

## **EFET position on the Third EU Internal Energy Market Package – building a workable way forward**

On 19<sup>th</sup> September 2007, EFET welcomed the European Commission proposals but expressed some serious reservations. Now that we have studied the two draft Directives and three draft Regulations and listened to many stakeholders in the energy market, we believe that a series of workable solutions is possible regarding all the main measures set out in the draft legislation.

This paper aims to restate the essential reform requirements, so that the European Parliament and Council can ensure that the new EU internal energy market (IEM) legislation is relevant and effective. On request, EFET will provide detailed amendments to the proposals, based on the principles set out in this paper.

**Effective separation** between operating, managing and investing in a transmission network (the “TSO” business) and any affiliated supply, trading, generation or production businesses is essential. Only effective separation will ensure that all TSO businesses will provide impartial services to all users. A corporate group or government must avoid conflicts of interest, both in the allocation and use of existing capacity and in the development of new infrastructure. The implementation of unbundling must also allow for supra- and intra-national grid operation, encourage proactive co-operation between grid operators and facilitate further market integration. Unbundling is not an end in itself, but **a means to ensure that the IEM can develop effectively.**

All TSOs in Europe should by now be at least “legally” unbundled. A substantial degree of functional, managerial, and accounting separation<sup>1</sup> has been already mandated by the Second IEM Directives adopted in 2003. The existing criteria (still) need to be fully implemented and enforced in all Member States. If there is to be a third unbundling option in the Third Package, beyond the possibilities of ownership separation and creation of an ISO, then further strict requirements would need to be created as part of that option, to ensure a reasonable degree of harmonisation. In any case it seems that now is the right moment for the Commission to reconsider whether the role of ownership of grid assets is the only decisive factor, and whether alternative means for some Member States to achieve absolutely non-discriminatory and objective terms of network access can be allowed.

Whether two or three options are given to Member States, we believe it is important that the EU achieves greater consistency between methods for unbundling of government and unbundling of privately owned TSO businesses. That is because trans-national collaboration in the operation of the interconnected transmission grids is as important as vertical disaggregation of those groups, which nationally run both transmission and energy supply or production businesses. We furthermore insist on the application of appropriate regulatory incentives to operators of transmission grids. Incentives must be designed by Regulators to help achieve the degree of efficiency, of inter-TSO cooperation and of network inter-operability, which together will help European industry and consumers realise the benefits of a truly integrated wholesale energy market. (See also the section after next)

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<sup>1</sup> e.g. Governance and compliance programmes from Board level downwards to prevent TSO discrimination in favour of an affiliate.

**The voice of network users** must feature more clearly in the 3<sup>rd</sup> package. The European TSOs' primary duty is to grant access and deliver a service to their customers, such as generators/producers, traders, shippers, suppliers, distributors and larger consumers. These users of transmission systems and services are commercially exposed to variations in access and service terms; sometimes they discharge public service obligations of their own: legislation establishing institutional structures and new rights for TSOs as a group must recognize these realities. The users must be in a position to optimise the energy value chain, through well functioning market mechanisms, based on the provision of effective and efficient services by the grid operators. The ideas of network users, at the very least when it comes to market operation and trading arrangements deserve institutional and regulatory parity with those promulgated by network operators.

**The foundation of ENTSO (gas) and ENTSO (electricity)** must therefore be balanced by a clear and institutionally robust role for network users at the wholesale level in the formulation of guidelines, rules or standards. Currently there are shortcomings and inconsistencies concerning cross-border access at nearly every national network interface across Europe. Institutionalising two pan-European bodies comprising all gas and electricity TSOs risks actually delaying the process of market integration, and may result in a market design that is crafted for the convenience of the TSOs rather than optimised in the interest of the overall European economy. We therefore suggest the new rights and responsibilities assigned to ENTSO **must be focused on the core international roles of TSOs** (i.e. to deal with the commercial and operational aspects of pan-European network access), not on supply issues, trading arrangements and market rules). We also insist that these rights and responsibilities **must be matched by powers vested in the Agency for Cooperation of Energy Regulators (ACER)** to approve or disapprove any ENTSO initiatives after due consultation.

In the amendments we are suggesting to the draft Electricity Regulation and the draft Gas Regulation we furthermore elaborate on the cross-border and regional duties, which should in future be discharged by ENTSO as a whole, and/or by groups of individual TSOs at a particular network interface or within a region. Those duties will need to be matched by interventions on the part of ACER.

For electricity the provisions should deal with:

- Wider information exchange between TSOs,
- How to calculate and allocate cross border transmission rights facilitating secondary markets in transmission rights,
- Eliminating national TSO and regulatory discrimination in favour of internal transmission access,
- Setting a hierarchy of purposes for spending cross border auction revenues, which recognises the role of operational measures to maximise available capacity and guarantee transmission rights once granted,
- Mandating regulatory incentives to make cross border access easier and improve regional harmonisation.

Although significant improvements have been made, the gas market is not yet at the same stage as the electricity market. **In addition to amendments in the same five areas as above, some basic obligations still remain to be placed on gas TSOs**, and enforced by Regulators, in particular:

- To invest within and across their network to satisfy economic market demand for capacity and to fulfil the capacity requirements of gas security of supply criteria,

- To maximise the capacity on both sides of a border that they offer to the market<sup>2</sup> (e.g. to offer all forecast unused cross-border capacity to the market on a timely basis),
- Not to discriminate between suppliers inside and outside their home country<sup>3</sup> either when making investment decisions or when allocating capacity.

**Supra-national regulatory co-ordination and collaboration** is essential in relation to cross border network access, and the proposed EU Agency, ACER, could be a good body to organise this. But the Agency needs to have:

- The primary role (instead of ENTSO) in promulgating both high level, binding principles for cross-border network access (subject to comitology) and more detailed guidelines on any market related or transaction related cross-border access issues (probably without resorting to comitology),
- Responsibility for monitoring the cross border capacity calculations by TSOs and the actual (aggregate) use of the interconnection capacity between the grids,
- Powers to resolve disputes between TSOs, and network user complaints about discriminatory, non-objective or non-transparent terms of access, concerning the operation of networks across national borders, and take binding decisions if no resolution can be found,
- Powers to impose meaningful sanctions on all Regulation or guideline transgressions by TSOs and in relation to upheld network user complaints, which involve TSOs in more than one Member State, if joint agreement has not been reached by the competent national Regulators.

**Transparency of data regarding use and availability of gas and electricity infrastructure** remains inadequate in many parts of Europe. There is still incomplete, inconsistent and inaccurate publication of data regarding transmission, demand and production. In particular a clear insight in energy flows and bottlenecks in the interconnected grids is lacking, which leads to major inefficiencies. The 3<sup>rd</sup> package must contain detailed pan-European measures to increase transparency of information on all aspects of regulated infrastructure.

### **In conclusion**

- Unbundling is axiomatic; further separation measures at the EU level will be helpful; but this is the moment when the Commission should reconsider the merits of ownership unbundling compared with other possible improvements,
- The creation of ENTSO must be balanced by a strengthening of the role of ACER and a recognition of a primary role for system users in relation to the elaboration of any EU market rules,
- The Electricity and Gas Regulation texts can be significantly improved, so as to add greater precision to the obligations of TSOs to grant cross-border transmission access and add greater punch to the activities of Regulators/ ACER in pushing market integration. Those improvements should be considered during the EU legislative process, rather than delaying the debate in waiting for so-called codes and guidelines,
- The Commission has partly ducked mandatory improvements in transparency, so additions to the two Regulations are also needed in this respect.

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<sup>2</sup> This obligation is already contained in the 2003 Electricity Regulation

<sup>3</sup> Whilst this might be covered by the general duty not to discriminate and EU Treaty provisions on trade and investment it is such a key point for the proper functioning of the energy market that it would be useful to make it explicit in the 3<sup>rd</sup> package