Energy: rules for the internal market in electricity. 'Electricity Directive'

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The European Commission has published its Annual Report on the Implementation of the Gas and Electricity Internal Market.

The new electricity and gas Directives were due to be transposed by Member States by July 2004 and the Regulation on cross border electricity exchanges also came into effect. The new rules are aimed at achieving to a competitive electricity and gas sector across the whole European Union as envisaged by the Lisbon Council objectives.

However, many aspects of implementation remain disappointing. In October 2004, eighteen Member States had to be sent a letter warning that they had still not fully notified to the Commission the legal measures taken to transpose the latest Directives. This delay is unsatisfactory since it is now clear that the provisions of the previous Directives have not been adequate to achieve the objective of competition, even for larger users. Such customers would normally be expected to negotiate with suppliers on a regular basis. However after five years of competition for electricity and over three years for gas, fewer than 50% have switched supplier in most Member States. In addition, many are unsatisfied with the range of services being offered. In many cases, customers have only been able to change to another domestic supplier with the result that penetration of national markets by foreign

companies is also disappointing in many cases, reflecting a lack of integration of markets and missing infrastructure links. In most cases, foreign suppliers represent less than 20% of market share.

Although electricity prices are lower than 1995 in real terms, they have increased in the last 18 months, partly due to increased prices for primary energy sources. At the same time, gas prices are higher than in 1995 due to the ongoing linkage with oil. Although such price fluctuations are normal, increases are unpalatable to customers where the prospects for changing supplier appear to be limited by regulatory barriers and where the negotiating power of customers is weak due to an unfavourable market structure. Particular concerns exist among the largest users that suppliers are failing to offer an adequate range of contract structures, especially longer term arrangements.

A key issue relates to the failure to fully integrate national energy supply into a wider European market. In this context it is vital for rules on cross border electricity exchanges to continue to be improved to ensure that existing infrastructure is utilised to its maximum possible extent. Likewise for gas, the adoption and implementation of the proposed Regulation is similarly important. New investment in infrastructure is also needed and progress in this regard remains slow, as was also noted in the Commission Communication on Energy Infrastructure and Security of Supply.

Secondly, Member States are still failing to deal with the issue of market structure. As has been highlighted in previous reports, the gas and electricity markets in too many Member States are dominated by one or two companies, and there is often inadequate capacity for cross border competition. It is imperative that solutions are found to such problems.

Thirdly, although much process has already been made in terms of unbundling of network operators and the introduction of regulated third party access, there are still certain aspects which remain unsatisfactory. A fully independent transmission system operator is crucial for a well functioning market. Likewise distribution system operators need to be adequately separated from supply companies to ensure cost

reflective tariffs and the removal of any cross subsidies. The independence of regulators is crucial in this respect in order to ensure fair network access in terms of tariff levels and structure. In this respect the gas sector is measurably behind that for electricity.

A final group of issues which may tend to be an obstacle to the internal market is the continued existence of a regulated end user prices for electricity and gas alongside the competitive market and associated long term power purchase arrangements (PPAs). Although such controls are a valuable transitional measure during the initial phase of market opening, there are risks that such an approach will stifle competition, constrain investment and confuse and contradict unbundling measures.

The report states that Member States need to maintain their commitment to this objective in the decisions they make regarding the implementation of the Directives and restructuring of the industry. It is only be doing this that the objective of a competitive and secure market will be achieved. With this in mind, the issue of investment in infrastructure and the sound operation of networks, in support of the competitive market, remains a critical issue. Although some of these issues have been addressed the concerns which were expressed in previous Communications and the proposed Directive on Infrastructure and Security of Supply remain pertinent and progress, in some form or another, is required on this issue. The role of independent regulators remains a crucial component of the introduction of competition and their decisions relating to network tariffs and other important market rules will continue to shape the development of the market. In this context it remains important to ensure that authorities have sufficient resources and competences. Whether the improvements made under the Directives are adequate to achieve the objectives of the internal market remains to be seen, especially if Member States take a minimalist approach to the transposition of the current legislation. One thing that is certain is that in the new global environment of higher primary energy prices it is more important than ever for the Community to live up to its commitment to a competitive market.