



POSITION PAPER

Assessment of implementation of the internal gas and electricity market

Not later than 1 January 2006, the Commission will send to the European Parliament and Council a detailed report describing the progress achieved in the creation of the internal electricity and gas market. As a representative at European level of local companies active in the field of electricity and gas distribution, CEDEC would like, in the context of this assessment, to draw the attention of the European Commission to some problems cited by its affiliated companies. The characteristics of the gas market are undoubtedly not the same as those of the electricity market, although the problems raised in this opinion are of a structural nature and are broadly applicable to the two forms of energy.

Distribution networks account for more than 90% of supply lines (as against 10% in the case of transmission networks) between production power stations and final industrial and residential consumers. Their renewal and improvement should therefore be ensured in order to maintain supply quality and continuity.

Progress achieved thanks to the new Directives

CEDEC finds that there has been a positive development with the adoption of the Electricity (2003/54/EC) and Gas (2003/55/EC) Directives.

It is glad that :

- * the specific character of small and medium-sized distribution companies has been taken into consideration to a greater extent (exemption from legal separation for distribution companies with fewer than 100,000 connected customers). This specific character should be maintained as local distribution companies play a major local economic role and have a basic and privileged relationship with local authorities;
- * the opening of the market is recommended in a more balanced way, in particular with the possibility of imposition of public service obligations of a social and environmental nature.

Obstacles to the achievement of a real internal energy market

As the European Commission remarked in its most recent annual report (COM (2004) 863) on implementation of the internal electricity and gas market, there is still no major European energy market but rather a juxtaposition of regional markets. To the extent that one can speak of a real "market" in these regional markets, it also has to be recorded that the levels of opening are not the same in all Member States.

- An unbalanced market structure at the level of supply

Liberalization of the energy markets can in fact be achieved only if – at the level of supply - several producers and several suppliers engage in real competition. As regards electricity, national markets are currently dominated by a de facto monopoly or by an oligopoly, especially at the level of production. As regards natural gas, the number of potential producers is not only limited but, in addition, producers from outside the European Union are not subject to the rules of the European Union, while they account for most of the supply.

It is only when the opening of the electricity production markets will lead to a market which is in fact competitive that a complete opening will benefit all consumers - including those with a more limited

power of negotiation. Otherwise the free choice offered to consumers in the context of the current Directives will not give rise to the advantages expected from liberalization of the market, especially in terms of price reductions and service level.

CEDEC is glad that in May 2005 the European Commission launched an investigation with the aim of checking on the effects of liberalization of the electricity and gas markets, including the problems relating to concentration. The Commission report, which is planned for the end of 2005, must absolutely report on situations involving domination of the market and (explicit and implicit) anti-competitive behaviour and should also make proposals to remedy them.

CEDEC members have always emphasized the need for regulatory bodies which are not only independent but also competent and effective in a market in which there are monopoly and/or dominant operators.

Regulators should not only focus on regulated transmission and distribution activities but should also generally ensure the smooth operation of the market. This requires that they take the initiatives necessary to end the maintenance of monopolies in production, especially as the economically logical phenomenon of the integration of production and supply activities is occurring. It could therefore be envisaged, for example, that the new production licences should be granted as a matter of priority to competitors of the dominant operator as long as the national market share of the latter exceeds a certain threshold.

CEDEC is of the opinion that only a balanced market structure at all levels (production-supply-distribution) is capable of giving rise to the advantages expected from market liberalization. This requires a diversity of actors, including in terms of shareholding.

Through their initiatives, municipal distribution companies have shown that they are market facilitators and that they have an important role to play in the development and smooth operation of the market. However, the constraints imposed in some States are highly prejudicial to the development of initiatives. Local distribution companies contribute to the diversity of actors in the market and are able to reconcile economic requirements with general interest objectives.

Increased checking of concentrations is called for if it is wished to avoid the elimination of local and regional actors and the formation of an oligopoly at European level.

- A lack of incentives to invest in the networks
→ a threat to security of supply

Local public energy distributors, which have strong roots at local level, make sure to guarantee a quality public service by ensuring the required investments in the distribution networks. They can, however, guarantee the quality and continuity of this public service only insofar as the financial resources freed up as a result of their activities are sufficient.

Equal access by third parties to the distribution networks and security of supply will be a reality only if those responsible for energy distribution really have the legal means and financial resources which will enable them to offer to all users - including those in the peripheral areas - of their networks an efficient energy supply service.

Regulators responsible for the approval of tariffs relating to access to the distribution networks should authorize an appropriate profit margin in order to permit a fair return to the shareholders.

Moreover, a depreciation policy which reasonably reflects the economic life of the assets may not be refused by a regulator for reasons which have to do with a short-term objective, in particular a maximum reduction of tariffs relating to access to the networks.

In the absence of these two elements - return and depreciation - the wish to invest will be lessened and - through a deterioration of network quality - security of supply will be jeopardized.

CEDEC finds indeed that regulators often have an excessively short-term vision aimed at reducing electricity supply (transmission and distribution) prices whatever the cost while losing sight of other

objectives which are, however, of a long-term nature: optimal development of the network and improvement - or at least maintenance - of network quality.

From this standpoint of security of supply, CEDEC requests the European Commission to pay particular attention to the following elements:

- ensure a reasonable financing policy for investments in the distribution networks by requiring regulators to establish depreciation periods corresponding to the economic life of the assets involved;
- maintain a profit margin sufficient to remunerate at its true value the capital invested by distribution system operators, thus enabling them to continue to attract the capital required to maintain and develop their networks;
- ensure that - in the context of the setting or approval of tariffs relating to access to networks – the objectives of effectiveness and efficiency eventually required by the regulators of distribution system operators, take account of the socio-economic reality of the environment (network density, portfolio of customers connected as well as their consumption profiles, share of underground networks, nature of the subsoil, etc.) of the latter;
- ensure that the benchmarking methodologies relating to tariffs and the cost of access to distribution networks introduced by regulators should include not only quantitative aspects (costs) but also qualitative ones (for example, reliability criteria relating to network quality) in such a way as to - at least - maintain the current network quality level.

Implementation of these various elements should encourage investment in electricity and gas distribution and transmission networks in order to maintain high-quality networks, thus guaranteeing long-term security of supply.

- Fair financing of public service obligations : avoiding cross subsidies

As regards the protection of consumer interests, CEDEC notices that public service obligations (PSOs) of both a social and environmental nature have been introduced.

Although this is a positive development, it can however be noted that these PSOs are in most cases financed solely by tariffs for distribution system operators and not by those for transmission system operators. Major industrial customers connected directly to a transmission network therefore often do not contribute or contribute little to the financing of these PSOs.

CEDEC would like to draw the attention of the Commission to the consideration that this is a form of cross subsidy which penalizes small companies and residential customers for the benefit of large industrial customers.

With a view to protecting the interests of consumers (especially residential ones), CEDEC also emphasizes respect for elementary principles in the approach to potential customers, which should find expression, if necessary, in a code of good conduct for suppliers.

- Sustainable development to be promoted to a greater extent: at the level of demand (energy efficiency) and supply (renewable energies)

This calls for introducing policies of sustainable electricity consumption and of energy services aiming at energy efficiency.

Local public distributors should be able to continue with activities which give concrete expression to their policies of sustainable electricity consumption and rational use of energy. They can also, by virtue of their experience, contribute effectively to the development of an energy services market.

The EC communication on the share of renewable energies in the EU (COM (2004) 366 final) clearly indicates that additional measures will be required in this area.

CEDEC would like, however, to draw the attention of the Commission to the fact that, generally speaking, distribution networks are not currently designed to accommodate a major share of renewable energies. Investments and therefore additional financial resources will be required to adapt the distribution and transmission networks to the development of renewable energies and also to structural changes in energy consumption (for example, the more general introduction of night/day meters, or air-conditioning which could lead to consumption peaks in summer).

A fair apportionment of financing - to be borne wholly or partly by the producers – will have to be found.

The development of wind power at sea also involves additional investments in order to transport the electricity.

Rational use of energy (RUE) should be promoted to a greater extent, in particular through the installation of electronic meters which should guide electricity consumers so that they will consume their energy more rationally.

- Introducing neutral and independent computer systems from the suppliers which permit automated "switch" management

In a completely open market, one of the obstacles which could have an adverse influence on the smooth operation of the market derives from the difficulties affecting the various processes for measuring flows and exchanges of information. In the absence of uniform and operationally correct processes, customers will experience difficulties in connection with a change of supplier (switch).
