

**Union of the Electricity Industry – EURELECTRIC
contribution to the Commission's consultation
on the progress report**

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These comments were drafted by the WG Market Regulation and approved by the EURELECTRIC Markets Committee.

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The **Union of the Electricity Industry - EURELECTRIC**, formed as a result of a merger in December 1999 of the twin Electricity Industry Associations, UNIPED and EURELECTRIC, is the sector association representing the common interests of the European Electricity Industry and its worldwide affiliates and associates. Its mission is to contribute to the development and competitiveness of the Electricity Industry and to promote the role of electricity in the advancement of society.

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Further to the entry into force and implementation of the Electricity Directive, the Commission is preparing a progress report setting out an evaluation of electricity markets and, where necessary, additional measures to the Directive. Given the importance of this piece of work, the Commission decided to engage in a wide consultation process with stakeholders.

EURELECTRIC welcomes this initiative as it comes at a timely moment with regard to our work on further market developments. In this paper, we wish to put forward our views on the experience so far and how we see the way forward.

WHAT LIBERALISATION HAS DELIVERED ...

The liberalisation of electricity markets started roughly ten years ago, which provides a reasonably good period of time to assess the impacts and benefits delivered to customers. These can be summarised as follows:

- **price level:** price development over the last ten years correlates with a clear downward price trend: 18 % price decrease for industrial customers and 11 % for household customers (real terms)¹ although a recent price increase is perceivable. This is all the more noticeable since, as a result of EC policies on emissions reduction and promotion of renewables, surcharges and levies have increased more rapidly than electricity prices. Therefore, customers have to a large extent not been able to see the price reduction. However it should also be noted that liberalisation is aimed to deliver competitive prices, which does not mean automatically lower prices. In view of growing scarce resources and the need for new generation capacity, prices are likely to go up. — FOR FURTHER REFERENCE, SEE ANNEX IV: EURELECTRIC PRICE EVOLUTION STUDY (CARRIED OUT BY KEMA CONSULTING).
- **Cost cutting:** with the opening-up of markets, electricity companies have gone through significant restructuring and cost cutting. In this respect, they have made important gains in labour productivity in the European electricity sector in parallel with socially responsible policies.
- **Best performing fuel source:** whilst gas and oil prices varied significantly with a sharp increase in 2000 and 2004 - which resulted in price increase of up to 40% and 60 % over the last three years respectively- the evolution of end users electricity prices has remained steady and far below the levels of gas and oil price increases over the decade.

¹ Eurostat sources : prices deflated on the values of 1995 for industrial customers (annual consumption of 24 GWh) and household customers (annual consumption of 3500 kWh).

- **High levels of public service obligation:** with the opening up of markets, high levels of quality in public service obligations have been maintained, thus showing that liberalisation can go together with customer protection and high quality standards (and notably safe operation of networks²).
- **Customer satisfaction:** EUROBAROMETER successive surveys show high scores of satisfaction for residential customers ranging from 87 to 89%. This high level of satisfaction primarily relates to the reliability of the supply and the affordability of electricity prices. It is also noteworthy that the services performed by electricity utilities rank first ahead of other utilities (gas, telecom, water, postal services and transport).

For more detailed assessment of electricity markets, further criteria can be found in Annex I of this Paper. As already mentioned in our comments on the third benchmarking report, we feel that a too predominant focus has been placed on customer switching rates which in themselves are insufficient to provide a picture as to how competition has developed in electricity markets. We believe that any comprehensive assessment should be underpinned with a broader range of indicators with respect notably to customer choice, generation, wholesale, cross-border trade and the creation of a level-playing field.

DEVELOPMENT OF MARKETS: MARKETS IN TRANSITION

These findings demonstrate that liberalisation has been able to deliver a number of expected results but not all of them. This can be explained to a large extent by the on-going developments in electricity markets, which although no longer purely national have not yet reached the stage of a pan-European market.

In this respect, it is worth noting that good progress has been made with the development of trading places, the increase in the volumes of wholesale trade and convergence of day-ahead prices in major markets. Also the competitive pressure resulting from the opening up of markets has led companies to restructure and engage in mergers and acquisitions. This process has allowed the emergence of new entrants in all EU markets. Likewise, there has been an increasing use of market-based mechanisms for congested interconnectors and their full application on all interconnectors seems to be within reach. However, the lack of sufficient cross-border infrastructure combined with the difficulties of building new interconnectors for reasons of public and political resistance or cumbersome administrative procedures constitutes a specific constraint in the development of electricity markets.

² It must be noted that according to EURELECTRIC's findings liberalisation did not in itself lead to the coincidental series of black outs in 2003 which could as well have happened before liberalisation.

Against this background, the liberalisation package is aimed at providing a common regulatory framework across the enlarged European Union but it is still lacking full implementation in some parts of the Union. Price control still exists in a number of countries and recent developments are showing that attempts to re-regulate competitive activities cannot be excluded. Also, the multiplication of legislative initiatives with sometimes contradictory objectives is causing uncertainties which are not favourable to investments. Furthermore, markets developments are being called into question by very large consumers who, unlike residential customers, have shown some dissatisfaction with their electricity prices and have raised concerns over the competitiveness of the European industry.

THE NEED TO MAINTAIN MOMENTUM

This short summary provides a positive though nuanced picture of the developments undergone in the electricity markets and stresses the necessity to address these challenges in a timely manner. **Since not all markets are yet fully open and competitive activities varyingly remain subject to some regulatory pressure, this intermediary stage may trigger doubts over the ability of liberalisation to deliver benefits to society. EURELECTRIC sees it as a critical time and believes that it is essential to maintain the momentum and to strengthen confidence in the market. There is a large consensus that today's situation needs to be improved by further enhancing market development. In order to do so, EURELECTRIC is putting forward a plan comprising four recommendations and in particular a road map to a pan-European wholesale market.**

WAY FORWARD

These recommendations are as follows:

1. Ensure full and effective implementation of the liberalisation package

The Electricity Directive has been able to strike an appropriate balance between regulatory supervision, customer protection and companies' freedom to do business, which will help to develop a level playing-field. The clear opening dates will also put an end to the uneven market opening observed following the first 1996 Directive. Therefore, if properly implemented, the Directive together with the Regulation on cross-border trade will provide a sufficient regulatory framework to allow cross-border trade to develop.

It is therefore imperative that Member States do their utmost to ensure a swift implementation of this package so that a common regulatory framework is rapidly put in place across the Union. Likewise, it is essential that the cross-border Regulation be completed with fully-fledged guidelines on congestion management, harmonisation of tariffs and inter-TSO compensation payment.

Furthermore, further progress is still needed in the gas sector so as to develop a proper competitive gas market, where gas prices should not be linked in the future to oil prices in order to develop a true gas-to-gas competition. In this respect, storage is of particular concern and effective third party access has to be ensured. EURELECTRIC welcomes the adoption of GGPSSO guidelines³ which must be fully complied with.

³ Guidelines for Good TPA Practice for Gas Storage System Operators (GGPSSO)

Once the package is implemented in an effective manner across all the Member States, EURELECTRIC believes that further market integration should be driven by market forces and seamless co-operation between TSO's, regulators and power exchanges.

2. Develop a committed attitude to the unbundling provision

Ensuring non discriminatory access to networks is key to a properly functioning market and EURELECTRIC believes that the Electricity Directive has found the right balance, allowing companies to keep their network assets, while putting in place strict rules to ensure independence of network operators in the day-to day business. EURELECTRIC considers that in order to develop a culture of unbundling, a proper organisational structure should be developed to implement strict unbundling of information and non discriminatory procurement of services. This can only be achieved through a firm separation of personnel (at least at management level) together with an appropriate compliance programme. EURELECTRIC is fully committed to making these provisions work effectively and in this regard has developed recommendations on the implementation of the unbundling provision.

- FOR FURTHER REFERENCE, SEE ANNEX II: EURELECTRIC RECOMMENDATIONS ON UNBUNDLING

3. Integrate markets through expansion of liquid wholesale markets: EURELECTRIC road map to a pan-European market

While the liberalisation package is essential to provide a common regulatory framework at European level, it will not in itself ensure a spill-over effect and integrate electricity markets into a pan-European market. Therefore, EURELECTRIC sees it very important to enhance further market development via our proposed road map to a pan-European electricity market. The rationale of this road map is to use wholesale trading and liquid wholesale markets as the driver for further market integration. The objective is to create liquid day-ahead and forward markets together with open intra-day and balancing markets which should deliver trustworthy prices. This should be done through four processes which can mostly operate in parallel with the regional markets as an intermediary step.

This approach is expected to deliver the necessary benefits for successful integration of markets: it will increase the number of market players and thus alleviate concerns of market concentration, it will also stimulate liquidity on the trading markets and the need for common rules on transparency. Ultimately, it will reinforce trust in price formation and markets' abilities to deliver.

However, to succeed, such integration of wholesale markets will require a strong commitment from the stakeholders and close co-operation between the different market actors, including electricity companies, TSOs, power exchanges plus the Commission, the regulators and the governments.

- FOR FURTHER REFERENCE, SEE ANNEX III: EURELECTRIC REPORT "INTEGRATING ELECTRICITY MARKETS THROUGH WHOLESALE MARKETS: EURELECTRIC ROAD MAP TO A PAN EUROPEAN MARKET"

4. Build trust in market fundamentals and reliance on prices

Today's situation shows a fairly advanced stage of market opening and on-going developments in cross-border trade and market integration. The liberalisation process being still incomplete, a number of criticism made on the functioning of the market seem to infer structural problems. However, these are linked to the interim stage and should fade away with further market integration. EURELECTRIC judges it important that all stakeholders, in particular the Commission, the governments, the regulators and the large consumers, keep faith with the original objective of creating competitive electricity markets and refrain from excessive intervention in the competitive activities.

With the further development of markets, it is important that large consumers become increasingly aware of developing opportunities to demand-side participation and utilise wholesale market opportunities in their electricity procurement. So doing will help them gain a better understanding of the fundamentals driving wholesale prices and of the need for their active presence as a contributor to the functioning of the markets. It should also be noted that in liberalised markets, electricity companies aim for the full recovery of their costs and are no longer allowed to offer cross-subsidised prices as was often the case in the past under certain governmental industry policies. Longer term contracts between generators and buyers on market terms should also be envisaged as an element of handling risks.

EURELECTRIC shares the concerns of large industrial consumers over the diminishing competitiveness of the European industry but sees this as originating elsewhere than in the functioning of markets, eg. increasing environmental surcharges, increase of primary fuel costs, more tightened situation of supply in some areas, inflation of the carbon price, etc. EURELECTRIC sees this situation as seriously worrying and we reiterate our call for further consistency, market-orientations and least cost approach to energy and environmental regulation.

ATTACHMENTS:

- ANNEX I: ATERNATIVE INDICATORS TO THE BENCHMARKING REPORT
- ANNEX II: UNION OF THE ELECTRICITY INDUSTRY - EURELECTRIC RECOMMENDATIONS ON UNBUNDLING
- ANNEX III: REPORT "INTEGRATING ELECTRICITY MARKETS THROUGH WHOLESALE MARKETS. EURELECTRIC ROAD MAP TO A PAN EUROPEAN MARKET"
- ANNEX IV: UNION OF THE ELECTRICITY INDUSTRY - EURELECTRIC REPORT ON PRICE EVOLUTION (CARRIED OUT BY KEMA CONSULTING) (TO FOLLOW)

ANNEX I

ALTERNATIVE INDICATORS TO THE BENCHMARKING REPORT

Alternative indicators to the benchmarking report

- Economic indicators:
 - productivity increase
- Customer choice:
 - contract renegotiations
 - number of competing offers
 - number of competing suppliers
 - number of new suppliers since market opening
 - customer satisfaction
 - administrative and financial barriers to customer switching
 - public service obligation and customer protection measures
- Generation, wholesale markets, expansion of relevant markets:
 - convergence of price zones
 - evolution of liquidity of spot and futures markets
 - development of data exchange and market information
 - participation of energy consumers in the power exchanges
 - repartition of investment shares in new generation (presence of new players in new investments)
 - capability to attract investments (generation adequacy)
 - cooperation between TSO's
 - evolution of percentage of generation with non market based pricing (eg RES, CHP based on feed-in tariffs)
 - progress in regional market creation
- Cross-border trade
 - percentage of interconnectors with market based congestion management
 - foreseen development of interconnectors
 - evolution of available capacity on interconnectors
 - utilisation of interconnectors (available capacity, congestion management methods secondary market for capacity, ...)
 - auction capacity price/3 years period
- Creation of a level playing field:
 - underlying competitive gas market
 - evolution of differences in taxation, levies
 - evolution of differences in G/L tariffication
 - implementation of IEM directive by member states
 - "gold plating" of IEM directive by member states.