

EFET POSITION PAPER

Acceleration and deepening of liberalisation of
energy markets in Europe
- necessary provisions for new Energy Directive

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Acceleration and deepening of liberalisation of energy markets in Europe – necessary provisions for a new Energy Directive

The European Commission has been set the task, by Member States, of producing a plan for the accelerated liberalisation of the gas and electricity markets in Europe. It seems likely that a new Energy Directive would be part of this plan. This paper sets out some fundamental provisions which EFET believes should be covered in a new Energy Directive so that liberalisation can be truly effective. We assume that any such legislation would be brought forward as a series of amendments to the 1997 and 1998 Electricity and Gas Directives. However, we have not attempted at this stage to describe the precise location nor wording of any amendments.

1. Market opening

Many countries now have plans for full market opening. Recent government announcements have been made about proposals for the acceleration of gas and electricity market opening in Austria, Belgium, the Netherlands and Spain. Some countries have not come up with any plans to accelerate full market opening, namely France, Italy, Portugal and Greece. A future Directive should call for full market opening by a date certain even if setting that date requires the granting of minor derogations. A case for distinguishing the timetables as between gas and electricity could be made because gas liberalisation has started later, not because it is more difficult. So it may be reasonable to mandate full **electricity** market opening **by 2004**, and full **gas** market opening **by 2005**. Another alternative would be to set a later date for domestic customers, although this does raise problems with definitions.

There are many necessary conditions for a successful competitive energy market. Two important aspects would be capacity release programmes (thereby starting to address market dominance) and effective systems for allowing the easy transfer of customers between competing suppliers. However, the most important condition is successful TPA.

2. Strengthening Third Party Access (TPA)

The Directives allow Member States to choose their access regimes. Most countries have chosen RTPA (Regulated Third Party Access), as opposed to Negotiated Third Party Access (NTPA). Experience in liberalised markets demonstrates that securing access to networks and related services can require significant regulatory input.

Even in Germany, which has opted for NTPA in both gas and electricity, the Cartel Office has been considering an increasing number of cases. Experience also shows that an NTPA system is likely to evolve into an RTPA system, as regulatory decisions make precedent. On that basis, it would seem to make sense for the Commission to provide more guidance on the form of access. Such guidance should, at a minimum, include rules on the issues identified under succeeding headings of this section 2.

a) Unbundling

The Electricity Directive requires managerial separation of the monopoly businesses from potentially competitive businesses. The Gas Directive requires accounting separation only. Experience from other liberalised markets highlights the importance of significant separation of monopoly activities from potentially competitive activities. Unbundling can help prevent discrimination against third parties in favour of affiliates and abuse of dominant position by a vertically integrated incumbent. It can also facilitate cost-transparency and regulatory intervention in case any of these problems arise. Finally, a suitably separated, and incentivised transport system operator can relieve regulatory burdens.

For the separation of activities to be truly effective and verifiable, we advocate separation beyond solely accounts unbundling and separation of management and information, to require physical, legal and financial separation of affiliate entities. Physical, legal and financial unbundling would imply separation of management structures, staff (including their career development), assets and liabilities, cash and debt management, information systems and buildings. Such separation also has relevance for the lower tiers of the transport network, generally known as distribution systems.

Looking at the experience with the Electricity Directive to date, there have been allegations that access to the network has been hindered due to the integrated nature of the companies offering system access. Also, there are instances, in several countries, of applications for access to the system resulting in the supply affiliate of the transportation business making competing offers to customers, implying a leakage of information between businesses.

We believe that all this points towards further unbundling than is currently included in the Gas and Electricity Directives. As argued above, we believe that the amended Directives should require physical, legal and financial separation. We also think that

the standard for management unbundling in gas should be brought up to that in electricity. Stricter unbundling should be accompanied by a requirement that Member States introduce effective monitoring and enforcement measures, so that it is achieved in reality.

b) Access to the system for all contracting parties

Successfully liberalised markets demonstrate a wide range of parties that need access to the system - suppliers, distribution companies, shippers, traders and end users being five distinct groups. The implication of 100% eligibility is that there would no longer be a need to define 'eligible customers.' As such, access to the system should be guaranteed under the new Energy Directive for all users and potential users of the system, subject of course to any reasonable licensing requirements. An example of this broad definition can be found in the Danish Electricity Supply Act. Users of the system was defined to include those companies that use the system for transportation of electricity only, for example companies that trade in electricity, (as well as customers and generators). Another successful example of dealing with this problem can be found in the existing German legislation, which gives broad rights of access without any such listing or any definitions at all. Such provisions and their application have reinforced the successful opening of the wholesale German power market.

A similar broad definition in the text of the Directive would exclude the possibility of discrimination against wholesale intermediaries. There is, of course, an alternative solution, which would entail exhaustive listing out of the categories of possible users of the system, but this appears unnecessarily cumbersome

c) Access to all services on like terms

The existing Directives call for non-discriminatory access to the transmission system. In both gas and electricity, access to transportation capacity is a necessary, but not a sufficient, condition for ensuring efficient, liquid and truly competitive markets. Thus, the availability of appropriate, economic balancing services from a network operator is an example of a highly important service to new market entrants. The necessity of third parties being able to contract for such a service has been recognised by the Commission in electricity (in the form of a concession in a merger case) and in gas. Access to storage, for example, is crucial for the gas sector and denial of such a

service to a market participant would virtually prevent it from exercising its right to supply gas to customers.

d) Information

It is difficult to over-estimate the importance to suppliers of information about the monopoly transportation networks. Such information includes capacity availability, prices, terms and conditions for access and network maps. The Commission could specify the information which Member States should require network operators to divulge. A starting point would be the information that the Commission has identified by published by the TSOs as part of the Florence and, we hope, the Madrid processes.

3. Cross-border issues

Creating a single European market for energy requires resolving access to networks within countries, as well as access to cross-border capacity. The Florence and Madrid processes have been used as a way of addressing these cross-border issues. However, it may be time that the valuable work of the Florence and Madrid processes are codified into a new Directive. Areas to be included would be -

a) Obligations for Transmission System Operators (TSOs)

We believe that the new Directive should include guidelines for the Member States on the obligations they should impose on their TSOs. Such guidelines should necessitate that the TSOs duly publish their available transfer capacity so that this information is accessible by all users of the system. Such guidelines should include measures that would encourage TSOs to use market based methods for increasing available capacity (through methods such as counter-trading or redispatch) and for allocating this capacity to all users on a non-discriminatory basis (via market splitting, implicit auctions based on commodity price, or auctioning of the capacity). These guidelines should certainly, whatever the methodology, require the application of the 'use-it-or-lose-it' principle in capacity allocation. Grandfathering of capacity reservation by TSOs for their affiliates should be forbidden, wherever the corresponding long-term commodity contract has not been explicitly approved by DG Competition. Also, where such capacity is reserved, it must be on the basis of the existing commodity contract, not a subsequently renegotiated version.

b) Congestion management

Physical upgrades to the existing cross-border transmission capacities are not necessarily the only solution to congestion problems. Market-based mechanisms, offering a more efficient utilisation of the capacity effectively available at present, often represent a viable alternative to the construction of a new capacity, especially if temporary market disparities or distortions may be overcome and dominant flows then change. To realise this potential, TSOs should manage existing interconnectors in such a way as to minimise inter-transmission system constraints. To achieve this, regulators may need powers to incentivise the TSOs and oblige them to co-operate with each other (see section above).

c) Interoperability issues

The introduction of competition in the electricity market has changed the flows of power between countries. In gas, the majority of gas consumed, even in unliberalised state of continental markets, has crossed a border, implying that issues of interoperability have been overcome. In this light therefore, there should be a requirement to explain how cross-border issues should be overcome. Another idea would be to require TSOs to develop, with interested parties, standard trading contracts at major trading locations.

d) Transit

Eligible customers already have the right to seek transmission access within a country in order to seek competitive supplies. However, not every Member State extends this right of transmission access explicitly to capacity used for transit (i.e. taking power or gas across a country's grid, rather than producing it or delivering it in that country). Before the energy Directives were adopted, there were the Transit Directives. These gave high voltage grid operators and gas pipeline operators the ability to transport electricity and gas transacted between themselves across each other's systems. A future Directive could repeal the Transit Directive, substituting a mandated explicit right of all third parties to have non-discriminatory access to grids for transit purposes.

e) Cross-border charges

Cross-border charges on the EU level have not been addressed in gas yet. In electricity, the Florence forum sessions have created a framework for discussions on the principles of transmission tariffication on a pan-European level. The consensus achieved at the recent Florence session in March 2000 has been against any

transaction-based tariffs and against any charges to be imposed on import or exports solely. We believe that there must be some provisions in a new Directive on the principles of a system of non-discriminatory, cost-reflective and transparent tariffs across borders even if the precise mechanisms of charging are left to subsidiarity.

Summary

EFET welcomes the Commission's proposals to accelerate the pace of liberalisation. The issues discussed above demonstrate that merely mandating 100% eligibility will not, in itself, deliver to customers the benefits of competition. Rather, the Commission must, as far as possible, deliver third party access, in practice, rather than theory. The Florence and Madrid processes still have much important work to do.