



Compatibility of National Legal Conditions Concerning Regulatory Competences

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1 Introduction / background

1. The independent national regulatory authorities have a key role to play in the overall framework of European and national legislation concerning the liberalisation of the energy markets. The actions of properly resourced and empowered regulators are an important mechanism by which the legislative framework has its effect, and the liberalisation process is driven forward.
2. If the liberalisation process is to be successful, electricity and gas consumers must benefit from increased efficiency of the supply industries as well as a high quality of the networks. It is therefore logical that the over-arching aim of regulators should be to protect the interests of consumers¹. The natural monopoly parts of the industry (i.e., the networks) cannot be opened to competitive pressures through liberalisation, and thus efficiency improvements must be achieved through price or revenue controls set by regulators. The parts of the industry which are not natural monopolies can be opened to competitive pressure, thereby driving improvements in efficiency (and innovation). Both these processes (regulation and opening to competition) require regulatory oversight. The interface between the competitive and the monopoly parts of the market requires particularly detailed regulatory oversight, especially where there is common ownership of monopoly and competitive parts of the industry (because of the risk of discrimination).
3. The aim of regulators – i.e. protecting the interests of consumers- is therefore discharged by a combination of regulating network monopolies, driving forward the introduction of competition and monitoring its progress, and exercising oversight of the proper separation between networks and the competitive parts of the industry.
4. In the context of the development of a competitive single market for electricity (and gas) across the EU, these aims take on a European context. National regulators' competences need to be compatible and complementary in order to develop the EU energy market.
5. This paper sets out EREGG's view of the national legal conditions concerning regulators competences, with a view to exploring and identifying the extent to which these may need enhancement. Chapter 2 begins with an examination of the present day legislative basis and competence set. Chapter 3 gives a broad discussion of what the 'in principle' competences might need to be, both in a national and 'cross border' context, allowing chapter 4 to make an assessment of what gaps might exist in terms of a comparison of the present and 'in principle' competences. Chapter 5 sets out recommendations.

¹ Consumers means all end customers. There is no inherent conflict between the interests of consumers and the legitimate interests of the energy industry. For example, a decision to reduce the industry rate of return below the cost of capital would prevent future investment, and thus harm consumers' interests.

2 Review of regulators' powers as given in legislation

2.1 Introduction

6. At an EU level, the legislative basis for the powers and competences of the regulators is given in the electricity and gas Directives (2003/54/EC and 2003/55/EC) and in the Regulations 1228/2003 on electricity and 1775/2005 on gas. The Commission Decision establishing the EREG² also contains certain provisions relating to regulatory competences.
7. At a national level, regulators have been prescribed powers and competences according to national legislation, which at a minimum are required to implement this EU legislation. National legislation in addition will vary in the extent and manner in which regulatory powers and competences have been given.
8. This chapter describes regulatory powers and competences in terms of the EU and national legislation.

2.2 European legislation

9. The Electricity Directive - as well as the Gas Directive - requires Member State to give responsibility for a number of decisions to designated "regulatory" or "competent" authorities. Article 23 of the electricity Directive provides for a set of competences for regulatory authorities.

Overview powers and competences

10. According to European legislation, the **aim** of regulators (regulatory authorities) is at least to ensure non-discrimination, effective competition and the efficient functioning of the energy market.
11. The scope of regulator's powers (**breadth**) covers, in general terms, network regulation (i.e. for electricity, transmission and distribution), ensuring effective competition, monitoring the level of transparency and competition, implementation of unbundling rules, and managing the interface between network monopolies and the competitive industry.
12. In terms of **depth**, European legislation establishes a distinction between the key tasks of regulators and other items over which regulators are also given responsibility:
 - key tasks (Article 23, paragraph 2): regulators intervene both on an *ex ante* and *ex post* basis. A key task is the approval of network access tariffs and conditions. Regulators must approve methodologies for tariff setting in advance (i.e *ex ante*) for both network access and balancing services. They can also change individual tariffs, *ex post*.

² Commission Decision of 11 November 2003 on establishing the European Group for Electricity and Gas.

- other items (Article 23, paragraph 1 and 4): Regulators must both monitor current practice and intervene if necessary regarding the :
 - o management and allocation of interconnection capacity;
 - o mechanisms to deal with congestion on a national basis;
 - o time taken by transmission and distribution undertakings to make connections and repairs;
 - o publication of appropriate information;
 - o effective unbundling of accounts to avoid cross subsidies and setting of compliance programme;
 - o connection of new producers;
 - o compliance of transmission and distribution system operators with the Directives and Regulation;
 - o level of transparency and competition.

Independence

13. The issue of **independence** is addressed in Article 23 of the Electricity Directive, which provides that “these authorities shall be wholly independent from the interests of the electricity industry”. This therefore does not necessarily require the regulator to be separate from existing government structures, and leaves open the possibility that in some countries regional government might have some regulatory tasks. As explained in a note of DG Energy and Transport³, this requirement also allows local regulators to deal with certain responsibilities since it states there may be more than one regulator. It may also be possible for one regulatory authority to deal with one issue, say network tariffs, and a different body to be established to deal with other issues, for example the requirements on unbundling.
14. Nevertheless, the Directive, according to Article 23, section 3, allows the intervention of a relevant body to review the regulator’s decision (even where the decision concerns one of the regulator’s key tasks, e.g. approval of network access tariffs, or decisions on exemption to normal access rules for new investments). The relevant body can accept or reject the regulator’s decision but cannot amend it. In case of rejection, the relevant decision must be published including its justification.

³ Note of DG Energy & Transport on Directives 2003/54/EC on the Internal Market in Electricity and Gas: the Role of the Regulatory Authority.

Enforcement and penalties

15. The question of penalties is according to present legislation one for *subsidiarity*. There are only some general requirements in the Directive providing that “undertakings are operated in accordance with the principles of this Directive, with a view to achieving a competitive and sustainable market in electricity” and that “regulators are able to carry out their duties referred to in paragraph 1 to 5 in an efficient and expeditious manner”. Other sanctions are mentioned in the Regulation under Article 12, which have to be defined by Member States or decided by the EU Commission.

Review of decision

16. The Directive, according to Article 23, section 3, does allow for the possibility that a Regulator’s decision (even where the decision concerns one of the regulator’s key task e.g approval of network access tariffs, or decisions on exemption to normal access rules for new investments) can be reviewed by the relevant Ministry. More specifically the relevant body can accept or reject the decision; it may not amend the decision of the regulatory authority.
17. Any party who is affected by the regulator’s decision on network tariffs or tariff methodology and who has a right to complain under national legislation may submit a complaint for review. Any such complaint must be made within two months of publication of the regulator’s decision or proposed decision. Such a complaint shall not have suspensive effect.

Monopoly regulation

18. In the area of **monopoly issues**, regulators are responsible for fixing or approving at least the methodologies used to calculate or establish the terms and conditions for connection and access to national networks, including transmission and distribution tariffs, and the provisions of balancing services.
19. They shall have the authority to require transmission and distribution system operators, if necessary, to modify the terms and conditions, tariffs, rules, mechanisms and methodologies, and to ensure that they are proportionate and applied in a non-discriminatory manner.
20. Regulators act as a dispute settlement authority, where a party has a complaint against a transmission or distribution system operator. The decision issued by the regulator has binding effect unless and until overruled on appeal.
21. As provided for by Article 23.1.e, regulators must monitor the effective unbundling of accounts, in order to ensure that there are no cross subsidies between generation, transmission, distribution and supply activities. Therefore for example, where TSOs and DSOs are combined operators, they required to submit their compliance programme to the regulator according to Article 17(d).

Competitive market issues

22. Regarding **competitive issues**, regulators may monitor the level of transparency and competition. The electricity Regulation grants them the power to exempt new interconnectors from TPA and regulation, provided, among other things, that the investment enhances competition in electricity supply⁴.

Cross border issues

23. There is some legal basis for **cross-border issues** in the Directive and Regulation on cross border trade of electricity. Under the Regulation on cross border electricity exchanges, the regulatory authority must :
- approve of general schemes for the calculation of the total transfer capacity;
 - decide on exemption to normal access rules for new investments;
 - ensure compliance with all binding guidelines adopted under the Regulation;
 - cooperate in order to meet the requirements of the Regulation.
24. Regulators are also required to contribute to the development of the internal energy market and of a level playing field by cooperating with each other and with the Commission in a transparent manner. Also, in the event of cross border disputes, the deciding regulatory authority shall be the authority which has jurisdiction in respect of the system operator which refuses use of, or access to, the system.
25. These provisions are complemented by the Regulation (regulators shall ensure compliance with the regulation on conditions for access to the network for cross-border exchanges in electricity), and by the Commission Decision establishing the ERGEG. According to Article 1.2 of the Decision, “the Group, at its own initiative or at the request of the Commission, shall advise and assist the Commission in consolidating the internal energy market (...). The Group shall facilitate consultation, coordination and cooperation of national regulatory authorities, contributing to a consistent application in all Member States of the provisions set out in the Directives”. According to the Decision, ERGEG is to comprise the heads of national regulatory authorities, where each authority has been established according to the requirements of Directives 2003/54/EC and 2003/55/EC.

⁴ Article 7.

2.3 National legislation

26. In December 2005, CEER published a Regulatory Benchmarking Report⁵, in the form of tables, providing information on the status, resources and competences of the 27 energy regulatory authorities that are members of the CEER. The tables show that the powers of national regulators vary widely. For example :

- **breadth:** some regulators are responsible for or at least have a role in monitoring security of supply (e.g. Austria, UK, Finland, Greece, Hungary, Ireland, Italy, Malta, Norway, Slovak Republic, Spain, Sweden) while others play no role in this area;
- **depth:**
 - o *budget and number of staff:* regulators are very different (of course it depends on the size of the energy market, of the level of competition); the following energy regulators have budgets that are subsumed within the larger budget of a parent organisation: Denmark, France, Germany, Norway and Slovak Republic;
 - o *financial penalties:* in the following countries, regulators have the power to penalise financially sector participants for failure to comply with license requirements and /or primary and secondary legislation: Cyprus, Czech Republic, Denmark, Estonia, France, Germany, UK, Greece, Hungary, Latvia, Lithuania, Malta, Norway, Poland, Portugal, Slovak Republic, Sweden, Luxembourg. This is not the case in the following countries: Austria, Finland, Ireland, Slovenia and Spain.
- **independence:**
 - o *political intervention:* all regulators are separate from the Ministry. However, the relevant ministry retains some powers to approve, reject or amend regulatory decisions in the following countries: Austria, France, Germany (instructions have to be explained and published), Greece, Italy, Malta, Norway, Slovenia and Spain;
 - o appointment, restrictions, security of tenure for regulators: in most countries regulators have security of tenure.

⁵ CEER Regulatory Benchmark report, December 2005 (C05-IEB-08-03) - http://www.ceer-eu.org/portal/page/portal/CEER_HOME/CEER_PUBLICATIONS/CEER_DOCUMENTS/2005 .

- **monopoly issues:**

- *network tariffs*: most regulators are the authority for transmission and distribution network tariffs. However, in the following countries, the relevant Ministry is in charge of making the final decision: France, Greece, Hungary, Slovenia, Spain, Luxembourg. In some other countries, detailed prescriptions regarding tariffs are already contained in legislation: e.g. Germany, Slovenia.
- *unbundling*: some regulators have the power to establish guidelines on separate accounts (e.g. in Denmark, Estonia, Finland, France, Greece, Ireland, Italy, Latvia, Lithuania, Norway, Portugal, Slovak Republic, Sweden) while the other regulators do not have this competence. However, the differences in industry structures need to be taken into account (ownership unbundling in some countries);

- **competitive issues:**

- *Market dominance and cooperation with NCAs*: in the following countries, the regulator is responsible for compiling information on market dominance and/or cooperating with NCAs: Austria, Cyprus, France, Germany, Ireland, Italy, Lithuania, Malta, Poland, Portugal, Slovak Republic, Slovenia and Spain. In other countries, other bodies (e.g. national competition authority) are in charge of compiling information on market dominance. Some regulators are also a competition authority (e.g. in the UK), while others do not even cooperate with the NCA;
- *Regulated tariffs*: in some countries, regulators retain powers to monitor and enforce wholesale and / or retail price controls, while yet in other countries ministries or local administrations have these powers.

3 Regulatory powers and competences

27. The appropriate regulatory powers and competences will depend on market conditions and dynamics. In an ideal electricity market characterized by proper separation of monopoly network from competitive activities, and where competition is effective at the production and retail levels, it is appropriate that regulators concentrate on such matters as monitoring and understanding the market, including the *ex ante* regulation and oversight of network activities and tariffs. .
28. Where markets are in a transitional stage, regulators in general require appropriate powers in order to oversee and expedite the transition, for example to ensure that wholesale market rules are imposed that facilitate competition and do not facilitate exercise of any market power. Given the position of EU energy market liberalization, in general most national energy markets remain in this transitional phase and so the scope of powers and competences described below are given in this context.
29. It is also worth recalling that it is possible in principle and under law for regulatory competences to be allocated among more than one authority in Member States. The 'in principle' set of powers described in this chapter remains open therefore to such an allocation, subject to national subsidiarity.

3.1 Core elements for regulators

30. A core set of powers are needed in order for regulators successfully to achieve their aim, and so perform their essential roles of ensuring that the benefits of liberalisation flow to consumers, contributing to the success of the liberalisation process as a whole, and managing the transition to a mature and effectively competitive single market. Overall these can generally be summarized as :
 - **Aims:** in order to be clear about the scope and decision framework for the regulator and regulated parties, it is necessary that the overall objectives or aims of the regulator are clearly specified, because it is the fundamental justification for action (as described above); this indicates - in general terms - *what* the regulator is supposed to achieve.
 - **Breadth:** the remit or scope of the regulator's powers needs to be right, in order to be able to achieve the defined aims — i.e. how wide is the regulator's sphere of action? For example, the scope could specify which activities (e.g., generation, supply) require regulatory oversight, as well as any general monitoring functions. This would cover, in general terms:
 - o network/ tariff regulation, including price and quality of service
 - o consumer protection
 - o implementation of unbundling rules, and managing the interface between network monopolies and the competitive industry
 - o implementing detailed rules such as network codes

- general monitoring of the energy industry and information gathering powers, to oversee proper market functioning
 - monitoring security of supply issues
 - **Depth:** the powers of the regulator need to be strong enough (ie what tools does the regulator have), and must cover monitoring and enforcing of compliance with regulatory decisions. The regulator must be able to:
 - require companies to produce information needed to determine compliance with regulatory decisions
 - enforce decisions (i.e., punish non-compliance, e.g. with penalties)
 - **Independence:** the regulator must, of course, be free from industry influence. It is also necessary for the regulator to be independent of political influence concerning its regulatory decisions. The regulator is to achieve the aim set out for it in law, using only those actions within its remit. At the same time, however, it is also important that there is an appropriate appeals mechanism for regulatory decisions (in order to encourage high-quality decision-making by the regulator). This can be achieved if :
 - regulatory decisions take place within the full judicial framework, the regulator is free from political interference
 - security of tenure is guaranteed
 - the intervention of the government must be minimised, ideally so that there is no overlap with that of the regulator (and certainly ministers should not be able to substitute their own decision for that of the regulator). Any roles and powers that are reserved to government should be transparently described, including the circumstances in which they might be exercised. This is particularly important where the state or other official entities own or control regulated companies or market participants.
31. The following detailed examples of necessary regulatory powers are powers which are essential tools for a regulatory authority to be able to meet its statutory objective.

3.2 Monopoly issues

32. In the area of networks, regulatory authorities should be able to carry out and if appropriate enforce the following activities in relation to all network operators:
- approve and monitor compliance with the basic rules for access to (and ongoing use of) the system, with oversight of the more detailed rules or industry codes (including approval of changes to those detailed rules) and request changes to these rules where necessary.

- approve tariff methodologies and/or levels for use of the system and connection, taking into account the need to maintain and/or improve quality of service and efficient cost levels
- resolve disputes between network operators and market participants/customers on key issues such as terms for network access and charges
- require that information is made available to wholesale and retail market participants on a non-discriminatory basis and in a timely manner, where this would improve the effectiveness of competition
- approve and monitor compliance with (and oversee changes) to balancing rules
- impose sufficient controls on network operators to:
 - o address concerns about actual or potential discrimination, including cross subsidisation, preferential treatment for affiliates
 - o implement (and enforce) unbundling arrangements
 - o oversee that they have the necessary funds to carry out their activities
 - o provide for the safe, economic and efficient development and operation of the network
 - o set appropriate quality of service targets, in order to guarantee that economic efficiency is not obtained at the expense of quality of supply

3.3 Competitive market issues

33. One of key tasks of the regulatory authority described in Directives is to ensure effective competition as well as the efficient functioning of the market. Moreover regulators should play a key role in the creation of the internal pan-EU competitive market. It is therefore very important that regulators are responsible for at least presenting independent advice on any policy evaluated by government related to energy sector which may influence the good functioning of the market, such as ownership policy or consolidation processes. For example if the consolidation process affects fair competition in a national retail market, there is no basis for the creation of an internal EU market since small consumers may not be able to freely choose an independent European supplier.
34. In relation to wholesale and retail markets the extent to which regulators will need to take action within the market is likely to change over time, as competition develops. For example, in a fully competitive retail market it will not be necessary for regulators to regulate end user prices. However, the taking of relevant measures where required should be the responsibility of the regulator and as such regulators should be able to :

- approve and monitor compliance with the market rules for wholesale and retail markets (including rules relating to the operation of balancing markets, settlement rules, imbalance arrangements and credit requirements)
- require that key market related information is made available to wholesale and retail market participants and/or network operators, where this is necessary for effective competition or efficient system operation
- impose sufficient conditions on generators and suppliers in order to:
 - o ensure compliance with market rules in order to protect the interests of customers and promote effective competition
 - o ensure that there is no undue discriminatory treatment
 - o promote security of supply and safety
- impose sufficient conditions on suppliers to protect the interests of retail customers including:
 - o where appropriate, rules on marketing of services to household or other small customers
 - o rules relating to the switching process
 - o any rules necessary to discharge public service obligations (typically set by the government)

3.4 National / cross border context

35. As European markets become increasingly regional in nature, and the extent of cross-border trade increases, it is important that 'regulatory gaps', i.e. differences in competences within national markets as opposed to those available to oversee cross border interactions, do not open up in respect of the breadth or depth of the powers of national regulators. As further moves are made towards regional markets, and ultimately single European markets for electricity and gas, disparity in the regulators' roles within individual member states can cause increasing difficulties and may significantly undermine market development (and thus impede cross border trade).
36. In any case, the regulatory competences described above increasingly need to be deployed in a cross border manner. Regulation of monopoly activities concerning transmission infrastructure will require some form of cross border competence such that regulators can for example act jointly in order to oversee TSO investment in and operation of the transmission network in order that appropriate cross border transmission capacity is provided. This will necessarily require the recognition that a regulator in formulating decisions for his/her own territory will need to take into account the interests of customers in the neighbouring markets.

37. Such actions will need to be complemented with an ability for regulators to exchange market sensitive or confidential information, and pursue or request investigations of activities that occur in one territory that affect markets in another.
38. An example of this concerns Norway, where the need to exchange information has now been recognized in legislation. The Norwegian Energy Act was amended 1 July 2006 in order to allow exchange of information subject to a statutory duty of secrecy (confidential information). Such information shall be given to the EU Commission and the EFTA Surveillance Authority provided that a justified inquiry is produced, and that the information is essential and proportionate to ensure that tasks pursuant to the EEA agreement are accomplished. The Norwegian Water Resources and Energy Directorate may exchange such information after consultation with the Ministry of Petroleum and Energy. The Norwegian regulator has also been delegated authority to exchange information, subject to a statutory duty of secret, with energy authorities in other member states of the EEA agreement (EU, Iceland and Liechtenstein). The assumption is that such exchange is essential to fulfil Norwegian obligations, and that the information is necessary to promote regulation of the energy market. Confidential information shall be subject to duty of secrecy with the receiver, and may only be exchanged to other parties pursuant to approval.
39. Summarizing, regulators are likely to need the following cross border competences:
- mandate to recognize customers' interests in adjoining or pan-EU markets, including
 - possibility to mandate cost transfers where costs arise in neighbouring markets that benefit customers in a particular market (e.g. transmission infrastructure investment or operation)
 - possibility to co-operate and act jointly with other regulators. This will include :
 - ability to exchange information
 - request and pursue market investigations, perhaps in co-operation with relevant neighbouring regulators
 - effective decision making processes to decide on joint actions
 - possibility to co-operate jointly as appropriate with competition authorities

4 Assessment of areas to be addressed

40. This chapter makes a first assessment of the gap that is seen to exist between the 'in principle' set of powers and competences discussed in Chapter 3 and those already given in law, set out in Chapter 2. The aim is to provide a first view of the omissions that may need to be filled.

4.1 Independence

41. European legislation only provides for regulators to be independent from the industry and in practice, a significant number of regulators are not free from political interference. Regulators should retain the final decision in their area of competences, especially when they are fulfilling their key tasks (e.g. network tariffs). Full independence is likely to be better assured where regulators have their own sufficient resources and have security of tenure, but ultimately can be guaranteed only by legislative action. These issues are not, in ERGEG's view, sufficiently addressed in either national or EU legislation.

4.2 Enforcement and penalties

42. Experience within Europe demonstrates that the creation of competitive markets requires strong and independent regulation, but it is also clear that the creation of laws and market rules will not be effective if they are not adequately monitored and enforced. However, the powers of national regulators vary widely. ERGEG believes that it is essential that the powers and independence of regulators be raised to the level necessary for them to undertake their role of implementing and overseeing competitive markets effectively.
43. Present legislation at an EU level provides few direct bases for regulators to be given sufficient enforcement powers, for example to introduce proportionate penalties. To some extent therefore there is arguably a mismatch at the EU legislative level between a number of the duties and functions that regulators are expected to undertake, for example relating to oversight of transmission tariffs and so on, and the means to be able to enforce rules and policies to fulfil these duties.

4.3 Monopoly Regulation

44. EU legislation provides a certain minimum foundation for the regulation of monopoly network activities, as described in the section on European legislation in chapter 2.
45. In ERGEG's view these competences do not give the regulators a detailed oversight of network market rules, tariffs, and monopoly activities. Regulators are not directly empowered in a broad sense to set or approve network tariffs on the basis for example of the objective of direct references to costs or efficiency targets or the incentivisation of network operators to achieve efficiency savings. The oversight of detailed network activity rules, which might be necessary to ensure efficient market functioning, appears not to be mandated.

46. In sum ERGEG would suggest that regulatory powers, given in EU legislation, regarding regulation of network activities tend to be narrow and relatively inflexible.

4.4 Regulation of competitive market activities

47. The EU legislation is relatively silent on the regulatory oversight of competitive activities, requiring only that regulators 'monitor' the market. ERGEG would argue that regulators need to take an active interest in the development of the competitive market, and that this will include a role in approving or vetoing market rules, as well as powers to gather appropriate information and oblige market players to act in a pro competitive and non-discriminatory manner, and in advising on government policy regarding the energy sector. These activities will be particularly important where the regulator is overseeing the transition from a pre competitive to a fully competitive market.

4.5 Unbundling

48. European legislation only provides for a limited role for the regulator in this area. ERGEG considers that progress is required in this area. In the absence of ownership unbundling information ring fencing and oversight is one mechanism which can help to reduce the possibilities for discrimination against network users. There should be strict arrangements for the management of information held by TSOs and DSOs to ensure that it is put into the public domain where possible, or strictly ring fenced where publication is not possible or is only possible with some delay.
49. ERGEG has developed Guidelines for Good Practice (GGP) with respect to information transparency and management in electricity and for unbundling – similar work is envisaged for gas. These GGPs could be used as an input to the development of new legislation. Compliance with unbundling requirements must be effectively monitored and fully enforced by regulators which have been equipped with the necessary powers to undertake this role. At present this is not everywhere the case and legislation may be necessary to ensure that a truly level playing field is created. For example, in Austria national legislation respects the formal wording of the Directives regarding unbundling, but in practice the situation is insufficient. The economic independence of grid companies is limited. The number of employees of the grid companies is extremely low (often below 50 persons, and services are mainly bought from the integrated mother company). Separate identities (offices, internet appearance) are seldom developed. Offers to consumers are normally not transparent regarding energy price and grid tariffs.
50. Further effective measures than information ring fencing could be contemplated. In the US and in Britain, the Regional Transmission Operator (RTO) and BETTA models require the separation of transmission asset ownership plus management from system operation plus those other areas of TSO activity which relate directly to network users. Ownership of the monopoly network thus becomes separated from control of the network, hence reinforcing independent system operation. In this way it is possible to substantially remove the possibility of discrimination whilst leaving intact the ownership of the transmission companies together with their legitimate commercial interests. The consequences of such a focused structural

separation would have to be carefully assessed notably with regard to the sustainability of appropriate infrastructure investment incentives and the choice of regulatory mechanisms applying to the network operator.

51. Under the current regulatory framework regulators are unable to monitor cross-border related unbundling where a single company located in one Member State may own a number of subsidiaries in other Member States. This is an important gap in the current framework which can be exploited by market participants in a way that undermines the current unbundling requirements. For example, where a multi national vertically integrated company exists, it will be helpful to ensure that accounting for unbundling is consistent across the company and so across borders. Cross border exchange of information between regulators relating to this is therefore necessary. (This example also relates to cross border competition issues.)
52. There is a need therefore to establish sufficient competence for involved regulators with respect to information gathering and sharing by regulators which includes monitoring cross-border unbundling arrangements.

4.6 Cross-border and EU level issues

53. Raising the level of the national powers of regulators up to a common standard, although necessary, will not be sufficient by itself to create a competitive European market place.
54. Regulators must in some joint manner be able to oversee the operation of the European grids to ensure that investments are made in the interests of European consumers, that markets are operating efficiently at a European level and that monitoring and enforcement happens effectively across European markets, not just national ones. The integration of balancing markets will also require some form of joint and cross border monitoring and oversight.
55. As EU energy markets become increasingly integrated the impact of decisions of TSOs, market participants and regulators will not be constrained to national boundaries. For example, in developing a European grid, TSOs' decisions on investments (including approval by regulatory authorities) will need to be regulated in a way that ensures investments are made in the interests of European consumers and not only national ones. Also, price effects might be felt in one jurisdiction that result from actions in another and appropriate monitoring and oversight will be required. At present, the regulatory and legislative framework is not consistent with the development of a more integrated (and ultimately single) energy market. The existing regulatory framework, where it has been properly implemented, is designed primarily to create the conditions for a liberalised market within national boundaries. This will not be sufficient to achieve a single competitive EU energy market.

56. Some examples illustrate these points :

Belgium, France, Germany, Netherlands	The important collaboration led by the Belgian, French, German and Dutch regulators, inside the roadmaps' framework, in order to monitor the good functioning of auction mechanisms to allocate cross-border capacity, currently faces the difficulty that respective national legislation severely limits the possibilities for national regulators to exchange confidential data.
'All Island' market	In creating an 'All-Island' market across the Republic of and Northern Ireland, in order to allow each regulator to sanction market rules that operate across the whole island in a way that benefits customers in both territories, it is also necessary to amend the duties of each regulator such that they take into account the interests of customers in both territories.
NordREG	Nord Pool has formal existence within Norway, but it is a trading platform across the four Nordic countries. Nordic regulators (NordREG) presently co-operate regarding Nord Pool and other market issues. They are actively considering ways of exchanging confidential information.
Czech Auction Offices	In order to facilitate trade around the countries bordering the Czech Republic, an auction office for use of the international electricity interconnectors in the countries neighbouring the Czech Republic has been established in the Czech Republic. This raises issues of how the auctioning activity should be licensed and which regulator or regulators should oversee it.
Austria, Czech Republic	A long term transmission capacity reservation of 400MW presently exists on the Austrian-Czech border, which originally formed part of a long term energy contract between Austria and Poland signed in the 1970s. Based on legislation and the decision of the European Court (C-17/03 of 7 June 2005), a market participant has made a complaint to the Austrian and Czech regulators that this reservation is discriminatory. The complaint initiated parallel national procedures in each country to deal with it. Furthermore the TSO in Austria claimed that the TSO in the Czech Republic was responsible for granting the capacity and that the Austrian regulator was not competent to deal with the Czech TSO, and vice versa. In any case, in June 2006 the Austrian regulator decided that the reservation is void, and in July 2006 the Czech regulator decided that the assigned capacities must be available to the market from early 2007.

The case clearly demonstrates various difficulties with the present approach:

- The complainant must initiate two different procedures at two different authorities, involving two national legislations
- There is no mechanism for ensuring a consistent decision in both cases
- In this example, the Czech regulator has the power to define a date for implementation of its decision, but E-Control does not. Consequently E-Control's decision would take immediate effect, which could lead to unclear capacity situations between the two TSOs

57. Regulators, therefore, need powers to co-operate in ways which extend beyond national boundaries.

4.7 Flexible legal approach

58. It is also important to consider the legal mechanisms that are used to put in place the regulatory framework for competitive European single gas and electricity markets. Experience shows that the dynamic nature of markets and our developing understanding of them require that the detailed rules applying to the market should be capable of change in a fair but straightforward and timely way. For example, the introduction of competition in retail markets is often accompanied by some form of price control to protect customers before and until effective competition is established. The establishment of competition may be accompanied by a decision to remove price controls. The regulatory oversight of this process and powers to assess competition and introduce and remove price controls will tend to be more efficient where regulators have flexibility under law to follow this process. It would be unhelpful for example if the need for retail price controls were enshrined in primary legislation.

59. ERGEG therefore suggests that primary legislation introduces sufficiently flexible instruments and tools in order that regulators can adapt market oversight in a way that reflects present and anticipated market conditions. For example, more use could be made of the mechanism of setting binding Guidelines under Regulations, so that the Guidelines can be changed and improved under a Comitology process in order to meet changing market needs.

60. It may also be helpful to allow regulators to place general duties on market operators and players such that they are obliged to act in a pro competitive and non-discriminatory manner. Such an obligation then provides a lever for the regulator to oversee tariff methodologies and market rules that are developed and put in place by the industry itself.

5 Recommendations

5.1 Introduction

61. This chapter gives ERGEG's first view on recommendations concerning how the gaps and areas to be addressed raised in chapter 4 might be addressed. In order for regulation to be effective, ERGEG would argue that regulatory powers and competences that relate to the cross border and single market issues need to be addressed at the EU level. Furthermore powers and competences also have to be effective at the Member State level in order for markets to be overseen at the local level and to complement the development of the single market.
62. In addition, it is the ERGEG's view that any legislative approach needs to be sufficiently flexible in order to accommodate the transition from pre competitive to competitive markets.

5.2 Cross border and EU level

63. In order to provide for consistent regulation across and between national markets, ERGEG recommends that EU legislation is further established in order to provide each national regulator with the competences and powers to :
- Facilitate the development of and competition in the Internal Electricity Market
 - Ability for regulators to act jointly to oversee TSO investment in and operation of transmission networks in order that appropriate cross border transmission capacity is provided
 - Ability for regulators to gather and exchange information, pursue or request monitoring or investigations of activities that occur in one territory that affect markets in another (for both competitive and monopoly market issues)
64. There may be a number of institutional and legislative methods available to collectively empower national regulators in these ways. It may be possible to enhance the role of ERGEG, so as to enable it to oversee EU markets and investment in some manner, including the facilitation of data exchange. National regulators themselves could, if given an appropriate mandate in legislation, work together more closely, developing market rules and allowing investment on the basis of the interests of EU customers as a whole rather than being required to maintain a focus on each national market and its customers. Through new legislation, it could be possible to make greater use of binding Guidelines, potentially under a Comitology procedure, and with the further cooperation of Regulators.
65. In terms of levelling up the powers and competences of national regulatory authorities in each Member State, and allowing cross border co-operation and action between them, there could also be a role for the Commission to legislate using Regulations, since these have consistent and direct effect.

5.3 National market level

66. In ERGEG's view, each regulatory authority or set of authorities at the national market level require a minimum set of powers and competences in order to promote the development of local and EU competition. It may be possible to address these issues with a combination of EU and Member State level legislation and action. According to the analysis in chapter 4, ERGEG recommends that attention is given to providing regulatory authorities at the national level with the following features.

Independence, enforcement and sanctions

67. Each regulatory authority or set of authorities should be established independently of industry and with powers to make regulatory decisions independently of government intervention, and should have access to its own resources. Security of tenure is an important part of this independence.

68. In addition, it is crucial for regulators to have a role in advising government with respect to energy markets, since this will have at least some effect on the level of competition at the national and eventually EU level.

69. These independent regulatory authorities also require sufficient powers to enforce their decisions and to introduce proportionate sanctions and penalties where for example breaches of market rules or discriminatory behaviour are detected. The decision making process to introduce any such penalties needs to occur in an independent environment, with the regulator making clear the reasons for such decisions. Of course, such powers should be subject to the normal judicial processes and appeals procedures operating at a national level. The transparency of the allocation of powers between governments and independent regulators should be improved notably by including the compliance of national organisations with Article 23 of Directive 2003/54/EC into Member State reports.

Regulation of monopoly activities

70. The necessary powers and competences to oversee monopoly network activities include the powers for regulatory authorities to :

- Approve and monitor compliance with basic rules for access to (and ongoing use of) the system, plus oversight of the more detailed rules
- Approve or set tariff methodologies and/ or levels for use of the system and connection, by for example setting overall revenue limits, and with the ability to incentivize network operators to improve service levels/identify additional capacity

Unbundling

71. In order to enforce the better separation of monopoly network and competitive market activities, ERGEG suggests that regulators must be empowered to :
- Ensure that wholesale and generation market transparency and information management is sufficient – e.g. that data held by network operators is either ringfenced or released to the market in a non-discriminatory manner.
 - Monitor and share information with each other regarding cross-border unbundling arrangements.
 - Develop and / or enforce binding Guidelines on unbundling where necessary.

Oversight of market rules and efficient market functioning

72. In order to both to encourage the transition from pre-competitive markets to effectively competitive markets, and to oversee these on an ongoing basis, ERGEG suggests that regulatory authorities need to be empowered to :
- Approve and monitor compliance with the market rules for wholesale market trading (and oversee changes to the more detailed rules), including rules relating to the operation of balancing markets, settlement rules, imbalance arrangements and credit requirements
 - Monitor and enforce compliance with market rules and non-discriminatory behaviour.
 - Require information and data relating to the electricity (and gas) market from all market participants in order to be able to monitor orderly market functioning, and to retain the legal right to pass such data to relevant national and EU competition authorities, where a competition investigation is being conducted.
 - Require all participants to publish or make available relevant information and data in order to improve market transparency and oversee compliance with the national and EU rules in this domain.
 - To be able to require market operators and players, in undertaking their activities, to act in a manner consistent with the development of the competitive market and in a non-discriminatory manner.

5.4 Flexible legal approach

73. ERGEG would emphasize that any new legislation or powers given to accommodate the above also need to be sufficiently flexible in order to allow regulators scope to make timely and efficient adjustments to the regulatory framework that reflect current and anticipated market developments.