

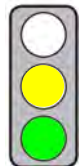
# PROGRESS IN THE INTERNAL GAS AND ELECTRICITY MARKET

Status: 15.06.2009

## MAIN ISSUES

**Objective of the Communication:** For the Commission to report on progress made in the liberalisation of the EU's gas and electricity markets and to indicate further action needed.

**Parties affected:** Directly, all companies active in the gas and electricity industries, indirectly also private and commercial end consumers and regulatory authorities.



**Pros:** (1) The Commission argues for competition and against price control.

(2) An advanced cross-border integration of gas and electricity markets increases competition.

**Cons:** The data used for statements on consumer satisfaction and on the switching of suppliers are inadequate.

## CONTENT

### Title

**Communication COM(2009) 115** of 11. March 2009: Report **on progress in creating the internal gas and electricity market**

### Brief Summary

#### ► Background

- In order to open EU energy markets for cross-border competition in 2003 the EU adopted the Directive on the internal market in electricity (2003/54/EC) and on the internal market in natural gas (2003/55/EC). In particular, they prescribe a separation of transmission networks (electricity and gas) from the energy supply and distribution networks. Regulation on the trade in electricity [(EC) No. 1228/2003] and natural gas [(EC) No. 1775/2005] were to improve the conditions for cross-border trade in electricity and natural gas.
- The Commission states that in establishing the internal energy market “the full potential of liberalisation has not yet been realised” (p. 2). The report on progress serves to indicate “the shortcomings of the current situation” (p. 2) and the areas in which further action is needed.
- The Commission wishes to increase competition between energy supply companies in order to expand the choice for consumers and to reduce prices for electricity and gas.

#### ► Improper implementation of EU legislation

- The Commission claims that neither the Directive on the internal electricity market (2003/54/EC) nor the Directive on the internal natural gas market (2003/55/EC) has been fully implemented yet, although the implementation deadline expired on 1. July 2004. It is therefore considering instituting infringement procedures against the Member States concerned.
- As for the Directives on the trade in electricity [(EC) No. 1228/2003] and natural gas [(EC) No. 1775/2005], the Commission stresses that not all national regulatory authorities have sufficient powers to impose penalties and that transparency requirements are not complied with in all Member States.

#### ► Electricity and gas price trends

- Oil prices influence gas prices – as they act as a reference price in long-term gas supply agreements – and therefore also electricity prices, in as far as electricity is produced in gas-fired power plants.
  - In 2008 electricity and gas prices were strongly influenced by rising oil prices which, in the first half of 2008, increased by 36% and decreased by 64% in the second half.
  - According to the Commission's estimation in 2009, the decreasing oil price will lead to lower gas and electricity prices.
- In 2008, average consumer prices for electricity rose by 2% and by 5–7% for gas.
- Taking into consideration respective purchasing power, the Commission has calculated the following consumer price levels in EU Member States:
  - Finland, France and Estonia have the lowest electricity prices; Hungary, Slovakia and Germany the highest.
  - The United Kingdom, Lithuania and Ireland have the lowest gas prices, whereas Sweden, Bulgaria and Austria have the highest.

**► Price regulation**

- Consumer prices for electricity and gas are regulated in 14 out of 27 Member States (Bulgaria, Denmark, Estonia, France, Hungary, Ireland, Italia, Lithuania, Latvia, Poland, Portugal, Romania, Slovakia, and Estonia).
- Consumer prices for electricity and gas rose in the entire EU; in the Netherlands and Sweden, where prices are not controlled, they were below the EU average.
- According to the Commission, the regulation of energy prices can impede the proper functioning of the internal energy market.
  - It can set wrong price signals and lead to distortion of competition (e.g. entry barriers for new gas suppliers, disincentives to switch supplier).
  - “Price control mechanisms might not be” compatible with EU law.
  - The protection of “vulnerable consumers” must not be confused with maintaining regulated prices for all consumers (or certain categories of consumers). A carefully targeted price regulation, however, may be necessary in order to protect “individual consumers in certain specific circumstances” (p. 12).

**► Switching suppliers**

- Few Member States could provide comprehensive and complete data on the frequency with which consumers switch gas or electricity suppliers.
- Where Member States did provide data, these convey very differing quota for the switching of suppliers.
  - In the United Kingdom, 18% of all private customers and small businesses switched their electricity providers; in Spain and Denmark 20% switched their gas suppliers.
  - In other markets there were almost no switching activities.

**► Concentration of suppliers in the electricity and gas markets**

- In the electricity wholesale market,
  - the three biggest generators control more than 70% of generation capacity in 15 Member States and
  - in 14 Member States they hold a market share of more than 80% of the end consumer supply (private consumers and companies).
- In the gas wholesale market,
  - the three largest wholesalers have a market share of more than 90% in 12 Member States and
  - in 15 Member States three suppliers hold a market share of more than 70% of the end customer supply.

**► Unbundling of network operators**

- The Commission can report that progress is being made in the unbundling of network operators. Ownership unbundling from energy supply operators is implemented in 15 electricity transmission networks and 12 gas transmission networks.
- However, the Commission still criticises that
  - the functional unbundling of distribution system operators has so far been too slow and
  - that more than half of the Member States exempt distribution system operators with less than 100,000 customers from legal unbundling requirements.

**► Cross-border integration of gas and energy markets**

- The Commission stresses that a key prerequisite for an integrated European electricity and gas market is that national markets are “adequately connected” and that their interconnections are efficiently used. The resulting increase in cross-border trade will help suppliers to become more competitive and consumers will benefit from “competitive” prices and services. (p. 3)
- This market integration is to be achieved in particular through the provision of new infrastructures, e.g. by building new interconnections.
- Although the volumes traded at power exchanges and gas hubs continued to rise in 2007, they are still relatively low compared to their total consumption.
- In order to improve the integration of the internal electricity market the Commission proposes:
  - the creation of a single auction platform for the trade of electricity in the entire EU and
  - market coupling, in which the cross-border trade in electricity is combined with the simultaneous allocation of the respective transmission capacities on interconnections between Member States.
- In order to improve the integration of the internal gas market the Commission proposes:
  - facilitating capacity allocation on pipelines,
  - offering services to enhance efficiency in the gas trade and
  - fixing regulated network tariffs which provide incentives for cross-border investments.

### ► Cooperation by regulatory authorities and network operators

- The Commission concludes that the cooperation of the European Regulators Group for Electricity and Gas (EREG) “have not resulted in the development of common standards and approaches for cross-border trade” (p. 10).
- It has announced the establishment of a “European Network of Transmission System Operators for Electricity” (ENTSOE) and a “European Network of Transmission System Operators for Gas” (ENTSOG). They are to have responsibility for the harmonising of network access rules and operational rules, for exchanging information between network operators and for coordinating new investments.

### ► Security of Supply

- According to the Commission, major investments are needed over the next decades to maintain a secure energy supply in the EU.
- To date, the Directive to safeguard the security of electricity supply (2005/89/EC) has been implemented into national law by only 19 Member States. The deadline for that expired on 24. February 2008.
- According to the Commission, the measures set by the Directive to safeguard the security of the natural gas supply (2004/67/EC) are not sufficient to ensure a timely response to a possible gas supply crisis.

## Changes Compared to the Status Quo

The Communication does not lead to any changes compared to the status quo.

## Statement on Subsidiarity

The Commission does not address the issue of subsidiarity.

## Political Background

In order to promote the liberalisation of the electricity and gas markets in the EU, the Commission submitted its “third energy market liberalisation package” in 2007, which will probably be adopted in June 2009 (cp. [CEP Main Page on Energy](#)). It consists of the Directive Proposal amending Directive 2003/54/EC on the internal market in electricity [COM(2007) 528, cp. [CEP Policy Brief](#) in German only], the Directive 2003/55/EC on the internal market in natural gas [COM(2007) 529, cp. [CEP Policy Brief](#) in German only] and the Regulation Proposal establishing an agency for the cooperation of energy regulators [COM(2007) 530, cp. [CEP Policy Brief](#) in German only] amending Regulation (EC) No. 1228/54 on cross-border electricity trade [COM(2007) 531, cp. [CEP Policy Brief](#) in German only] and Regulation (EC) No. 1775/05 on natural gas transmission networks [COM(2007) 532, cp. [CEP Policy Brief](#) in German only].

## Options for Influencing the Political Process

Leading Directorate General:	DG Energy and Transport
Consultation procedure:	Not provided

# ASSESSMENT

## Economic Impact Assessment

### Ordoliberal Assessment

**It is to be welcomed that the Commission** wishes to promote the liberalisation of the gas and electricity markets and that it **shows its preference for competitive solutions prevailing over price regulation**.

Remarkable is its statement that regulated prices for electricity and gas might even impede the proper functioning of the internal market. To date, the Commission has always held the view that the regulators’ options for interventions should also comprise price regulation in order to create competition. Now it appears to view the effects of comprehensive price regulation at the end customer level with scepticism. However, the Commission is not consistent in following this thought through, as it deems a “targeted price regulation” necessary in order to protect “individual consumers in certain specific circumstances” (p. 12) without substantiating the conditions requiring this necessity.

The statements given on customer satisfaction and the frequency of supplier switching are based on inadequate base data and thus cannot be used for any kind of assessment. As part of the “Consumer Scoreboard”, the Commission has in fact already demonstrated that it does not shy away from basing statements on insufficient base data and arbitrary assessments [cp. [CEP Policy Brief](#) on the Second Consumer Scoreboard COM(2009) 25].

The statements regarding the concentration of providers in national electricity and gas markets are to be evaluated differentially. The report states that currently high concentration does not necessarily lead to high end customer prices, since prices are also influenced through regulation. In the long run, the aspired closer cooperation of national electricity and gas markets could counteract the negative effects of a too high provider concentration and thus make the regulation of end customer prices obsolete.

### Impact on Efficiency and Individual Freedom of Choice

A workable competition in electricity and gas markets enhances efficiency and increases consumer choice. Therefore the closer cooperation of national electricity and gas markets as aspired to by the Commission and the expansion of capacities in cross-border interconnections is to be welcomed.

### Impact on Growth and Employment

**Liberalised energy markets with low prices have a positive impact on growth and employment.**

### Impact on Europe as a Business Location

Liberalised energy markets with low prices increase the quality of Europe as a business location.

## Legal Assessment

### Legal Competence

Pursuant to Art. 95 TEC, the EU is entitled to harmonise the national rules of Member States which are opposed to the establishment of an internal market in the gas and electricity trade.

### Subsidiarity

Unproblematic.

### Proportionality

Unproblematic.

### Compatibility with EU Law

Unproblematic.

### Compatibility with German Law

In Germany, in particular the Energy Industry Act (*Energiewirtschaftsgesetz – EnWG*) and the Ordinance for Regulating Grid Connection of Electricity Generating Installations (*Kraftwerk-Netzanschlussverordnung – KraftNAV*) implement the Commission's wish to improve competition in the energy markets.

According to them, "vertically integrated" energy supply companies and affiliated, legally independent companies must ensure a non-discriminatory and transparent operation not only of transmission networks but also of distribution networks (§ 6 EnWG). They must separate the operation of these networks legally, organisationally and in terms of accounting from other activities of the group (§ 7-10 EnWG). However, unlike the Directive Proposals on the internal market in electricity [COM(2007) 528, cp. [CEP Policy Brief](#) in German only] and the internal market in natural gas [COM(2007) 529, cp. [CEP Policy Brief](#) in German only], German law does not oblige energy companies to choose between either the proprietary unbundling of transmission and distribution networks, or their operation through a group company which offers full independency guarantees. Such an obligation is also problematic because of the principle of guarantee of ownership pursuant to Art. 14 of the German Basic Law.

Whoever builds a power plant with a capacity of over 100 MW has the right to be connected to the grid, unless this is unacceptable for the network operator under the concrete conditions (§§ 4, 6 KraftNAV). In order to prevent the high concentration of electricity and gas network providers from leading to excessive prices, German network tariffs are currently subject to cost-oriented price regulation (§ 21 (2), 23a EnWG). Therewith a system consisting of upper limits and efficiency requirements was introduced on 1. January 2009, which is to convey incentives for cost reduction ("incentive regulation", § 21a EnWG).

## Alternative Policy Option

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## Possible Future EU Actions

Currently not foreseeable.

## Conclusion

The Commission's commitment to a liberalisation of the electricity and gas markets and the preference for a competitive solution prevailing over price regulation is to be welcomed. The aspired closer market integration boosts competition and thus has a positive impact on the quality of Europe as a business location. The statements of the report on customer satisfaction and the frequency of supplier switching are based on inadequate base data and thus cannot be used as grounds for assessment.