Energy Community Dispute Resolution Forum

Gas Natural Fenosa vs Moldova

(Sailing in Troubled Waters)

September 27, 2018
Gas Natural Fenosa in the World in Moldova
Gas Natural Fenosa in the World

- **EBITDA**: €3,915M
- **Assets**: €47,332M
- **Customers**: 18+ M
- **Employees**: 15,375

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

Mexico
Gas distribution and electricity generation.

Puerto Rico
NG/LNG infrastructure and generation of electricity.

Dominican Republic
Electricity Generation

Costa Rica
Electricity Generation

Panama
Electricity distribution and generation

Colombia
Gas distribution, electricity distribution

Brazil
Gas distribution

Argentina
Gas distribution, Electricity Distribution

Peru
Gas Distribution (start gasification)

Chile
Electricity Transmission and Distribution, gas distribution

Spain

Portugal
NG/LNG commercialisation and commercialisation of electricity

France
NG/LNG commercialisation

United Kingdom
NG/LNG commercialization, GN/GLN infrastructure

Belgium
NG/LNG commercialisation

Netherlands
NG/LNG commercialisation

Luxembourg
NG/LNG commercialisation

Italy
Gas commercialisation and distribution, Regasification.

Germany
NG/LNG commercialisation

Moldova
Electricity distribution

Korea
NG/LNG commercialisation

Japan
NG/LNG commercialisation

India
NG/LNG commercialisation

Oman
NG/LNG supplying and infrastructure

Morocco
NG/LNG infrastructure

Algeria
NG/LNG supplying and infrastructure

Angola
NG/LNG infrastructure

South Africa
Coal supplying

Egypt
NG/LNG supplying and infrastructure

Kenya
Electricity generation

Australia
Wind generation projects

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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)

Note: Figures as of December 31, 2017.
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

Productivity reached via the introduction of international best practices
Gas Natural Fenosa in Moldova

Operational expenses

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

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.
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.

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).
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
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

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
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.
Dispute and Settlement

Problem solving

In Abril 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.

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

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