



GEODE POSITION ON EUROPEAN ELECTRICITY AND GAS MARKETS.

Contribution to DG-TREN report on the impact of electricity and gas directives

I.- Current situation of the European gas and electricity markets.-

It is defined by the following obstacles:

- Europe is still divided into many geographic electricity and gas sub-markets.
- The level of competition varies significantly between market areas, due to e.g. the number of actors in the market, especially in the field of generation.
- In some market areas, the TSO's are still closely linked to commercial actors, that may take advantage of this position.
- TSO's are still operating in a rather isolated way, not promoting market area enlargement.
- Bottlenecks limit trade and market development, not only due to physical constraints but also the way they are managed.
- Market concentration process, increasing market power of dominant generating and vertically integrated companies.

GEODE considers that the current situation is not developing into the right way and problems are getting worse. **GEODE** asks for strongest policies by the European Union in order to address the obstacles mentioned above. Only then distributors can fulfil their duties and a fair and competitive internal market can be developed. The EU authorities should supervise the development of the regulatory framework in the Member States as to ensure a balanced regulation and avoid over-regulation.

II.-Necessary improvements in the process of market opening.-

GEODE considers that the following aspects of the market opening framework should be improved at European level:

- **Need for an integrated and competitive European energy market:** An integrated European energy market is the goal, but it is still far from being achieved. Instead the different national markets still pose serious obstacles to the creation of one competitive energy market. The combination of disintegrated markets with the issue of market concentration in each Member State prevents a market structure with a sufficient number of players facing effective competition. The creation of trans-national uniformly regulated energy markets should dilute market power of individual actors



and thus enhance competition. This view taken by **GEODE**, is supported by the remarkably low level of consumers switching.

- **Reduced number of market participants:** National markets are kept close by the lack of a sufficient number of market participants and the lack of effective competition between large vertically integrated companies. This market structure is reinforced by the ongoing market concentration in the different Member States, especially in the field of generation and import. **GEODE** considers the market concentration in the field of power generation at a national level, a major and still growing obstacle in the process of market liberalisation.
- **Standardisation in the implementation of the Directives:** An integrated European energy market requires the application of common rules. Today the Directives are implemented in a very different way in different countries. This requires a strict supervision of the implementation of the Directives by the European Commission.

The situation in Germany exemplifies the importance of strict supervision of the implementation procedure in the Member States by the Commission. First, the implementation of the Directives had been delayed significantly in Germany. Right now, Germany is just transforming the Directives into German law which means the creation of regulatory authorities in Germany. Whereas the Electricity Directive bases on a proven network access model, there is no such reliable model for the gas network access. Therefore the new German Energy Act does introduce an entry-exit-system with effectively only one, due to technical restraints maybe a handful market zones. **GEODE** therefore welcomes that the transport client will have to conclude only one entry- and one exit-contract to gain access to the whole gas network in Germany. This basic principle is to be set out in detail in a regulation (inferior to the Energy Act). The regulation however does not reflect the system introduced in the Energy Act and contradicts the requirements of the Gas Directive. Such a contradictory legal framework leads to major uncertainty in Europe largest gas market.

- **Stronger co-operation between TSO's:** In-depth cooperation is essential to facilitate cross-border transactions to be fulfilled at European level. **GEODE** strongly supports the establishment of a single European TSO.
- **Cross-border trade and congestion:** Electricity must flow between Member States as easily as it flows within one individual country. **Congestions** must not be used as an excuse for dominant players to keep national markets closed.

The ERGEG assessment of the Mini-Fora only recognises explicit and implicit auctions as acceptable mechanisms for congestion management.



GEODE also considers other tools appropriate, i.e. re-dispatching or counter-trading mechanisms. Such mechanisms are already used by TSO's in their national markets. Explicit auctions are very complex systems. Local and regional players therefore can not afford to actively deal with them. Especially explicit auctions required access to information about capacity, loads and generation. Such information is **only** available to TSO's. Compared to a situation with explicit auctions, implicit auctions better, but the effectiveness of implicit auctions are still maybe unclear.

The position of **GEODE** is supported by the experience in some Nordic countries. Counter-trading is used in a successful and in a very market-oriented way, and its increased use is studied in order to merge price areas, where there is generally only temporary (not severe and structural bottlenecks). This development should rather be promoted than prevented.

- **Unbundling:** Due to the high level of market concentration transmission network operation needs to be separated from other activities in the energy sector. Every TSO must be effectively unbundled from other activities of a vertically integrated company as to avoid a conflict of interests. Given their size TSOs will have the financial resources to implement the unbundling requirements. The application of the rule of proportionality must ensure that these undertakings do not have to bear an unreasonable and inappropriate level of regulation.
- **Adequate tariffication systems:** Distributors need adequate financial compensation. The costs for fulfilling the distributor's functions and obligations have to be identified and included in the tariffs in order to create an incentive for distributor investments. **GEODE** therefore supports a system based on rewards for improvements rather than a system imposing penalties.
- **Interconnections:** Due to the still disintegrated national markets, energy exchanges between Member States lack the necessary liquidity and do not exist in sufficient numbers. Interconnections, in both quality and quantity, have to be improved. The modest target fixed by the Commission for the increase of interconnections between the Member States should at least lie in the range between 10%-20%. In Member States with very high concentration of generation facilities, a higher level of interconnection is in particular desirable.
- **Competition policies:** Competition policies have to be reinforced and intensified in cooperation with national antitrust authorities. The market concentration process should be regulated and supervised, in order to dilute the market power of dominant generating and vertically integrated companies and to prevent the abuse of dominant market positions, as long as national markets remain.



- **Balancing regimes:** Various balancing regimes in certain market areas may even pose a barrier for new market participants. This is in particular the case when the balancing power or gas is priced in a way punitive in case of minor forecasting errors. Furthermore **GEODE** would like to emphasise that all market participants must be able to take care of their own balancing arrangements. This is important for the generators of balancing power as well as the demand of balancing power. It is therefore tempting to conclude that regulatory bodies should assert their authority to trans-national balancing zones rather than national (member state) boundaries. Balancing regimes shall be fully market-based and organised in close cooperation between TSO's and power/gas exchanges.

- **Specifics of the European gas market:** The development of competition in the European gas market is of significant importance as the European union is increasingly depending on the import of natural gas from non-EU states. In order to be an attractive market on the one hand and to keep gas prices at a relatively low level (e.g. by decoupling the oil-gas link) there is strong need for much more competitive pressure in the European gas market. Besides enhancing liquidity on the offer side by reviewing specific anti-competitive clauses in long-term contracts, such as demarcation clauses, and encouraging trading business at certain intra-European hubs and gas exchanges, there is also the area of non-discriminatory access to gas networks at fair prices. The activities in this area should according to **GEODE** focus on
 - a strict benchmarking (on the basis of fixed criteria) of the different entry-exit systems in the different Member states in order to be able to pick out the best solution for each problem and to implement such solutions in a European regulation concerning access to transmission pipelines;
 - a strict cost-orientated tarification system with no exclusions, such as foreseen in Germany where pipe-to-pipe-competition is presumed;
 - a competitive approach to increase flexibility, e.g. by regulating access to storage if otherwise not sufficiently achieved.

- **Modification in the regulatory framework of power generation:** In order to develop a competitive electricity market it is also necessary to stimulate competition in the power generation market. This market could have always been competitive as it is no natural monopoly and not necessarily affected by the restrictions of transportation. In practice the power generation in each Member state lies in the hand of between one up to four market dominant players that also own the transmission system and are still legally aligned to each other. As a matter of fact, the power generation market in each Member State is dominated by an oligopoly that tries to block out



independent power producers and optimize the revenues of its affiliated companies on the wholesale electricity market.

If national markets keep closed, it is not possible, in practice, that new IPP build new power capacity, due to market control by the existing generators. The creation of a European single market will dilute the market power of generators, permitting new IPP to invest in a more competitive framework.

Therefore, **GEODE** also suggests to issue

- strict regulations in order to get fair access to the transmission system for independent power producers,
- to enhance the transparency of power generation in the wholesale market (e. g. by forcing the power generators to issue its revision schedules long enough in advance) and
- if the above described steps are not sufficient – to legally unbundled power generators on a compulsory basis

III.- Reinforcement of measures to protect the interests of customers.-

As a precondition for enabling consumers to choose between different suppliers markets must include a sufficient number of players, all of them applying transparent prices and conditions. Therefore it is essential to overcome the mentioned obstacles.

At the same time it is also necessary to reinforce the position of distributors as key operators in a well functioning, liberalised energy markets. Only distributors assure the necessary quality of service the right of each consumer to choose its supplier.

It is therefore necessary to establish well functioning switching procedures and adequate tariffication systems that provide incentives for distributors to invest into the necessary infrastructure, providing good standards of quality to the customers and assuring them their right to choose its supplier.

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