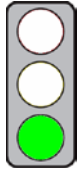


KEY ISSUES

Objective of the Communication: The Commission reports on the progress made towards completing the internal energy market and proposes additional measures in this regard.

Affected parties: Whole economy, particularly companies in the energy sector.



Pro: (1) Infringement proceedings against Member States may help to create a level playing field in the internal energy market.

(2) Cross-border energy infrastructure must be completed on time.

(3) Government intervention in the internal energy market should be avoided, in principle, because it may be used improperly to give domestic companies an advantage in European competition.

Contra: –

CONTENT

Title

Communication COM(2014) 634 of 13 October 2014 on the Progress towards **completing the Internal Energy Market**

Brief Summary

► Context and objectives

- As part of its efforts to complete the internal market for electricity and gas ("internal energy market") the EU is pursuing three objectives [see [cepCompass: EU Climate and Energy Policy](#) (in German only), p. 47 et seq.):
 - Climate protection: The internal energy market will facilitate the integration of renewable energy into the electricity supply system.
 - Security of supply: The internal energy market will create incentives for the construction of energy infrastructure which is important for security of the energy supply.
 - Competition: The opening up and deregulation of energy markets will result in "competitive" energy prices.
- The Commission estimates that the economic benefits of completing the internal market amount to between 16 and 40 billion euro (p. 4).
- The Commission reports on the implementation of existing EU law by the Member States and explains what further measures will need to be taken in order to complete the internal market.

► Progress and constraints on completing the internal energy market

- Formerly vertically integrated energy undertakings (VIE) which both produce electricity or natural gas and have disposal over energy infrastructure (electricity transmission cables or gas pipelines) have to prove that they no longer have any control over electricity transmission cables or gas pipelines. For this purpose, they have to choose between three unbundling options (Art. 9 Internal Electricity Market Directive 2009/72/EC, Art. 9 Internal Gas Market Directive 2009/73/EC; see [cepCompass EU Climate and Energy Policy](#), p. 49 et seq.):
 - full "ownership unbundling",
 - use of an "independent system operator" (ISO) or
 - use of an "independent transmission operator" (ITO).
- So far, VIEs have verified the unbundling of 96 of "approximately 100" transmission operators (p. 8). Most commonly, VIEs have chosen the model of full ownership unbundling.
- Since 2011, the Commission has brought infringement proceedings against several Member States which failed to correctly implement the EU requirements for completing the internal energy market by 3 March 2011. This increased pressure on the Member States to speed up the transposition of EU requirements into national legislation.
- The EU's target is for the capacity of cross-border electricity inter-connectors with other Member States (interconnection level) to make up at least 10% of domestic electricity generation capacity by 2020 and 15% by 2030, in all Member States ([Conclusions](#) of the European Council of 23/24 October 2014, para. 4). The interconnection level is currently at approx. 8% (p. 8).
- Important infrastructure projects to increase the security of energy supply have been completed in the last few years; these include gas pipelines with "reverse flow" capability. Other infrastructure projects are currently under construction; these include a liquefied natural gas ("LNG") terminal in Poland.

- EU average retail prices for electricity and gas rose between 2008 and 2012 although the wholesale price of electricity fell and that of gas remained constant in the same period. The rise in retail prices is caused in particular by significantly higher taxes and charges for financing energy and environmental measures [p. 6 et seq., see also Communication on Energy Prices and Costs COM(2014) 21; see [cepPolicyBrief](#)].

► **Expansion of energy infrastructure**

- Energy infrastructure in particular will be expanded in order to
 - diversify gas supplies in central and southern Europe and in the Baltic and
 - to link the Iberian peninsula, the Baltic Region, Ireland and the UK to central Europe.
- The TEN-E Regulation [(EU) No. 347/2013; see [cepCompass EU Climate and Energy Policy](#), p. 106 et seq.] provides for the accelerated planning and implementation of cross-border infrastructure projects which are important for the completion of the internal energy market ("Projects of Common Interest"). The Commission criticises the fact that there have been delays in the implementation of the TEN-E Regulation caused by the Member States, such as in the designation of single points of contacts for permit granting.
- "Uncertainties" on the gas market are currently making LNG and gas storage operations unprofitable. The Commission calls for the resulting impact on security of supply to be examined (p. 9).
- The Commission calls, in particular, for the electricity distribution grids to become "smarter" and for "the breaking down of barriers between wholesale and retail markets" (p. 12). All consumers will be able to react to price signals on the wholesale market and receive financial incentives to adapt their electricity consumption more flexibly to a fluctuating electricity supply.

► **Harmonisation of national legislation**

- According to the Commission, in order for it to function, the internal energy market requires harmonised EU regulation of energy infrastructure which guarantees that all suppliers are able to use the existing gas and electricity infrastructure without discrimination and at a "fair price". Appropriate legislative rules ("Network Codes") are currently being developed. (p. 10)
- The production of electricity from wind and solar power is subject to fluctuations arising from the weather and the time of day, which can lead to sudden unforeseen surpluses in electricity. According to the Commission, additional "short term markets" must be developed on which such surpluses can be traded within a day ("intraday markets", p. 11).
- The Commission calls for an "increased" internationalisation of balancing markets – i.e. markets for energy which can be made available at short notice to balance out supply and demand – in order to allow the most effective balancing of resources between countries. For this, the rights and duties of the transmission system operators and suppliers of balancing energy must be harmonised EU-wide by way of binding Network Codes (p. 11).

► **Government intervention in the internal energy market**

- The Commission calls on Member States to refrain, in principle, from government intervention in the internal energy market. In the case of permitted government intervention – e.g. to promote renewables – distortions of competition on the energy market will be avoided [p. 13; see also Communication on the Completion of the Internal electricity market C(2013) 7243; see [cepPolicyBrief](#)].
- The "capacity mechanisms" which are planned, or have already been put in place, by some Member States to safeguard the electricity supply must be in line with the relevant Guidance from the Commission [p. 14 et seq.; see also Working Paper SWD(2013) 438; see [cepPolicyBrief](#)].
 - Capacity mechanisms will give market operators incentives to hold electricity capacity
 - on the supply side by way of power plants and storage facilities,
 - on the demand side in particular by a reduction in consumer demand for electricity.
 - Capacity mechanisms cannot place an unnecessary burden on consumers and will have no negative impact on
 - investment in energy efficiency,
 - the construction of new interconnectors or
 - the change from fossil to low carbon energy sources ("decarbonisation").
- The Commission calls for revenue from capacity mechanisms to be available to:
 - foreign suppliers who can effectively contribute to security of supply and
 - electricity consumers who, where necessary, are able to compensate for a drop in electricity generation by reducing their demand.

► Regional Approach

- In many regions of the EU, neighbouring Member States have complementary energy mixes. "Regional initiatives" whereby initially only the energy markets of individual Member States are integrated, may allow regional surplus capacity in one Member State to be used to balance out a deficit in the neighbouring country. This is a cheaper way of securing the energy supply.
- The Commission emphasises the importance of regional initiatives for security of the gas supply in the Baltic Region and South-East Europe.
- The coupling of 14 "day-ahead electricity markets" – on which electricity is traded for the following day – could smooth out the price differences for this electricity between the Member States involved (p. 11).
- The Commission calls for integration of regional markets to continue because it represents a decisive step towards completion of the internal energy market. The various regional processes will be better coordinated.

Policy Context

Since the 1990s, the EU has put together measures in three "Internal Energy Market Packages" [cepCompass EU Climate and Energy Policy](#), p.47 et seq.), which will gradually complete the internal energy market. The "Third Internal Energy Market Package" covers the Internal Electricity Market Directive (2009/72/EC; see [cepPolicyBrief](#)), the Internal Gas Market Directive (2009/73/EC; see [cepPolicyBrief](#)), the Regulation on network access conditions for cross-border electricity exchanges (No. 714/2009; see [cepPolicyBrief](#)) and the Regulation on network access conditions for gas pipelines (No. 715/2009; see [cepPolicyBrief](#)). Prior to the entry into force of the 3rd Internal Energy Market Package on 3 March 2011, there were already indications that its implementation in the Member States would be slow and would not comply with time limits. On that basis, in February 2011, the Prime Ministers and Heads of State of the European Council set the target of completing the Internal Energy Market by the end of 2014 ([Conclusions](#) of 4 February 2011, para. 4). In its Communication "A Functioning Internal Market" [COM(2012) 663; see [cepPolicyBrief](#)], the Commission had already lamented the failure to implement the 3rd Internal Energy Market Package by the Member States and called upon them to take concrete measures to complete the internal energy market by the end of 2014.

Options for Influencing the Political Process

Directorate General: DG Energy (leading)

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

The desired completion of the internal energy market promotes fulfilment of the EU's climate and energy policy targets – climate protection, security of supply and competition. This is because, firstly, competition between energy suppliers will be increased as a result, thereby giving rise, in principle, to lower electricity and gas prices. Secondly, an internal energy market increases security of energy supply because it promotes diversification of the gas supply and thus the independence of individual gas suppliers from non-EU countries as well as transport routes. Thirdly, it may reduce the costs of climate protection measures in the energy sector thereby making them more attractive for Member States.

The **infringement proceedings** brought by the Commission **against Member States** who have not properly implemented EU legislation to establish the internal energy market **may help to create a level playing field in the internal energy market**. The Commission should therefore continue to use infringement proceedings to combat the failure to comply with EU rules.

Impact on efficiency and individual freedom of choice.

Cross-border energy infrastructure, particularly electricity transmission networks and gas pipelines, is a basic requirement for the completion of the internal energy market. It **must therefore be completed on time**.

Infrastructure such as LNG terminals and gas storage facilities can make a substantial contribution to the security of the gas supply. However, the cost of construction and maintenance often makes them uneconomical so that there is a risk that investment in them will be lacking and existing facilities closed down. If, as a result of this, the security of the gas supply is put at risk, alternative financing concepts for the construction and maintenance of this type of infrastructure must be examined whilst also considering their compatibility with competition law.

Since, as a result of the increasing use of wind and solar power, the electricity supply will be subject to ever greater fluctuations, there is – as the Commission rightly points out – a need for more active participation by consumers in balancing supply and demand. Smart grids allow electricity demand to be brought more effectively into line with supply. This requires substantial investment in the electricity infrastructure. In addition, consumers must be offered sufficient financial incentives to reduce their electricity consumption at times when electricity is in short supply. **The retail electricity prices must be sufficiently flexible and able to**

react to shortages of supply on the wholesale market so that a sufficient number of consumers are willing to alter their electricity consumption habits.

As the Commission rightly urges, **government intervention in the internal energy market must, in principle, be avoided as it can be used improperly to give domestic companies and locations an advantage in European competition** thereby reducing the efficiency of the energy supply.

Capacity mechanisms to secure an adequate energy supply must not be permitted to damage the internal market by giving domestic companies an advantage over the foreign competition.

Regional initiatives are important interim steps towards the integration of national energy markets into a common internal energy market. They offer the advantage of allowing market coupling to be tested at regional level first before integration of these regional markets into one EU-wide energy market takes place. Coordination of the regional initiatives may thus prevent these markets from developing in isolation from one another which would hinder subsequent integration.

Impact on growth and employment

Completion of the internal energy market strengthens competition between the energy suppliers. In the long term, this will increase economic growth thereby increasing employment.

Impact on Europe as a business location

A functioning internal energy market increases security of supply and may result in lower energy prices. This has a positive impact on the EU as a business location.

Legal Assessment

Legislative competency

Unproblematic. The EU is entitled to issue energy policy measures in order to secure the functioning of the energy market, to guarantee security of energy supply, to promote the interconnection of energy networks as well as to support energy efficiency, energy savings and the development of new and renewable energy sources (Art. 194 TFEU).

Subsidiarity

Unproblematic.

Conclusion

Infringement proceedings against Member States may help to create a level playing field in the internal energy market. Cross-border energy infrastructure must be completed on time. The retail electricity prices must be able to react to shortages of supply on the wholesale market so that consumers are willing to alter their electricity consumption habits. Government intervention in the internal energy market should be avoided, in principle, because it may be used improperly to give domestic companies an advantage in European competition.