPO concludes that the lack of guidelines and clear regulatory framework have inflicted financial loss on NEK.

According to the Energy Act, the Regulator's decisions must be justified. **In its report the BNAO conludes that the majority of decisions lack the rationale behind the methods employed for pricing of electricity, heat and electricity cogeneration, natural gas and the link between them.**

Decisions for the period 2007 – 2012 only contain information on the new prices approved by the Regulator without any comparative data about adjustments of previous pricing decisions. The Regulator's decisions lack information about applicable prices of natural gas, heating energy or electricity by company which would facilitate users' awareness about price changes and would make historical comparisons possible.

The Regulator has the authority to set so-called availability quotas - the amount of electricity to be purchased by NEK on the regulated market from each power generator. For its quota, every electricity producer is obliged to conclude sales contracts at regulated prices with the Public Provider (NEK).

Such an obligation, without a doubt, inhibits free competition and is designed to mitigate the negative effects on final consumers, stemming from the process of energy price liberalization, the BNAO concludes.[10] This is also reiterated in the World Bank's report. However, its temporary enforcement can be justified due to the relatively low price levels at the beginning of reforms in the Bulgarian energy sector, which had been maintained artificially with the help of budget subsidies and at the expense of industry decapitalization. Even if this mechanism is not prohibited by EU law, its functioning in Bulgaria is not transparent, leading to an infringement procedure against the country in 2008. After the adoption of the Method for Setting Electricity Generation Capacity at Regulated Prices[11], the procedure was closed. **Nevertheless, the quota system has not been improved and the level of transparency remains poor.**

Unequal treatment of market participants

Apart from the examples of violation of the above-mentioned principles, some of the Regulator's decisions have been in direct contradiction to the principle of non-discrimination of separate market participants. Examples of discriminatory regulation by the SEWRC are particularly exemplary with regard to renewable energy producers.

In September 2012 SEWRC modifies the compensatory mechanism, which is supposed to alleviate the costs for purchasing electricity from RES. It introduced provisional prices for access to the electricity transmission and distribution networks paid by wind- and solar-powered electricity producers with feed-in tariffs.

However, **the Supreme Administrative Court repealed the access prices and ruled that the proceeds from these prices be restored to the energy producers.** As a result the Regulator introduces a new price for access to the transmission grid amounting to 1.25 €/MWh which is paid by all wind- and solar-powered producers, that did not appeal against the overturned decision, as well as by those with regard to whom (as of the date of enactment of the decision for approval of final access prices) there are no cancelling rulings entered into force. The prices are owed to the Electricity System Operator by all producers of wind- and solar-powered electricity, purchased at preferential prices, regardless of theconnection point. **This is yet another example of a biased decision by the**

[9] http://www.prb.bg/main/bg/News/3427/
[10] Bulgarian Energy Law, Article 21, Paragraph 1, line 21
[11] Decision № 31/09.03.2009.

Regulator, which represents unequal treatment of companies even in the same segment of the market, lack of transparency in the decision-making process, lack of argumentation and impact assessment.

The unequal treatment extends to the EDC since **the regulator does not introduce a price for access to the distribution grid, despite the fact that the three companies have presented reports to the Regulator showing the additional costs associated with the production, distribution and balancing of electricity from RS**. However the SEWRC turns a blind eye to these references. Furthermore, the price for access to the transmission grid from producers connected to the distribution grids would be paidto the EDC, which then transfer the proceeds to the ESO. With its decision the Regulator imposes the obligation on the EDC for the gratuitous collection of external claims (those of ESO) and the responsibility associated with it, in the absence of a legal basis for such an obligation. This leads, without a doubt, to additional costs for these companies, which are not met with an additional revenue source.

The State Budget for 2014 and amendments to the Renewable Energy Sources Law (Article 35a, Paragraph 2) from 5 December 2013 introduced a new tax for wind-powered and photovoltaic electricity producers equal to 20% of their revenues. **This creates an uneven playing field for different producers of electricity from RS and is undoubtedly discriminatory.**

Furthermore, high-efficiency cogeneration of electrical and thermal power also benefits from preferential prices, but is not subject to the new tax.

The 20% reduction in income can be treated as a fee if the Regulator can present a well-argued case showing that these additional funds are required to compensate arising costs from the generation of electricity from wind and solar powered plants.

As of today, the Regulator has not presented such arguments, which is why the reduction in revenues should be treated as a tax, which violates several European and national legal frameworks as well as the logic behind conducting regulatory policy.

Considering the abovementioned nature of the revenue reduction the new 20% tax is in effect a 20% reduction in the feed-in tariff. This is a direct violation of the established provisions of § 17, Paragraph 3 of the Transitory and Final Provisions of the Renewable Energy Law and Article 31, Paragraph 4 of the same law which provide that the preferential price cannot be changed for the entire duration of the purchase agreement entered into between the power plant and the buyer of electricity.

Article 31, Paragraph 2 of the Bulgarian Energy Law states that the prices of energy companies shall recover the economically justified costs of their activity. All economically justified costs of the energy companies in terms of access are covered by the defined and already applicable prices under the Regulator's price decisions from 29.7.2013 and 30.12.2013.

Fixing of prices for access for renewable energy producers will actually lead to a double payment and additional revenue to the benefit of the electricity distribution and transmission companies which completely contradicts the regulatory framework.

An investigatory article in the *Sega* daily shows that for the first quarter of 2014 € 11.7 mn have been collected from the tax and have been transferred onto the SEWRC account. In response to the question of *Sega* what the collected amount will be used for, the Energy Regulator has explained that these are state fees and the Regulator has no commitment to how they will be distributed. A representative of the Ministry of Economy and Energy, in turn, said that the issue was not in their remit. **This development further strengthens the case that the new reduction in income has the characteristics of a tax rather than a fee (as it collects money for a state institution with no specific purpose, i.e. for no specific service) and raises more questions regarding its legitimacy.**

SEWRC's projections for income from the aforementioned tax amount to € 76.7 mn in 2014, however the data presented in the article of *Sega* Daily suggest that this is overly optimistic. One reason is the treatment of electricity producers from RS, whose production capacities are continuously limited by ESO. According to Article 73, Paragraph 1 of Energy Law the Operator of the transmission grid can impose limits on producers of electricity when the integrity of the electricity system is under threat (Line 3). Limitations can be imposed for no longer than 48 hours. However, there are no other rules, guidelines or methodologies according to which ESO makes the decisions to limit the production capacity of one power plant or another.

This, again, creates a regulatory vacuum and opens the door to discretionary regulatory policy, which is not transparent and can be harmful to both consumers and producers.

Arbitrary regulatory decisions or regulatory failure

Several of the above-mentioned flaws of the regulatory policy in the sector fall into different groups of principles that have been violated. That is certainly the case with the amendments introducing a permanent price for access for the wind- and solar-powered generations with feed-in tariffs. Costs that are caused by the purchase of electricity from renewable power plants are not included in the price for access to the network by final consumers.

As per the model established by the Energy Law, the cost for purchase of electricity from renewable energy sources shall be distributed among all network users through a green energy surcharge included in the price for transmission of electricity. In this sense, the cost of integrating the renewable power plants and their management are not included elsewhere as a pricing component. **Introducing permanent charges for electricity producers from wind- and solar-powered generations with feed-in tariffs is, therefore, a direct violation of the logic behind the Energy Law, on one hand, and a double taxation, on the other[12].**

In the beginning of April 2013 the SAPO publishes its findings from the inspection of the activities of NEK, ESO and SEWRC[13]. Based on them Sofia City Prosecutor's Office forms 5 pre-trial proceedings.

The following proceedings in draw attention:

Against unknown perpetrators - allegedly guilty officials in NEK. During the period 2001-2012, in Sofia, there is evidence of deliberate mismanagement on behalf of NEK, and the lack of maintenance and preservation of the entrusted property regarding agreements with AA-AES Maritza East 1 and Contour Global Maritsa East 3. As a result NEK has incorporated significant damages and the case is particularly serious - a crime under Article 219, Paragraph 4 in connection with Paragraph 3 in connection with Paragraph 1 of the Criminal Code.

Against an unknown perpetrator - allegedly guilty officials from the SEWRC. During the period 13.09.2012-14.09.2012 there is evidence of violation and/or neglecting duties under the Energy Law, Statutory Rules of the Regulator relating to the opening and examination of the administrative file formed by the applications of the Electricity System Operator,CEZ Distribution Bulgaria, EVN Bulgaria Electricity, and Energo-Pro networks regarding the issuing of the Regulator's decision from 14.09.2012 in order to provide for himself and/or another material benefit and this could cause major adverse effects – a crime under Article 282, Paragraph 1 of the Criminal Code.

Despite the fact that SAC repealed the September 2012 decision of SEWRC to introduce provisional fees for access to the electricity transmission and distribution networks paid by wind- and

[12]As already mentioned the green energy surcharges to the transmission price of electricity through the HV grid have been transferred directly to the price of electricity, paid by final consumers on the regulated market. The additional price is also borne by the participants on the unregulated prices and is paid to NEK in its function as a Public Provider.

[13]http://www.prb.bg/main/bg/News/3430/

photovoltaic-powered electricity producers with feed-in tariffs the Regulator has not updated its Methodology to compensate the cost of the Public Provider and End Suppliers of resulting from imposed obligations to the public for the purchase of electricity at feed-in tariffs from renewable energy sources and high-efficiency combined heat and electricity generation. Furthermore, the SAC ruled that the proceeds from these fees are to be restored to the energy producers, therefore **the Regulator has to decide on a new mechanism for the compensation of these costs by the Public Provider and End Suppliers. As of May 2014 no such steps have been taken.**

There are examples of Draft Ordinance and Regulatory Rules that have undergone public discussions are later adopted with different content. Such examples include Electricity Trading Rules from May 2014; Rules for Measuring the Amount of Electricity from November 2013; Methodology to compensate the cost of the Public Provider and End Suppliers of resulting from imposed obligations to the public for the purchase of electricity at feed-in tariffs from renewable energy sources and high-efficiency combined heat and electricity generation from 2012.

The system for the preferential purchase of electricity from RS at feed-in tariffs works as follows:

- an End Supplier Company buys the produced energy from the producers and then sells it to the final consumer at a regulated price;
- the company then transfers the proceeds from its final customer to NEK;
- after NEK has received the payment it then compensates the End Supplier Company for the preferential purchase of electricity from RS at a level of 100%.

However, as a result of the non-cost-reflective regulatory policy of SEWRC with regard to the purchase of electricity from RS at feed-in tariffs the End Supplier Companies start withholding some of the funds they should transfer to the NEK up to the amount of 100% of their costs for the preferential purchase of electricity from RS. The NEK makes an official complain to the Regulator, which in mid March 2014 starts a procedure to revoke the licenses of the three End Supplier Companies on the basis that they threaten the stability of the Electricity System. In an interview in *Standard* Daily from 22.05.2014[14] a member of the SEWRC that the procedure will be closed if the private companies reach an agreement with the NEK and pay the withheld amounts. **This is in direct violation of the law-established procedure and can be even viewed as an act of arm-twisting.**

[14]http://www.standartnews.com/mneniya-intervyuta/nyama_prichini_da_poskapne_tokat-238793.html