

Prospects for the internal gas and electricity market

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PURPOSE: to present a report on the prospects of the internal gas and electricity market.

CONTENT: this communication outlines the conclusions from the experience gathered over the last seven years in putting into effect a competitive European market for electricity and gas. This initiative has been a qualified success. While there are some positive results, the outcome of the sector inquiry and the country reviews have given the Commission a substantial insight into the current state of the liberalisation process, which has shown, despite significant shortcomings, some progress and considerable further potential benefits.

On the one hand, during this time, the basic concepts of the internal energy market have become embedded in terms of the legal framework, institutional arrangements and the physical infrastructure such as IT equipment. However, at the same time meaningful competition does not exist in many Member States. Often customers do not have any real possibility of opting for an alternative supplier.

Even customers who have successfully changed supplier are often not satisfied with the range of offers they receive. In summary, stakeholders do not yet have a high degree of confidence in the internal market.

As a consequence of these shortcomings, the Commission has, throughout 2005-06, been conducting an inquiry for the gas and electricity sectors under competition law.

The Commission thinks that it is now time to examine other options which should be pursued in completing the internal energy market. The key outstanding issues are as follows:

1) Ensuring non-discriminatory access to networks through unbundling: legal unbundling of TSOs has already led to an improvement in third party access (TPA) to networks. Basic principles of non-discrimination have been established and, for the most part, tariff structures have been developed which encourage the development of competition. Although progress has been made since 2004, the evidence reported from both the country reviews and the sector inquiry indicates that legal and functional unbundling as currently required by the legislation is not sufficient to ensure that a real competitive European market for electricity and gas can develop.

The Commission has examined the unbundling issue closely and concluded that only strong unbundling provisions would be able to provide the right incentives for system operators to operate and develop the network in the interest of all users.

It is therefore considering two main avenues for further TSO unbundling measures, with a view to making formal proposals:

- **fully (ownership) unbundled TSOs:** the TSO would both own the transmission assets and operate the network;
- **separate system operators without ownership unbundling:** this solution would require separation of system operation from ownership of the assets. The Commission will examine both options closely with respect both to the electricity and gas networks taking account of the individual

characteristics of each sector. The objective in both cases will be to ensure fair network access for all companies and ensure that sufficient incentives are in place for TSOs to provide adequate capacity, notably through new infrastructure.

2) Improve regulation of network access at national and EU level: the Commission has, therefore, come to the conclusion that energy regulators need to be strengthened at national level and have the required level of discretion to take decisions on all relevant issues. The Commission considers that regulators need strong ex-ante powers over the following areas: i) all aspects of third party access to networks, ii) access to gas storage, iii) balancing mechanisms, iv) market surveillance of e.g. power exchanges, v) compliance with functional and account unbundling for distribution system operators, vi) all cross border issues, vii) consumer protection including any end-user price controls viii) information

gathering, ix) sanctions for non-compliance. It therefore intends to propose a strengthening of the Directives on this basis. It is also essential to ensure that decisions at national level do not have an adverse effect on the aspects most critical for market entry and the evolution towards an EC internal market, respectively for gas and electricity. To this effect, certain individual national regulatory

decisions, in particular as regards cross border issues and the effective development of

competition, should be notified to the Commission.

3) Reducing the scope for unfair competition: many national markets are characterised by high levels of concentration and consequent concerns about wholesale market manipulation. Both gas and electricity markets are susceptible to concentration due to the existence of pre-liberalisation monopolies and their natural characteristics. In the short term, market participants have identified a range of other possible measures that would also assist the process of moving to more competitive and contestable electricity and gas markets and which relate to: a) transparency, b) contract structures and c) gas storage. The Commission therefore intends to examine measures which would best balance the need for effective access with maintaining incentives for new storage developments. This may need a specific regulatory framework requiring the following: a) legal unbundling, b) the adoption of binding guidelines following further advice from ERGEG, and c) increased powers of regulatory agencies over gas storage on an individual facility basis.

4) Co-ordination between transmission system operators: gas and electricity needs to be able to flow freely across the European Union in accordance with compatible technical rules. In order to achieve this, it is essential that TSOs make sufficient transmission capacity available to meet demand and integrate national markets without jeopardising the quality of supply. The network in the Member States was designed to fit the needs of many partitioned national markets not those of a single European one. The TSO group may be required by the Commission or the regulators, in particular in view of ensuring security of supply, to report on European grid operation and investment as well as the development of technical standards for network security. It could also, in particular, be responsible for monitoring the developments of networks so as to improve the transmission capacities between Member States. Efforts should also be made to have a gradual evolution towards regional system

Operators such as the setting up of cross border system operators. These would be independently owned and would require additional unbundling as discussed above.

5) Providing a clear framework for investment in generation plant / gas import and transmission infrastructure: increased regulatory certainty at EU level will act as a significant magnet to further investment and help deliver security of supply. Creating a stable and attractive environment for investment must be a priority of future action at EU level. It should be emphasised that, in the energy

sector as in other sectors, creating a framework necessary to increase investment in R&D and innovation should be a priority at EU and Member States levels. Trends in RTD investments in the energy sector will be closely followed.

6) Issues relating to households and smaller commercial customers: from 2007 all electricity and gas customers will have the right to switch supplier from the historical incumbent. There are a range of outstanding issues that need to be resolved in order for this final phase to be successfully realised. Country reviews suggest that there are several Member States where the preparation for full market opening in 2007 is not well advanced, while the sector inquiry has also confirmed significant obstacles at the distribution level.

A clear picture of the national measures that Member States have taken to transpose the energy Directives with regard to consumer rules is not available. Existing data suggests that Member States have made rather limited use of targeted PSOs to address vulnerable customers. Indeed only half the Member States have even attempted to define this group and only five have any form of social tariffs. There are also substantial differences in terms of compensation for supply interruptions – only 8 Member States have refund systems – and codes of conduct for transparency of prices and contract conditions.

The Commission will therefore assess the national legislation in this field, its impact on operators as well as on households. In particular through the infringement procedures, it will provide guidance as to compliance of national measures with Community law. The Commission will also keep under constant review the retail markets to assess the effects of liberalisation on households, in view of increasing consumers' confidence in the energy market and limiting the risk of market manipulation.

Finally, the Commission will launch a major information and awareness raising campaign in the run up to full market opening in July 2007, and intends to develop an **Energy Customers' Charter** to (i) tackle fuel poverty, (ii) improve the minimum level of information available to citizens to help them choose between suppliers and supply options (iii) reduce red tape when customers change supplier and (iv) protect customers from unfair selling practices in compliance with the relevant EC directives. The Commission will also examine whether further specific action is required in this area of smart metering.

The Commission has already initiated an impact assessment procedure to identify the most suitable methods for implementing these intentions in practice. It will conclude this exercise later in 2007. A further Communication including detailed formal proposals to the Council and the European Parliament will be produced.

The Commission calls on the Council and European Parliament to confirm that the key objectives to be pursued in completing the internal energy market are those identified by the Commission and to endorse the Commission's intention to table further measures to ensure that they are achieved.