

**Union of the Electricity Industry – EURELECTRIC
Position Paper on the proposed Directive
concerning measures to safeguard security of electricity supply
and infrastructure investments**

March 2004

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The **Union of the Electricity Industry–EURELECTRIC** is the sector association representing the common interests of the European Electricity Industry and its world-wide 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.

GENERAL OBSERVATIONS

General

EURELECTRIC views reliable electricity supply at reasonable prices as a precondition for economic growth and the welfare of the citizens of Europe. Accordingly, the European electricity industry is strongly committed to maintaining high standards of security of supply for its customers. Primarily this requires an appropriate framework, which facilitates a properly functioning competitive electricity market and provides appropriate incentives for network businesses.

In EURELECTRIC's view, the new Electricity Market (IEM) Directive¹ and the Cross-border Trade (CBT) Regulation² already provide a comprehensive framework for dealing with supply security. The IEM Directive is to be implemented in the Member States by 1st July 2004, implying significant changes for the European electricity industry. When the liberalisation package was going through the adoption process, the Commission indicated³ that there would be a period of legislative stability regarding liberalisation, until the provisions had been fully implemented. This was to allow the EU Institutions, Member States and market players to evaluate the impact in practice. EURELECTRIC believes that this promised regulatory stability is crucial in ensuring the right climate for investments along the electricity supply chain, which are in turn indispensable if liberalisation is to be successfully completed. Given that not enough experience has yet been gained in the use of the existing tools available, it is difficult to assess the added value of the recently-proposed Directive on Security of Electricity Supply (*hereafter referred to as the Directive*). EURELECTRIC does not therefore see a pressing need for the Directive and questions its appropriateness.

In its Communication of December 2003, the Commission refers to the power outages throughout Europe during 2003. EURELECTRIC recognises that such events are a matter of concern for citizens, politicians and the industry itself. However, according to a EURELECTRIC analysis, this coincidental series of independent blackouts could equally well have happened before liberalisation. Hence, these incidents cannot justify such regulatory measures such as those proposed in the Directive. In any case, the Directive does not address the actual problems that led to the recent blackouts.

In EURELECTRIC's view the introduction of additional measures relating to security of electricity supply at this stage of the liberalisation process may be premature. Given the vital importance of security of electricity supply, EURELECTRIC is prepared to contribute constructively to the debate on the right market framework. EURELECTRIC fully endorses and considers as part of the electricity industry's mission the principle that European citizens must not suffer from malfunctioning of the electricity system.

¹ Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC

² Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity

³ The Commission in its "interpretative note" of January 2004 on security of electricity supply concludes: "The Electricity Directive gives the European Union and the Member States enough instruments to ensure that the security of supply at reasonable prices can be achieved".

Generation and supply

On a European level, the competitive electricity market has not yet reached maturity and wholesale markets are still developing. This competitive framework, chosen by Member States in 1996 with the first IEM Directive and reinforced in 2003, should be allowed to function properly before any conclusions on its appropriateness are drawn. Therefore, EURELECTRIC deems it of the utmost importance to implement the IEM Directive without undue delay, and allow market participants to gain experiences in the functioning of the competitive market.

In EURELECTRIC's view, liquid wholesale markets are the most important prerequisite for creating credible price signals that can stimulate new investments in electricity production. It is important that market actors be provided with a free choice of instruments for risk management, e.g. the ability to take out short- or longer-term contracts or purchase on the spot market. The introduction of regulatory measures that are not market-oriented would interfere with the functioning of the market. This particularly applies to any burden related to security of supply imposed on players in the competitive segment of the market. Any regulatory measure should be carefully designed and calibrated to ensure it achieves its goals.

Networks

Networks are natural monopolies and consequently subject to tighter regulation. Yet, they too are basically businesses, which react to economic incentives and require an adequate return on capital. The specific requirements of society, i.e. continuity of electricity supply at reasonable prices, should be ensured by the regulatory framework. One important element of this regulatory framework is the need to ensure the long-term perspective of the infrastructure investments. Another is to take into account the European perspective in transmission investments and operation. In this regard, EURELECTRIC acknowledges the desirability of more cross-border interconnections in certain areas in Europe, so as to facilitate the completion of the single European electricity market, taking into account the difficulties that continue to delay this development. Nonetheless, the Directive's reliance on non-economic factors and centralised planning may prove to be an inappropriate way to contribute to security of electricity supply.

EURELECTRIC believes that European and national legislation, as well as voluntary cooperation among European TSOs, have developed in the right direction. The most serious barrier to greater interconnection, however, does not lie with regulation, but with the difficulty of obtaining public acceptance and the lengthy nature of permitting procedures.⁴

⁴ In EURELECTRIC's view, the Communication overestimates the potential scope for undergrounding of high-voltage lines, whereas public opinion's preference for undergrounded lines rather than overhead lines is not as obvious as some might believe. Having also considered the differences in costs of underground and overhead lines, EURELECTRIC suggests that the question of undergrounding be left to cost-benefit analyses and case-by-case negotiations with the communities involved.

Securing a reliable electricity supply

EURELECTRIC agrees that it is essential to have clear and published roles and responsibilities in relation to security of electricity supply in all Member States. This will contribute to regulatory clarity, and thus to an investment-friendly climate. However, these issues could be best dealt with at Member State level.

Forasmuch the issue of secure supply is not confined to national borders, EURELECTRIC agrees that a high degree of consistency among national policies is desirable in order to ensure a level playing field, which is crucial for a high degree of market functionality.

The existing “toolbox” provided by the IEM Directive and the CBT Regulation contains a comprehensive set of instruments both to prevent situations, where the electricity supply may be endangered, and to intervene as a measure of last resort. However, only limited experience has been collected to-date on the practical functioning of this “toolbox”. EURELECTRIC stresses that experience should first be gained in order to identify whether additional measures might be necessary.

A clear distinction must be made between short-term security of supply, which relates to the operational reliability of the system (system reliability); and long-term security of supply (system adequacy), which requires sufficient power generating capacity (both base- and peak-load) and robust networks (both transmission and distribution). Although inter-linked, these two aspects of secure electricity supply are not synonymous and they call for different solutions. In addition, it should be stressed that the third element of secure electricity supply – the continuous access to relevant fuels at reasonable prices – must always be taken into account.

Future investments

As a predictable regulatory framework is among the most important preconditions for investor-confidence, any political signal sent by legislators is of importance. The explanatory memorandum of the Directive contains assumptions about the future of the electricity sector that are clearly unrealistic. The scenario that investment needs in electricity generation in the EU-15, projected both by EURELECTRIC and by the IEA at around 600 GW over the next three decades, can be covered primarily by demand side management, renewable energy sources, distributed generation and CHP is misleading. This scenario can hardly be developed through market forces, contradicts the approach of the IEM Directive and runs counter to the objective of an efficient internal market. In reality, substantial amounts of conventional generation capacity will be needed in the next three decades, both to provide energy and to supply reserve for intermittent sources, such as wind-power.

EURELECTRIC regards demand side management, renewables and distributed generation as important elements in developing a diversified and robust electricity system on a competitive basis. However, if the competitive liberalised electricity market is to develop further, the choice of technology and fuel must be left to investors. It must also be noted that a decrease in overall energy consumption can actually be achieved through increased electricity consumption⁵.

⁵ EURELECTRIC Position Paper on the proposal for a Directive on energy end-use efficiency and energy services

COMMENTS ON INDIVIDUAL ARTICLES

Article 2

Among the definitions, a distinction between short- and long-term security of supply is missing. Short-term security of supply relates to the operational reliability of the system, whereas the term “long-term security of supply” covers the adequacy of generating capacity and networks.

The specific definitions of “new market entrant” and “company with small market share” are not necessary, as all market actors should be treated equally (see Article 3).

Article 3

EURELECTRIC agrees on the need to establish and publish national policies on security of electricity of supply, including a description of roles and responsibilities.

Investments should mainly be based on economic considerations. This is hardly reflected in the Directive’s listing of important factors for security of supply policies.

The Article (together with Recital 5) should refer to the need for a predictable and investment-friendly regulatory framework, an issue discussed at length in the explanatory memorandum, and deemed of key importance by EURELECTRIC.

“Unreasonable burdens” should not be placed on any market actor.

Article 4

EURELECTRIC can agree with the rationale of setting minimum operational standards on network security in dialogue with neighbouring Member States. Close co-operation among TSOs, whose importance was highlighted by a series of blackouts last year, is also needed.

Article 5

A clear distinction is needed between measures necessary to deal with short-term and long-term security of electricity supply, whereas the Article appears to confuse the two aspects.

“Establishment of liquid wholesale markets” must be the preferred option for maintaining the supply/demand balance and should be placed on the very top of the list. Additional instruments must as far as possible be market-oriented. Direct regulation (obligations on market actors) should only be used where absolutely necessary, e.g. for ensuring security of supply after “gate closure” (in operational timescales).

As a crucial element in the functioning of the market, customers’ involvement (e.g. response to price changes, interruptible customers, etc.) should be encouraged.

Article 6

The scope of this Article seems entirely flawed. Basically, network investments must satisfy the demands of end-use consumers, generators and other suppliers in the market and thus the cost-effectiveness of the investment must be the primary condition. Instead, the Article exclusively focuses on non-economic criteria. This cannot be consistent with the agenda of improving Europe's competitiveness and promoting an efficient internal market.

The wording of the Article reflects a vision of local self-sufficient systems, independent of costs – in clear contradiction to Article 7 with its emphasis on interconnection.

Article 7

EURELECTRIC believes that the development of cross-border lines should be facilitated. However, the Directive proposal's introduction of centralised planning with additional bureaucratic stages of approval and sanctions does not offer a comprehensive solution.

The focus concerning interconnector investments must always be on

- ❖ economic considerations such as the cost-effectiveness of the investment;
- ❖ cooperation between TSOs in order to obtain economic incentives for investors, which reflect net benefits for the interconnected systems;
- ❖ streamlining of approval procedures.

The wording de facto seems to rule out the building of “merchant lines”, which is in conflict with the CBT Regulation. EURELECTRIC believes that the option of entrepreneurial approaches should remain open, particularly in the case of highly capital-intensive projects, such as DC links.

EURELECTRIC can support the call for a “rate of return on investment that compares to the average cost of capital for investments with similar risks”, which addresses one of the key questions for the construction of interconnection.

EXISTING TOOLS

Existing legislation provides a comprehensive package of instruments to address security of security of electricity supply.

The Commission in its “interpretative note” of January 2004 on security of electricity supply concludes: “The Electricity Directive gives the European Union and the Member States enough instruments to ensure that the security of supply at reasonable prices can be achieved”.

Both the IEM Directive and the CBT Regulation contain a number of provisions regarding security of supply:

IEM Directive

Art. 3.2: An option to impose public service obligations relating to security of supply.

Art. 3.7: A requirement to implement appropriate measures to achieve the objective of security of supply.

Art. 4: A requirement to ensure monitoring of security of supply. In the report to the Commission, any measures planned or taken to deal with problems of security of supply must be outlined.

Art. 7: A requirement to establish a procedure for tendering of new capacity (or equivalent demand side management) should the market not generate sufficient investments to balance supply and consumption.

Art. 9: Responsibility for the TSO to ensure adequate transmission capacity and system reliability. The obligation to provide other TSOs with sufficient information.

Art. 14: Responsibility for the DSO for maintaining a secure, reliable and efficient electricity distribution system. In planning the development of the network also demand side management measures, plus distributed generation must also be considered.

Art. 24: Safeguard measures in the event of a sudden crisis.

CBT Regulation

Art. 5: A requirement on the TSOs to put in place coordination and information-exchange mechanisms. A requirement on the TSO to establish and publish safety standards.

Art. 6.6: TSO revenues from congestion management must be used for relevant measures, such as investment in interconnectors.

Art. 7: The option of “merchant lines”.

Art. 8: Transmission tariffs must include locational signals.

Art 13: Comitology procedure implying a co-operation between Member States.

Art. 14: Commission report containing an evaluation of the Regulation's impact on security of supply.