

COMPLETING THE INTERNAL ENERGY MARKET: THE MISSING STEPS

1. In the old days of national monopolies, energy utilities were under Government's "command and control". The benefits and costs of this approach were supported by consumers and utilities according to national criteria. Cross-border energy trade was limited to wholesale transactions among incumbent utilities, cross-subsidies between different groups of national consumers were tolerated, some utilities were subsidised while others were not sufficiently remunerated. Since there was no competition among utilities and no choice for consumers, national decisions had no direct impact upon utilities or consumers in other countries.
2. Directives 96/92/EC (electricity) and 98/30/EC (natural gas) established the legal basis for the Internal Energy Market. Millions of eligible consumers are already free to choose their electricity or natural gas supplier in any Member State of the European Union. Energy undertakings are free to trade and to invest in all Member States. This means that national energy systems are now open. Political, legislative or regulatory decisions concerning energy investment and trading frameworks in one Member State have a potential impact upon all Member States. Acquisition, investment or trading decisions by one energy undertaking have a potential impact upon all EU energy markets. However, the Internal Energy Market is still far from being a reality.
3. The Internal Energy Market provides new opportunities to energy consumers and to energy undertakings. It has the potential to increase economic and technical efficiency, as well as security of supply, thus improving European welfare and the competitiveness of European industry. It can also be an important tool to reinforce political and economic links with Eastern European and South Mediterranean countries, thus contributing for stability and development in these areas.
4. If the Internal Energy Market is not properly organised, and if the increasing interaction between national political, economic and institutional decisions is not duly taken into account, it may engender inefficiencies, leading to high energy prices and poor quality of service and even endangering security of supply.
5. Completion of the Internal Energy Market is a complex and relatively slow process. It is strongly influenced by the different speeds of national legal, institutional and industry developments. The present stage of the Internal Energy Market is a critical one. It is the duty of energy regulators to point out the present difficulties and to suggest appropriate solutions leading to fair, efficient, secure and integrated energy markets in the European Union.

6. The five major factors hindering the fast development of a single energy market may be grouped into the following categories:
- Lack of transmission capacity (in particular, cross-border interconnection capacity).
 - Lack of transparency in network access conditions (including network access tariffs and congestion management).
 - Lack of transparency in the technical operation of interconnected systems.
 - Lack of robust, deep and liquid organised energy markets in most geographical areas.
 - Lack of transparency and predictability concerning rules applied to the approval or refusal of mergers and acquisitions in the energy field.
7. Transmission capacity, in particular cross-border interconnection capacity, is essential for the development of efficient energy trade and for increasing security of supply. While a few new interconnectors are under construction and the European Council requested electricity interconnection capacity to be substantially increased by 2005 (up to, at least, 10% of the installed production capacity in each Member State), five main problems remain:
- Administrative procedures are too lengthy and sometimes prone to political interference, leading to unreasonable delays and even, in some cases, to project cancellation.
 - The allocation of interconnection capacity to long-term contracts between utilities reduces the available commercial capacity in some areas.
 - Vertically integrated utilities usually have no interest in developing new interconnectors.
 - Special regimes applied to the construction, operation and use of merchant lines may reduce the commercial capacity available to network users in general and discourage the expansion of public networks.
 - Some degree of coordination among those responsible for transmission network planning and construction is necessary if “patchwork” solutions are to be avoided.

Recent initiatives from the European Commission related to energy infrastructure recognise some of these difficulties and will lead to suitable solutions.

A clear and integrated map of transmission capacities available and under construction in Europe is urgently needed, both for electricity and for natural gas.

8. Transmission networks were not developed in order to support efficient trade. Distribution networks were not developed in order to support the efficient integration of decentralised generation into the electricity system. Therefore, network planning – and not only interconnection planning – must be adapted to the new requirements, in order to ensure quality and security of supply under new market and environmental conditions.

9. Transparency in network access conditions must be improved in order to ensure fair treatment of all network users, independently of their size, nationality, contractual arrangements or ownership.

Trust in the independence and non-discriminatory behaviour of Transmission Systems Operators (TSOs) is strengthened by their full separation from any other interest in generation, trading or supply. Ownership unbundling, although introduced in an increasing number of Member States, is not yet fully applied. This situation is particularly worrying in those countries where independent energy regulators have not yet been appointed (Germany and even more Switzerland).

In order to ensure non-discrimination, network access tariffs must be fully cost-reflective. Cross-subsidies between different activities (e.g. transmission and generation in vertically integrated undertakings) or between different groups of consumers (e.g. low-voltage and high-voltage) result in harmful distortions of competition.

The recent Regulation (EC) n° 1228/2003 of the European Parliament and of the Council on conditions for access to the network for cross-border exchanges in electricity lays down basic principles with regard to tariffication and capacity allocation. Regulatory authorities and the European Commission will co-operate in order to ensure appropriate compliance with the Regulation and full transparency.

As a consequence, from 2004 on, access to electricity networks will be more transparent throughout Europe. A similar Regulation for natural gas is needed.

10. Transparency of network access and efficiency of network operations is better ensured when the TSO is also the owner of all relevant transmission assets.

11. Technical coordination among TSOs is essential for the proper operation of the interconnected electricity and natural gas systems. Lack of coordination has two major inconvenients- it may:

- jeopardise reliability and security of the interconnected systems;
- limit the commercial freedom of network users beyond strictly necessary levels.

The technical rules, procedures and criteria governing operation of the large interconnected EU energy systems have to be adapted and rewritten, taking into account the complexity resulting from the increasing number and diversity of commercial transactions taking place nowadays. They shall be prepared by TSOs, approved by regulators (since they may have impact upon costs and competition) after extensive consultation of all stakeholders and made public; review procedures shall be transparent and known in advance.

Following the CEER's request at the Electricity Regulatory Forum in February 2002, European TSO associations are working towards the definition of a comprehensive set of common security and reliability standards. Similar efforts should be developed by natural gas TSOs.

12. The step-by-step completion of the Internal Energy Market requires the increasing convergence of regional markets. However, in some regions organised energy markets still do not exist and in other regions the existing markets are not robust, deep and liquid enough. The design and implementation of efficient energy markets (electricity and gas) in Europe should be a high priority. Well functioning market must also provided appropriate risk management instruments: in a market environment, vertical integration is not necessarily the most efficient mechanism.
13. Moving from national monopolies to EU electricity and gas markets requires important adjustments to the present energy industry structure. EU energy markets cannot function properly without a reasonable number of energy undertakings selling their products and services in several Member States. Restructuring of the energy industry will bring more innovation and more efficiency to energy markets. Therefore, it is important that national governments and competition authorities co-operate among themselves and with the European Commission in order to implement a coherent policy regarding the approval of merges and acquisitions, as well as the assessment of market power. Energy regulators have signalled their will to co-operate towards this common goal.
14. The recent Directives 2003/54/EC (electricity) and 2003/55/EC (natural gas) provide a clear framework for completing the Internal Energy Market. The way forward was jointly defined by the European Parliament and by the Council.

The CEER will work with the European Commission, in close co-operation with all relevant stakeholders, in order to ensure that the Internal Energy Market, through appropriate regulation, will fulfill consumer expectations in terms of price, quality and security of supply.
15. Recent – unrelated – incidents that affected many electricity consumers in Europe may be the consequence of some factors described above which hinder the development of a single energy market. They are not a consequence of liberalisation and integration of European electricity market. These problems have been identified, as well as their respective solutions.

Some people believe that the Internal Energy Markets magnifies the risks and reduces opportunities. The CEER thinks the opposite is true. Therefore, we will endeavour to complete the Internal Energy Market as soon as possible, according to the mandate which was given to us by the Member States, by the European Parliament and by the Council. The CEER are working towards the completion of the Internal Energy Market to ensure that European consumers obtain the full benefits of liberalised markets as well as secure supplies of energy.

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