

Message from the College



1

From 1st July 2008, France will hold the Presidency of the European Union. A sign of the times, energy is one of its key priorities for the term of the French Presidency.

The second half-year of 2008 could well see the consolidation of a process begun back in 1996, when the European Commission and the EU Member States started working toward the development of an internal electricity and gas market that combines security of supply, economic competitiveness and measures to combat climate change.

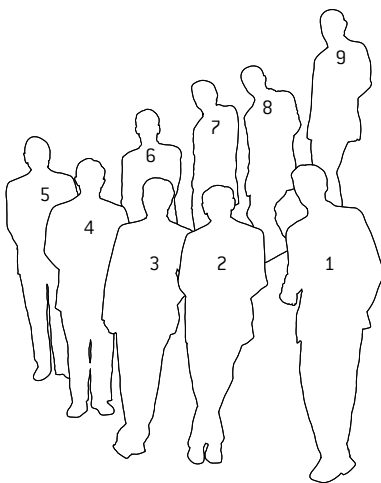
These three objectives are interdependent. In promoting the free movement of energy flow, the EU internal market aims to optimise the complementary nature of the energy mix and boost Europe's competitiveness. Granting freedom of establishment to producers and suppliers will encourage the development of diversity of production sources, including renewable ones. It also provides Europe-wide development opportunities for market players.

These are the objectives announced in March 2007 by the European Council, which has made the development of an "efficient, fully operational and interconnected internal energy market" one of the prerequisites for ensuring security of supply within the European Union.

The aim of the "3rd Energy Package", presented by the European Commission on 19th September 2007, following the Energy Packages defined in 1996-1998 and 2003, is to speed up progress on developing this internal market. To this end, three major measures are proposed: improve operation of the electricity and gas transmission networks in Europe; align and consolidate the powers of national regulators, both in terms of the scope of their authority and of their independence; and set up an agency for cooperation among energy regulators.

The establishment of the internal market implies a need to lift obstacles to trade between the various networks. Furthermore, inadequate investment in interconnections, together with the resulting congestion, act as a brake on the development of this market.

This is also one of the findings presented in the report entitled "*Sécurité énergétique et Union Européenne – Propositions pour la présidence française*" (Security of energy supplies and the European Union – Proposals for the French Presidency), submitted to the



1. Philippe de Ladoucette (Chairman)
2. Michel Lapeyre (Vice-Chairman)
3. Maurice MEDA (Vice-Chairman)
4. Pascal Lorot
5. Hugues Hourdin
6. Éric Dyèvre
7. Jean-Paul Aghetti
8. Emmanuel Rodriguez
9. Jean-Christophe Le Duigou

French Prime Minister by Claude Mandil on 21st April 2008. According to the report, “full and determined implementation of the internal market will not compromise security, as we have heard all too often.” On the contrary, it is essential for creating solidarity within the Union. Nonetheless, it is crucial that this be a single, fluid market, not twenty-seven separate markets which, even if liberalised, remain divided by contract practices, the lack of transmission infrastructure and of regulatory harmonisation.”

To achieve this goal, a pragmatic approach has been taken: regional cross-border markets are being set up, based on developing and optimising the use of interconnections. With this in mind, CRE is actively involved in four regional initiatives in the electricity sector and two initiatives in the gas sector.

Tangible progress has been made in this area.

In the electricity sector, this mainly involves changing the interconnection access rules and defining common mechanisms to manage congestion in Europe, similarly to the coupling of the French, Belgian and Dutch market, which is to be extended to include the German and Luxembourg markets in 2009.

In the gas sector, regional initiatives have improved transparency thanks to the publication by system operators of data that is essential to market players. In addition, these initiatives help optimise the use of existing capacity and boost development of natural gas imports from Spain, Germany and Belgium.

Developing the regional markets should not, however, eclipse the ultimate objective of uniting them into a single European market, implying that a minimum of harmonisation between regions should be established from the outset.

* * *

In France, the process of opening up the gas and electricity markets to competition was completed on 1st July 2007 when the household customers markets were opened. Now that unbundling of systems operators' activities has been completed, in compliance with the Act of 7th December 2006, regulations applicable to these natural monopolies can be modified as required.

In parallel with the gradual introduction of the new tariff structure for the use of the electricity and natural gas networks, beginning on 1st July 2008, CRE has started to set up mechanisms aimed at encouraging systems operators to offer the most efficient service at the most reasonable price.

Within the framework of incentive-based regulation of costs, the new tariff structure is defined for a period of three to four years and takes account of productivity objectives set by the tariff decision. This new regulatory framework, which has already been implemented by some European regulators, will provide greater visibility for suppliers and operators. In accordance with the Law, any changes to new tariffs for access to the networks should be passed on in the regulated electricity and gas retail tariffs

CRE is also working on developing an incentive-based regulation of quality. Based on information now available regarding the setting up of ERDF, CRE has observed a degradation, originating from well before the opening of the market, in the quality of electricity distributed on the networks granted to this operator. A supreme effort to improve quality must be made in the coming years.

Furthermore, the emergence of an interconnected and competitive market requires significant development of electricity and gas infrastructures.

Among the investments planned by RTE, electricity interconnection is seen as a key pri-

ority. The obstacles encountered in developing these interconnections are not financial, but involve local residents' environmental concerns and the complexity of certain administrative procedures. It is essential to find a compromise between the legitimate concern to protect the environment and the need to rapidly complete engineering works that are crucial to developing trade and solidarity between EU Member States and to ensuring safety.

In the gas sector, planned investment for interconnection with Germany, Belgium and Spain will create new gas entry capacities in France. Similarly, the planned LNG terminals will not only enable greater diversity of supply sources, but will also contribute to ensuring the surplus capacity required for market development.

* * *

CRE has seen to it that all the technical and legal conditions for the full opening up of the markets on 1st July 2007 are met: any customer who wishes to change supplier can now exercise this right in full knowledge of the facts, simply, free of charge and with the guarantee that the same quality and safety standards are maintained.

Developing an understanding of how the competitive market works will nonetheless be a very gradual process. It is dependent on providing clear information to the customer. Moreover, only one third of French households are aware that they can now choose their gas and electricity suppliers. This demonstrates that the introduction of competition, in both these sectors, requires information and time.

The development of the competitive market should be seen in the context of high energy costs, due to the rising prices of raw materials, of dealing with environmental requirements and the scale of investment required for restructuring and development in the areas of production, transmission and distribution.

In France, progress in the competitive market is held back by the fact that regulated retail tariffs are maintained, in parallel with market contracts.

In the electricity sector, four years after being fully opened up to competition, the business market is sluggish: the introduction of the transitory regulated tariff for market adjustment (TaRTAM) has closed the market to large companies; in the SME-SMI market, alternative suppliers are still suffering from a tariff scissor effect in their efforts to compete against the regulated retail tariffs.

A year after being opened up, competition on the electricity market for residential customers is still very slow.

In all, 2.7 % of the sites – i.e. 31 % of France's electricity consumption – have switched supplier. Nonetheless, nearly two-thirds of business customers' consumption via suppliers on the open market is subject to the TaRTAM.

In the gas sector, competition is more dynamic: in the case of household customers and business customers alike, the number of sites using gas supplied via the open market is rising consistently. The change from five to three balancing zones, due in January 2009, will create one large market zone in the northern half of France. This will boost the development of liquidity in the wholesale gas market within this zone. In addition, setting up a gas exchange should improve trading conditions for newcomers.

In order for alternative suppliers to be competitive, regulated retail tariffs need to be adjustable so that they can take account of gas import costs, as provided by law.

In all, 4 % of delivery points – i.e. 43 % of gas consumption in France – are supplied at market prices.

Implementing the task of monitoring the wholesale markets conferred upon it under the provisions of the Act of 2006, CRE investigated the spikes in electricity pricing observed on the Powernext Day-ahead Auction in October and November 2007, when pressure on supply and demand was very intense. No reprehensible behaviour on the part of any individual was found. CRE did, however, identify several failures in the system which were factors in these price spikes. Consequently, it issued recommendations that players in the electricity wholesale market, producers, Powernext and RTE have begun to implement.

* * *

The suppliers' commercial dynamism should lead to them being able to offer the consumer more innovative solutions in terms of controlling energy use and the supply of electricity from renewable sources.

CRE is concerned to control electricity demand. For example, it recommends widely deploying metering systems developed by systems operators. To this end, it is monitoring ERDF's pilot scheme to replace 300,000 meters with smart meters, in 2010, prior to installing them for all customers. Innovation such as this will help suppliers diversify their offers, systems operators improve the quality of their services and customers be more aware of how much energy they consume, and thus, how to save it.

Smart metering systems are only one of the many forms of smart systems being developed to equip networks in the future and which, for the customer's benefit, make it possible to manage these engineering works more effectively and develop new services. On this subject, it is worth mentioning electricity flow management thanks to distributed load shedding, which is the result of aggregating a large number of minor load shedding actions at sites connected to the public distribution systems. CRE approved the rules proposed by RTE for the experimental integration of such load shedding adjustments in the balancing mechanism.

* * *

In its bid to meet the energy challenges of the 21st Century, Europe has opted for an open, competitive market. Implementing this policy must, necessarily, pass through the transition stages, during which many questions may be raised. One answer to such questions is to regulate the gas and electricity markets in a strong, efficient and independent fashion. This is CRE's ambition, with regard to both the French and the European markets.

How CRE works

I. CRE regulatory authority and organisation PAGE 8

1. Powers PAGE 8
2. Organisation PAGE 9

II. Budget resources PAGE 12

III. Personnel PAGE 13

I. CRE regulatory authority and organisation

The Act of 7 December 2006 relative to the energy sector completes the provisions ensuring transposition of the European Directives of 26 June 2003, especially those measures relating to full opening of the electricity and natural gas markets to competition as from 1 July 2007. This Act extended CRE's authority.

1. Powers

According to Article 28 of the Act of 10 February 2000, pursuant to Article 5 of the Act of 7 December 2006, CRE's remit is to "assist in ensuring the proper operation of the electricity and natural gas markets for the benefit of the end-user. In particular, CRE ensures that the conditions of access to electricity and natural gas transmission and distribution systems do not hinder the development of competition. It monitors, for the electricity and natural gas sectors, all transactions made between suppliers, traders and producers, all transactions made on the organised

markets and cross-border trading. It ensures that suppliers, traders and producers propose offers that are consistent with their financial and technical constraints" (see Insets 1 and 2).

The Act of 7 December 2006 relating to the energy sector extends CRE's regulatory authority to include the gas sector.

It monitors the implementation of and compliance with regulations giving consumers the right to choose their supplier in a competitive market, and allowing new suppliers to enter the market.

In this context:

- CRE monitors the conditions of access to gas and electricity transmission and distribution systems and infrastructures

CRE is responsible for ensuring fair and equitable access to the public electricity and gas transmission and distribution systems and to liquefied natural gas (LNG) facilities. Competition can only come into play if all energy suppliers have transparent and non-discriminatory access to all the systems, structures and facilities in the energy transportation chain through to the end consumer.

Inset 1: Major aspects of CRE's authority (outside the CoRDiS framework)

Authority to propose tariffs:

- for the use of energy transmission and distribution systems, and tariffs for access to LNG facilities;
- for the related services provided by electricity system operators.

Authority to propose cost levels:

- for the public electricity service;
- related to the transitory regulated tariff for market adjustment (TaRTAM) applicable only in the electricity sector;
- of charges assignable to the special social tariff for electricity and to the special solidarity tariff for gas.

Authority to approve:

- investment programmes defined by

electricity and gas transmission system operators;

- the rules relative to account unbundling in the electricity and gas sectors;
- between supply, transmission and distribution activities,
- between supply to customers who have exercised their eligibility and those who have not.
- the rules for presenting bids and supply programmes prior to launching, and the balancing proposals submitted to the electricity transmission system operator;
- billing tariff tables for connecting users to the public electricity distribution systems;

Additional regulatory competencies in the electricity and gas sectors relative to:

- conditions for connecting users to the systems;
- conditions for using the systems.

Monitoring the wholesale markets and the power of inquiry with regard to operators in the performance of its duties;

Organising calls for tenders decided by the French Ministry for Energy to develop new electricity production facilities and giving its opinion on companies submitting bids;

Providing its opinion on regulated retail tariffs for electricity and gas.

Note 1: Article 5.1 de la loi du 7 décembre 2006

Within this framework, CRE proposes tariffs for the use of systems and infrastructures to the government.

CRE ensures the development and effective operation of systems. To this end, CRE approves the investment programmes defined by electricity and natural gas transmission system operators. It also approves the legal accounting principles applicable to unbundling transmission, distribution and supply activities. Each year, it publishes a report on compliance with codes of good conduct and the independence of electricity and natural gas system operators

- CRE monitors the markets

CRE is in charge of monitoring transactions carried out on the organised and non-organised wholesale markets, as well as cross-border trading.

Market monitoring entails checking that price structures are the result of fair competition. CRE analyses prices and players' decisions in order to detect any behaviour which may appear suspicious and might indicate price manipulation. Effective monitoring reassures participants, encouraging the development of transactions and reinforcing the market's ability to give opposite price signals. Confidence in how prices are set is also a determining factor for investors.

- CRE is involved in implementing measures relative to the public energy service

This includes:

- purchase obligations imposed on incumbent suppliers within the framework of developing cogeneration and renewable energy sources, in the case of electricity;

- the special social tariff for electricity, considered to be a "basic necessity", and the special "solidarity" tariff applied to gas.
- national equalising system relative to electricity production costs in non-interconnected areas.

2. Organisation

Pursuant to the Act of 10 February 2000, in the amended version introduced by the Act of 7 December 2006, CRE now has a College of Commissioners and a Standing Committee for Dispute Settlement and Sanctions (CoRDIS). CRE is composed of departments that come under the authority of the Chairman – or, in the case of missions assigned to CoRDIS, under the authority of the Committee Chairman – and directed by the Managing Director.

2.1. The College

Introduced by the Act of 7 December 2006, the College of Commissioners comprises 9 members:

- The Chairman, appointed in 2006 by Presidential decree; in the future, pursuant to the Act of 2006, the appointment of the Chairman will be subject to approval by the French National Assembly and Senate committees competent in this matter;
- Two Vice Chairmen, appointed, in accordance with the Act of 7 December 2006 establishing these offices, by the President of the National Assembly and the President of the Senate respectively, from the members they nominated;
- Two members appointed respectively by the President of the National Assembly and the President of the Senate respectively;
- One member appointed by the Chairman of the Economic and Social Council;

- One member appointed by decree;
- Two representatives of electricity and natural gas consumers, added in application of the Act of 2006, appointed by decree at the beginning of 2007.

The members of the College are appointed for a term of six years; and this term of office, which cannot be revoked, is not renewable.

In March and April 2008 the first partial renewal of the College since the introduction of the Act of 2006 took place: in accordance with the Act of 7 December 2006, the two members of the College whose term of office had come to an end, and who exercised their duties on a full-time basis, were replaced by two new members who exercise their duties on a part-time basis: Mr. Hugues Hourdin, appointed by the President of the French Senate, and Mr. Jean-Christophe Le Duigou, appointed by decree.

In accordance with Article 35 of the Act of 10 February 2000, the members of the College, like all CRE members and agents, act with complete impartiality in the exercise their duties, and receive no instructions from or come under the authority of any institution, person or organisation.

They are independent. As such, they are subject to incompatibility rules, which do nonetheless differ depending on whether a member is full-time or part-time. The offices of Chairman and the two Vice Chairman are incompatible with any professional activity or elected office at municipal, departmental, regional, national or European level, with membership of the Economic and Social Council, and with any position in the public sector or any direct or indirect interests held in the energy sector. The offices of all the other members of the Col-

Inset 2: Four kinds of proceedings

- **Decisions:** proceedings notified to the parties concerned. These decisions are legally binding and the parties concerned are liable to sanctions if they fail to comply.
- **Proposals:** proceedings addressed to the government, which may either ratify them or reject them as a whole, without

the possibility of modifying them (tariffs for access to the systems and public service charges). Such proposals are made public when the government's decision is published in France's Official Journal.

- **Opinions:** proceedings addressed to the government regarding draft texts. CRE's

opinions do not bind the government. They are made public when the government's decision is published in France's Official Journal.

- **Communications:** proceedings in which CRE makes its position known on a subject that comes within the scope of its jurisdiction.

lege are incompatible with elected office at national or European level and with any direct or indirect interests held in a company in the energy sector.

2.2. The Standing Committee for Dispute Settlement and Sanctions (CoRDIS)

2.2.1. How CoRDIS was founded

The Standing Committee for Dispute Settlement and Sanctions (CoRDIS), which is separate from the College of Commissioners, was set up under the Act of 7 December 2006 relative to the energy sector.

It was set up as the result of an amendment put forward by the French Senate's Standing Committee for Economic Affairs. According to a report by Senate member Patrice Gélard, this committee's studies revealed that CRE, in failing to separate its duties regarding the regulation, examination and implementation of sanction procedures, risked being in violation of the requirements relative to the right a fair trial set out under Article 6 of the European Convention on Human Rights (ECHR) and, more particularly, of the principles of independence and impartiality set out in the first paragraph.

To resolve this, two options were examined by the Senate Standing Committee: first, to increase the number of College members so that, within the framework of sanctions procedure, the people responsible for deci-

sions are not involved in the complaints examination procedure; or, second, to set up a separate body responsible for settling disputes and sanctions.

The Standing Committee for Economic Affairs did not think that increasing the number of members of the College would be advisable, so it decided to propose an amendment to set up a special body within CRE.

Article 5 of the Act of 7 December 2006 conferred upon CoRDIS the duties formerly attributed to CRE insofar as regards dispute settlement and sanctions (Articles 38 and 40 of the Act of 10 February 2000).

2.2.2. Members of CoRDIS

Article 5 of the Act of 7 December 2006, amending Article 28 of the Act of 10 February, states that the Committee shall comprise four members - two Councillors of State appointed by the Vice President of the French Council of State (*Conseil d'État*) and two Councillors of the Supreme Court of Appeal (*Cour de Cassation*), appointed by the First President of the Supreme Court of Appeal.

On 18 December 2006, the First President of the Supreme Court of Appeal decided to appoint Ms Dominique Guirimand and Ms Jacqueline Riffault-Silk, and, on 5 February 2007, the Vice President of the Council of State appointed Mr Pierre-François Racine and Mr Jean-Claude Hassan as the members of CoRDIS.

The members of CoRDIS are appointed for a period of six years, except in the case of its initial set-up, for which the term of office of two of its members, drawn by lots, is set at three years. At the CoRDIS meeting on 28 February 2007, this draw attributed a three-year term of office to Ms Riffault-Silk and Mr Hassan.

Pursuant to the Decree of 15 February 2007, Mr Racine was appointed Chairman of CoRDIS.

2.3. Departments

(see organisation chart on the right)

2.4. CRE's activity in figures

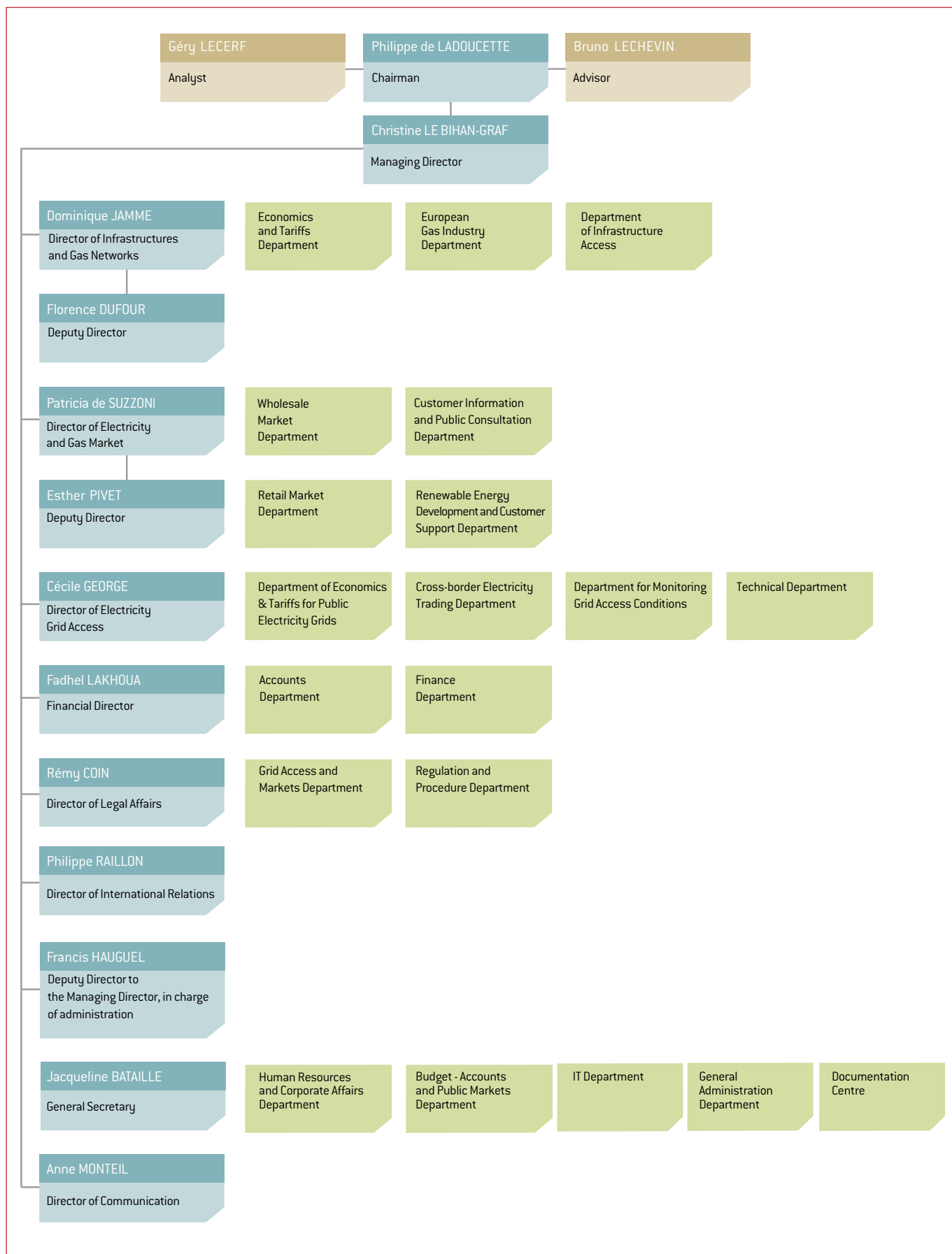
Between 1 June 2007 and 31 May 2008, CRE held 271 sessions resulting in 145 proceedings. (cf. Table 1)

Due to the preparation of new tariffs for access to the electricity grids and gas networks, the number of hearings almost doubled: 247 this year compared with 137 during the previous year.

CRE proceedings are made public on its website, except in the case of those comprising secrets protected by law.

Table 1: CRE activity in figures from 1 June 2007 to 31 May 2008

	Gas	Electricity	CRE organisation	Total 2007-2008	Total 2006-2007
Decisions	9	19	2	30	21
Proposals	1	10		11	0
Opinions	88	8	1	97	94
Communications	1	6		7	10
Hearings	135	112		247	137
Public inquiries	1	0		1	1
Dispute settlements	1	3		4	3



II. Budget resources

The Commission's budget resources are allocated in the French State budget. In the Budget statement, they come under the heading "Economic Development and Regulation", as part of the "Economic Regulation" programme whose mission deals with "Energy Market Regulation and Monitoring" activities.

The budget allocated under the initial Budget Act of 2007, 18 million euros, proved insufficient for dealing with the issues involved in full opening to market competition and in CRE's extended responsibilities as provided for in the Act of 7 December 2006. This led to the need for additional operating appropriations which could only be met by carrying over appropriations, while needs for extra personnel generated

by CRE's new responsibilities have remained unfulfilled.

The 5.8% increase in CRE's total budget for 2008 is already proving to be inadequate and fails to cover the creation of new jobs at a time when there should be more new positions created to cope with the activities entailed by the extension of CRE responsibilities, i.e. developing market monitoring tools, dealing with the number of external audits and EU activities, and providing consumer information.

The structural deficit in the CRE's operating budget cannot, as revealed in a recent report published by the French Court of Auditors (the *Cour des Comptes*), simply be dealt with by means of one-off, random

measures, such as carrying over appropriations. The only valid solution to meet the needs generated by the new scope of CRE's responsibilities is to re-establish the budget, factoring in an increase in operating appropriations, and to plan ahead for their probable further extension as a result of the EU's Third Energy Package in 2009.

It is therefore essential to readjust CRE's resources, within the framework of the multi-year budget for 2009-2011, thereby enabling it to perform its duties, and in light of the EU directives defined in 2003 requiring Member States to make every provision to ensure that the national regulatory authorities have the resources they need to "carry out their duties [...] in an effective and expeditious manner."

III. Personnel

The number of full-time equivalent personnel working for the CRE rose from 117 agents at the end of 2006, to 120 at the end of 2007 and to 128 as on 30 June 2008.

In 2007, 85% of personnel was executive-level staff. 47% of employees were women and 53% were men. The average age was 38. (cf. Figure 1)

86% of staff is under contract, with over a third coming from energy sector companies, while the other 14% consists of civil servants.

The employees' broad range of professional backgrounds (companies, consultancies, universities, other regulatory bodies, etc.), their technical expertise and the wealth of their experience cannot be emphasised too strongly. CRE's powers and responsibilities mean that it requires a high level of

expertise, in the field of energy and also in financial auditing. The employees recruited with such expertise therefore boast a very high level of training and usually have many years of experience behind them (currently, only 13 CRE employees are in their first job). The majority are graduates of the *Grandes Ecoles* of Engineering or come from audit offices.

Nearly 80% of staff is directly assigned to regulation duties and performs jobs related to CRE's specialist activities (engineers, economists, technical-economists, financial and legal experts), while 20% of the staff is involved in support jobs (administration, accounts, IT, etc.).

A proactive and continuous training policy ensures that skills are continuously updated to deal with changing regulatory duties, to improve personal performance (IT skills and foreign languages) and to

support employees' career development plans, including courses that result in recognised qualifications, related to CRE activities. In 2006, 60% of CRE personnel went on one or more training courses.

CRE's pay policy is based on recognition for professional ability (level of training and experience), and takes into account the level of responsibility held as well as the effort made by each employee to achieve planned objectives. In 2006, average annual gross salaries, including bonuses, were as follows: €3,500 € for non-managerial staff and administrative staff, €5,000 € for middle management, €6,000 € for heads of department and €14,000 € for directors.

Figure 1: Age pyramid

