



# Building a single European energy market

## Overview [PAGE 22](#)

### I. Organisation and coordination of the main European regulators [PAGE 26](#)

1. Work carried out collectively by European regulators [PAGE 26](#)
2. Regulator organisation and development [PAGE 27](#)
3. CRE's relations with European Community institutions [PAGE 28](#)
4. Development of CEER activities outside the European Union [PAGE 28](#)

### II. CRE's European activities [PAGE 30](#)

1. The contribution of European regulators to the Third Energy Package [PAGE 30](#)
2. Integration of gas markets [PAGE 30](#)
3. Integration of electricity markets [PAGE 34](#)
4. Operation of the European interconnected electricity grid and security of supply [PAGE 39](#)
5. Opening up markets to benefit consumers [PAGE 39](#)

### III. European Community activities [PAGE 46](#)

1. The European Commission's proposals for the internal energy market:  
the Third Energy Package [PAGE 46](#)
2. The European Commission's proposals for fighting climate change:  
the Climate Package [PAGE 50](#)
3. Infringement proceedings initiated against France by the European Commission [PAGE 51](#)

# Overview

The Treaty of Lisbon, signed on 13 December 2007 by the heads of state and government of the 27 Member States of the European Union, makes energy a shared competence within the European Union. From this date forward, the Union is competent to manage operation of the energy market, and assumes new competence in terms of security of supply. The Treaty also provides that if one or more Member States are experiencing supply difficulties, their needs can be met by pooling resources available within the Union, based on the principle of solidarity.

Endowed with the authority to govern issues concerning the internal market and competition, since 1996 the European Commission has been promoting the construction of a European energy market that combines security, competitiveness and sustainable development.

The objective is to create an open, competitive market where electricity and gas flows can circulate throughout Europe and all final customers can freely select the European supplier of their choice.

On a practical level, this involves moving from 27 juxtaposed national markets to a genuine single market. Through its daily participation in regional electricity and gas initiatives, CRE contributes to market integration, which consists of reinforcing interconnections and encouraging more effective use of existing infrastructures, while harmonising and reinforcing the authority of regulators.

## CRE and integration of the internal electricity and gas market

To integrate open national electricity and gas markets, it is necessary to harmonise practices in each country in terms of network access, and make cross-border exchanges as easy and fluid as they are in a nationwide network.

CRE is working with the other European energy regulators to make these goals a reality. Since 2006, its work has mainly been organised within the framework of regional «electricity» and «gas» initiatives defined by the European Commission and the European Regulators' Group for Electricity and Gas (ERGEG). By bringing together regulators, transmission system operators, stock markets and market players (consumers, producers and traders) in the same geographical area, these regional initiatives are gradually bringing about advances in managing exchanges at cross-border interconnections, leading to the emergence of genuine regional markets.

### CRE is participating in four regional electricity initiatives

These regional initiatives have set their priorities on developing methods for managing congestion at borders, advancing market transparency, and promoting balancing energy exchanges at borders.

Regional initiatives have helped identify a growing consensus around target mechanisms for managing congestion at interconnections. This point was addressed at the 14th Florence Forum, which brought together electricity market players in September 2007.

To integrate open national electricity and gas markets, it is necessary to harmonise practices in each country in terms of network access, and make cross-border exchanges as easy and fluid as they are in a nationwide network.

In 2009, France will be directly involved in setting up these target mechanisms, with:

- the creation of a single bidding platform for allocating periodic capacities in the Centre-West region; this single platform is intended to replace the three existing allocation platforms;
- extension of the coupled French, Belgian and Dutch markets to Germany and the North region;
- implementation of balancing energy exchanges between France and England.

Completing these three projects will be an important stage in building the internal electricity market. This model must then be extended to other regional initiatives.

With the authority to approve the RTE annual investment programme, CRE encourages the reinforcement of interconnection infrastructures, which is essential to bringing market integration into reality.

#### **CRE is participating in two regional gas initiatives**

For half of its gas supply, France depends on the efficiency of transmission and transit networks in other European states. Gas entry capacities in France are needed by new suppliers in order to occupy strong and lasting positions on the French market.

In the Northwest region of the European Union, CRE and its German counterpart BNA are responsible for improving gas exchanges at interconnections. The priorities defined by regulators in a roadmap for 2008-2012 focus on optimising existing capacities, developing new capacities and improving transparency.

Significant progress has been observed at interconnections with Belgium and Germany concerning transparency of data published by transmission system operators and access to short-term capacities. Difficulties persist, however, in transporting gas to France, as Belgium and Germany have not challenged the long-term

transmission contracts which today cover all the existing firm capacities in their networks.

In the South region, priority has been given to developing gas interconnections between France and the Iberian Peninsula. A major investment plan has been launched, which should enable the creation of a new gas import point in France in 2010.

Investment projects for interconnection points should be based on coordinated open seasons to avoid any imbalance on either side of borders.

#### **Coherence and convergence of regional initiatives are a condition for market integration**

Regional initiatives can only make progress if there is consensus between stakeholders. Time lags reported in their development, inherent in the heterogeneity of market architectures and in the lack of harmonisation of regulators' powers, should not be an obstacle to achieving the internal market.

EREGG has set up two working groups to ensure the coherence and convergence of regional electricity and gas initiatives. These groups, co-led by CRE, monitor the progress of regional initiatives, check the compatibility of projects underway in the different regions, and define a shared vision of the future European energy market.

For electricity, the working group closely monitors compliance with implementation lead times for projects under development in the Centre-West and France-United Kingdom-Ireland regions. En gaz, les efforts d'harmonisation concernent principalement l'initiative régionale Sud.

For gas, harmonisation work is focused mainly on the South regional initiative.

### Greater focus on consumer issues

On 5 July 2007, the European Commission submitted a draft European charter of energy consumer rights for public consultation. This initiative resulted in a guide for European consumers. The guide was presented on 6 May 2008 at the conference to promote energy consumer rights organised by the European Commission.

The European Commission planned to organise the first meeting of the Forum devoted to consumers and retail market functioning in the autumn of 2008. Like the Florence and Madrid Forums, this permanent forum will bring together all stakeholders concerned: Member States, consumer associations, suppliers, system operators and energy regulators.

The European Commission is advised on these matters by the ERGEG Customer Focus Group, chaired by CRE since January 2008. Since June 2007, ERGEG has published three reports accompanied by recommendations on retail price regulation, smart electricity metering systems and practical terms for supplier switching.

An assessment of retail electricity and gas price regulation – which in France led to regulated retail tariffs – was published on 15 June 2007. This report showed that many Member States were regulating retail prices according to very different terms and conditions. It also revealed that before 1 July 2007, in Member States where regulated prices and market prices coexisted, reversibility for household clients was permitted, except in France. In its conclusions, ERGEG considered that the coexistence of regulated prices and market prices would not be viable in the long term.

In its publication of 31 October 2007 on smart electricity metering systems, ERGEG recommended that national regulators adopt a policy encouraging or making compulsory the installation of smart metering systems.

A study on procedures for switching electricity supplier resulted in the publication of a best practice guide on 10 April 2008. Regarding the necessary processing time reported in Europe (between

3 weeks and 2 months), ERGEG is encouraging national regulators to define standard procedures so that supplier switching takes less than one month.

### European developments in electricity and gas supply

The Energy and Climate Package presented by the European Commission, stating the objectives set by Member States in March 2007 for creating a low-carbon economy, is often the focus of attention when considering energy issues. But the outcome of debate on the Third Energy Package will also constitute a major milestone towards improving operation of the internal electricity and gas market.

#### Heated debate over the Third Energy Package

The Council of European Energy Regulators (CEER) gave a favourable reception to the Third Energy Package proposed by the European Commission on 19 September 2007. It did, however, issue some comments and proposals.

The Third Energy Package plans not only to harmonise and broaden the powers of national regulatory authorities, but also aims to reinforce their independence. One of the proposed measures involves mechanisms requiring that incumbent operators release part of their energy production on the market, which would represent significant progress. Furthermore, granting national regulatory authorities the power to approve and have modified the rules proposed by system operators concerning interconnection exchanges would enhance smooth energy trading between different markets.

The European Commission is also proposing the creation of an Agency for the Cooperation of Energy Regulators (ACER). ACER would provide a European organisation capable of ensuring smooth operation of European electricity and gas systems, with a

## The outcome of debate on the Third Energy Package should constitute a major milestone towards improving operation of the internal electricity and gas market.

special focus on cross-border issues. To accomplish this mission, ACER must have adequate authority to deal with the European Network of Transmission System Operators (ENTSO), an organisation also proposed in the Third Energy Package.

To achieve «effective unbundling» between production and supply activities on one hand and transmission activities on the other, which are currently subject to legal and accounting unbundling, the European Commission has proposed to make ownership unbundling compulsory.

Eight Member States, including France, have proposed a «third way», which leaves open the possibility of integrated group ownership of transmission systems.

Adoption of the Third Energy Package depends on the outcome of discussions between Member States and the European Commission regarding reinforcement of transmission system operator independence.

### **The Energy-Climate Package makes sustainable development an integral part of internal market operations**

The Energy-Climate Package, proposed on 23 January 2008 by the European Commission, sets targets for reducing greenhouse gas emissions, developing renewable energy sources and augmenting energy efficiency. This will impact operation of the internal electricity and gas market, both in terms of supply and adaptation of systems to new, mostly decentralised, modes of production.

The European Commission is considering giving producers who generate electricity from renewable sources priority access to the grid. To be effective, priority access would have to be reconciled with the principle of non-discriminatory access to the grid and with balancing requirements for transmission and distribution systems.

# I. Organisation and coordination of the main European regulators

## 1. Work carried out collectively by European regulators

Coordination of the work performed by regulators is essential to accomplish their joint mission to create a single electricity and gas market, which is why they very quickly set out to work together.

CRE participates in most CEER and ERGEG working groups (see Inset 3) and chairs several of them. It chairs the group responsible for international strategy and the group responsible for consumer-related issues.

Independently of regional initiatives (see p. 30 and p. 35), extensive work was carried out by regulators within CEER and ERGEG over the past year.

In order to improve internal energy market operation and transparency, European regulators adopted and published reports and guidelines for good practice, including *Guidelines on Open Season Procedures for Gas Infrastructures* adopted on 21 May 2007.

Other guidelines are also in the process of being drafted and have undergone public consultation. This is the case for calculating the capacity of gas infrastructures.

As every year, in accordance with their obligations, the regulators published:

- national reports on the state of opening up electricity and gas markets to competition, submitted to the European Commission in July 2007;
- the overall assessment report on opening up energy markets drafted by ERGEG

in autumn 2007, based on the aforementioned national reports.

During the previous year, proposals in the Third Energy Package (see p. 30 and p. 46) gave rise to special initiatives such as:

- sheets on the main issues of the Third Package;
- an analysis of the European Commission's proposals and suggestions for improvement.

CEER also proposed amendments to members of the European Parliament with a view to improving operation of the internal market.

### Inset 3: ERGEG and CEER

The Council of European Energy Regulators (CEER) was set up in 2000 by the national energy regulators from the European Union Member States and the European Economic Area.

The CEER's organisational structure comprises a General Assembly – the sole decision-making body – an Executive Board, specialised working groups (WG) and task forces (TF) active in a range of fields (including electricity and gas, the Energy Community of Southeast Europe, and international strategy), and a secretariat located in Brussels. A work programme is published every year. In accordance with the association's statutes,

decisions are taken by consensus or, failing that, by qualified majority vote.

The aim of the European Regulators Group for Electricity and Gas (ERGEG), created within the framework of the implementation of directives of 2003, is to advise and assist the Commission in consolidating the internal energy market by helping to fully implement European directives and regulations, and to prepare future legislation in the areas of electricity and gas.

ERGEG is composed of the European Commission and independent regulators from the 27 European Union Member States, Member States of the European Economic Area and countries that have applied for

membership to the Union are invited as observers. To achieve its objectives, which are also part of a public work programme, ERGEG has a structure similar to that of CEER. In addition, ERGEG widely consults energy sector players on issues where their opinion is required. This opinion also involves the European Commission, which can then give it legally binding status through the Community comitology process.

CEER and ERGEG now have a joint Internet site ([www.energy-regulators.eu](http://www.energy-regulators.eu)).

EREGG has also published the following:

- a report on the application of the provisions of Regulation 1775/2005 (gas) relative to transparency. EREGG concludes that the current regulation provisions are not adequate to ensure development of an effective competitive internal market and recommends improving rules for transparency within the framework of the Third Energy Package proposals;
- a report on the application of the provisions of Regulation 1228/2003 (electricity) and the guidelines relative to handling congestion. EREGG emphasises that handling congestion and application of Regulation 1228/2003 are still posing problems, mainly in the absence of agreement on the terms for implementing the financial compensation mechanism (ITC, Inter-TSO Compensation Mechanism) between transmission system operators;
- a study on the regulation of tariffs for final customers. EREGG recommends abolishing regulated sale prices which, in its opinion, “constitute an obstacle to mar-

ket operation and present a risk to both security of supply and the fight against climate change” in the European Union. It concludes that “while protection of vulnerable customers remains necessary within the framework of a competitive market, it must not be confused with maintaining regulated prices for all consumers”.

## 2. Regulator organisation and development

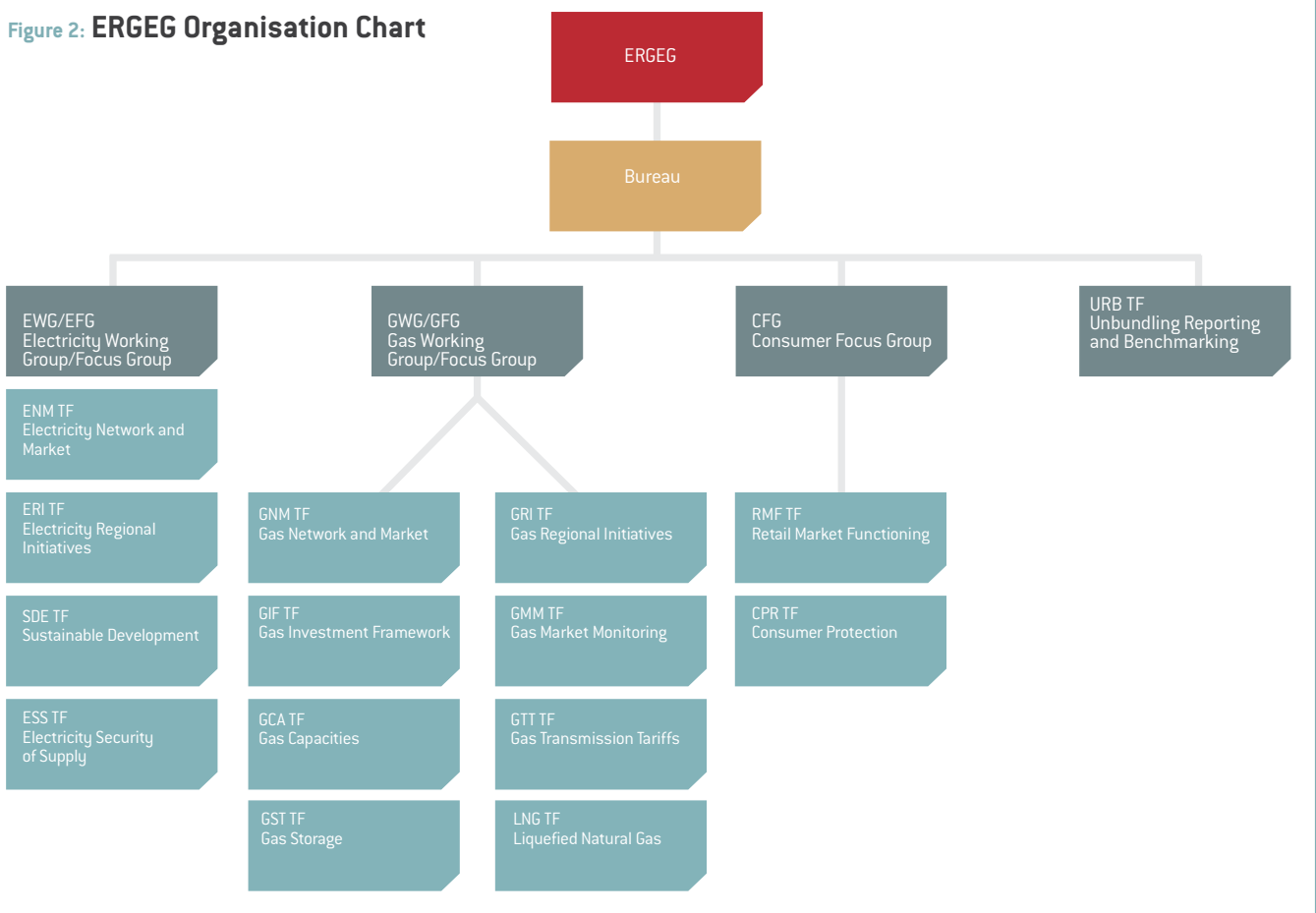
The organisation of CEER and EREGG evolves every year according to matters at hand (see Figures 2 and 3). In this logic, a working group, specifically dedicated to following up the legislative Third Package (ENP, Energy Package Working Group), was set up in September 2007. Its purpose is to coordinate and synthesise the opinions of other groups on the main themes of new Community texts (ownership unbundling, energy regulators agency, relations with system operators, regulators’ powers,

etc.). The group also centralises the study of amendments to European Commission proposals presented by regulators. An initial series of amendments was included in a summary document and sent to members of the European Parliament at the beginning of March 2008.

With the development of the internal market, it has also appeared necessary to have a clearer vision of the impact of the development of financial products on electricity and gas markets. A working group on the subject (FIS, Financial Services Working Group) was therefore set up. It is mainly responsible for preparing an inventory of existing financial products on the energy market, analysing transparency on wholesale markets and studying factors that influence market liquidity.

Lastly, the task forces set up within working groups dedicated respectively to electricity and gas have also undergone reor-

Figure 2: EREGG Organisation Chart





organisation in order to complete the tasks scheduled in the work programme for 2008.

### 3. CRE's relations with European Community institutions

Alongside its role within CEER and ERGEG, CRE strives to consolidate its relations with major European Community institutions.

In addition to work carried out jointly with regulators, CRE maintains regular contacts with:

- the European Commission Directorates-General for Transport and Energy (DG TREN) and for Competition (DG COMP), which has called on CRE consultancy services;
- members of the European Parliament's Committee on Industry, Research and Energy (ITRE);

- the Council of the European Union: CRE advises France's Secretariat General for EU Affairs (SGAE) on changes to texts.

### 4. Development of CEER activities outside the European Union

The General Assembly of the Council of European Energy Regulators (CEER) decided in December 2006 to entrust strategic thinking on international issues to a new working group, the ISG (International Strategy Group), chaired by CRE chairman, Mr. Philippe de Ladoucette.

To strengthen the effectiveness and coherence of cooperative and technical assistance actions conducted by regulators, the ISG is tasked to define a global strategy of international cooperation for CEER, to make proposals concerning priority matters and regulator actions, and to develop

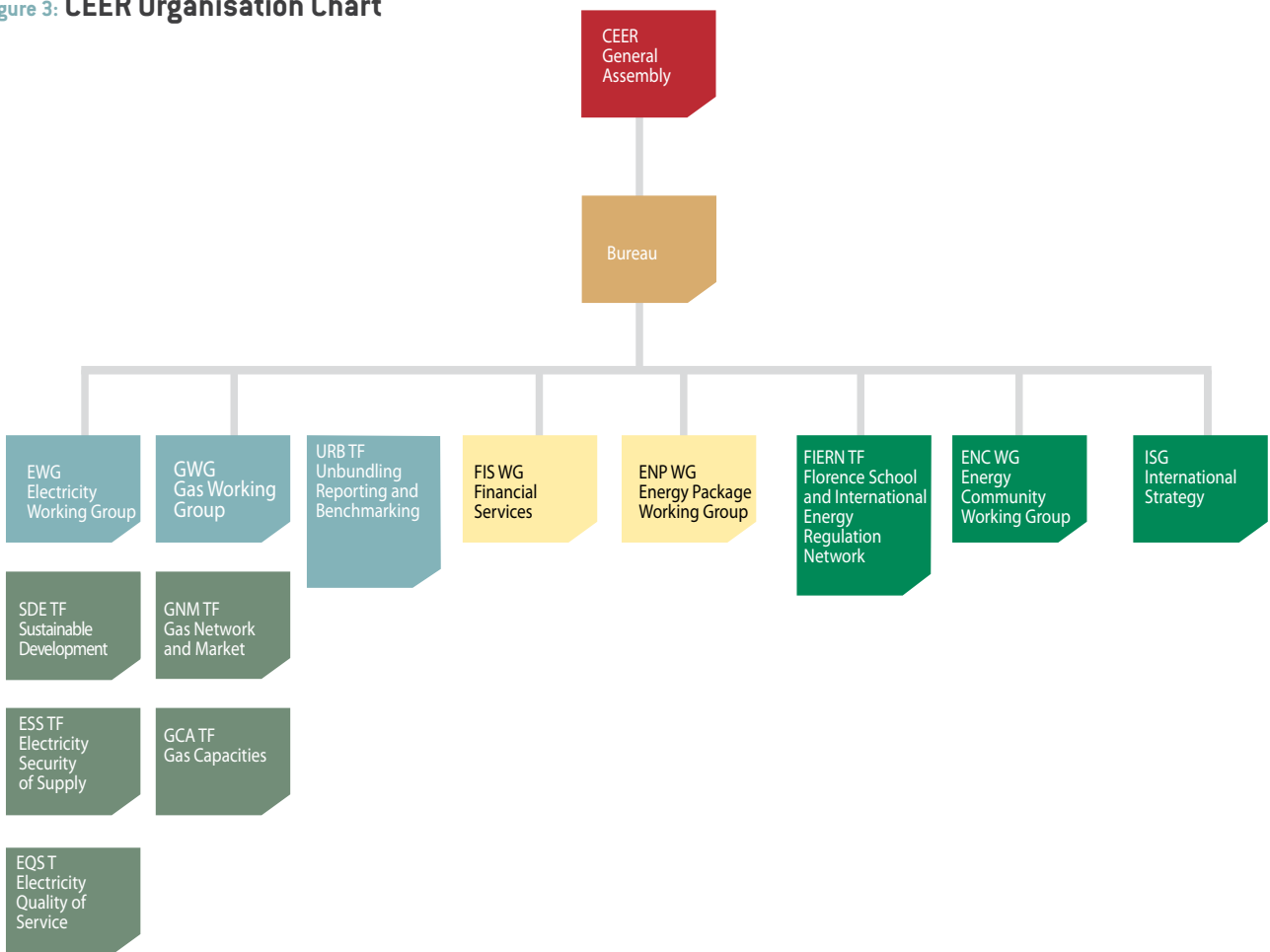
and coordinate responses to training requests made by external partners.

Since it was set up in Paris on 5 March 2007, the ISG has met on seven occasions.

These meetings have helped outline the principles of an international strategy for CEER, validated by the General Assembly in July 2007. The ISG has identified three areas with top priority:

- The first priority is security of supply. For CEER, this involves developing collaborative activities with producing or transit countries, in conjunction with the European Commission.
- The second priority is implementation of the *acquis communautaire*. CEER proposes to develop actions to be taken with countries who are current or future candidates for entry to the European Union. The regulators' goal is to encourage better

Figure 3: CEER Organisation Chart



harmonisation of energy market regulation practices between Member States and neighbouring countries.

- The third and last priority concerns relations with other regulators and international organisations. For CEER, this involves organising an ongoing dialogue with regional regulator associations and with the international bodies involved in energy projects.

On this basis, the ISG drafted a work plan approved in January 2008 by CEER's General Assembly. This work plan details the actions that the ISG must conduct throughout 2008.

For example, the chair of the ISG took part in the Association's Annual Congress attended by African water and energy regulators in April 2008.

From 2009 onwards the ISG will also organise short training sessions for regulators of the Energy Community that are not members of CEER (Croatia, Serbia, Bosnia-

Herzegovina, Kosovo, Former Yugoslav Republic of Macedonia, Albania, Montenegro). Contacts will be strengthened with the association bringing together energy regulators from Central and Eastern Europe and Caucasian countries (ERRA, Energy Regulators Regional Association) and INOGATE (programme of cooperation in the energy sector between Baku Initiative countries). Ukrainian and Moldavian regulators will be invited to an ad hoc meeting with ISG members.

In addition, the ISG is working on implementing a database on the CEER Internet site, listing the names and qualifications of consultants from CEER member regulators. This database will give information on the know-how offered by regulators and will facilitate response to requests for assistance, training and exchange from external partners. It is part of a wider approach by CEER that aims to improve the organisa-

tion and coordination of its consultancy services with a view to participating in external training. The database should be operational at the end of the first half of 2008 and be updated throughout the year.

## II. CRE's European activities

### 1. The contribution of European regulators to the Third Energy Package

The proposals for the internal market in electricity and gas contained in the Third Energy Package, which has a very tight timetable for negotiations, were the subject of important work carried out mainly within CEER.

CEER has, in fact, set up a working group dedicated to these issues (the Energy Package Working Group). Its purpose is to gather the observations, comments and suggestions of all the other working groups, evaluate their pertinence and submit proposals for action by the principal players capable of influencing changes in legislation, chiefly the Council of Ministers and the European Parliament, to the General Assembly.

It was within this framework that draft amendments to the European Commission's proposals were drawn up to improve internal market functioning and reinforce the relevant regulations. CEER stressed the need to give the Agency for the Cooperation of Energy Regulators (ACER) sufficient powers to fulfil its missions within an adequate legal framework: for example, approving network investment plans and conducting public consultations. CEER also called for a proper balance to be found between the powers of the transmission system operators and those of ACER, a balance that originally was unsatisfactory.

CRE played a large part in drawing up these proposals. It proposed amendments on consumer-related matters (chairing the regulators' working group on this subject) and on improving interconnection management between the European Union Member States.

CEER also took position on one of the main points in the Third Energy Package, namely the method of unbundling transmission systems from their parent companies in the case of vertically integrated companies. Ownership unbundling as recommended by the European Commission was considered the safest method by most regulators.

CEER and certain regulators presented their views to the various stakeholders in the energy sector and to European legislators to advise them on the best options. On 24 and 31 January 2008, several regulators took part in hearings with the European Parliament's Committee on Industry, Research and Energy (ITRE), and on 19 February 2008, CEER organised a seminar for members of the European Parliament, especially the rapporteurs for the various proposals. The CRE Chairman gave his views on the authority that should be given to ACER to make it effective. In particular, he spoke in favour of maintaining the primacy of external regulation over self-regulation by the TSOs.

The CRE Chairman also attended hearings with the Third Energy Package working

groups, set up by the French Senate Economic Affairs Committee and the National Assembly Committee on Economic Affairs, Environment and Territorial Development.

### 2. Integration of gas markets

The creation of a competitive European gas market likely to bring tangible benefits to consumers depends on the development of cross-border exchanges. Furthermore, due to France's geographical situation, creation of the internal gas market will prove to be an asset to the the French gas market, given that a large part of French procurements transit through European countries.

In order to contribute to the integration of European gas markets and to the eventual consolidation of an internal gas market, CRE has been committed for a number of years to close cooperation with its European counterparts. This cooperation takes two different forms:

- intense involvement in the Gas Regional Initiative launched by ERGEG in 2006;
- participation in the ERGEG task forces and chairing of one of them.

**2.1. Development of the Gas Regional Initiative**

The Gas Regional Initiative was launched in the spring of 2006. It aims to facilitate regional market integration, a first concrete step in setting up the internal gas market. There are now three gas Regional Energy Markets (REMs) (see Figure 4):

- the North-West region, including Belgium, Denmark, France, Germany, Great

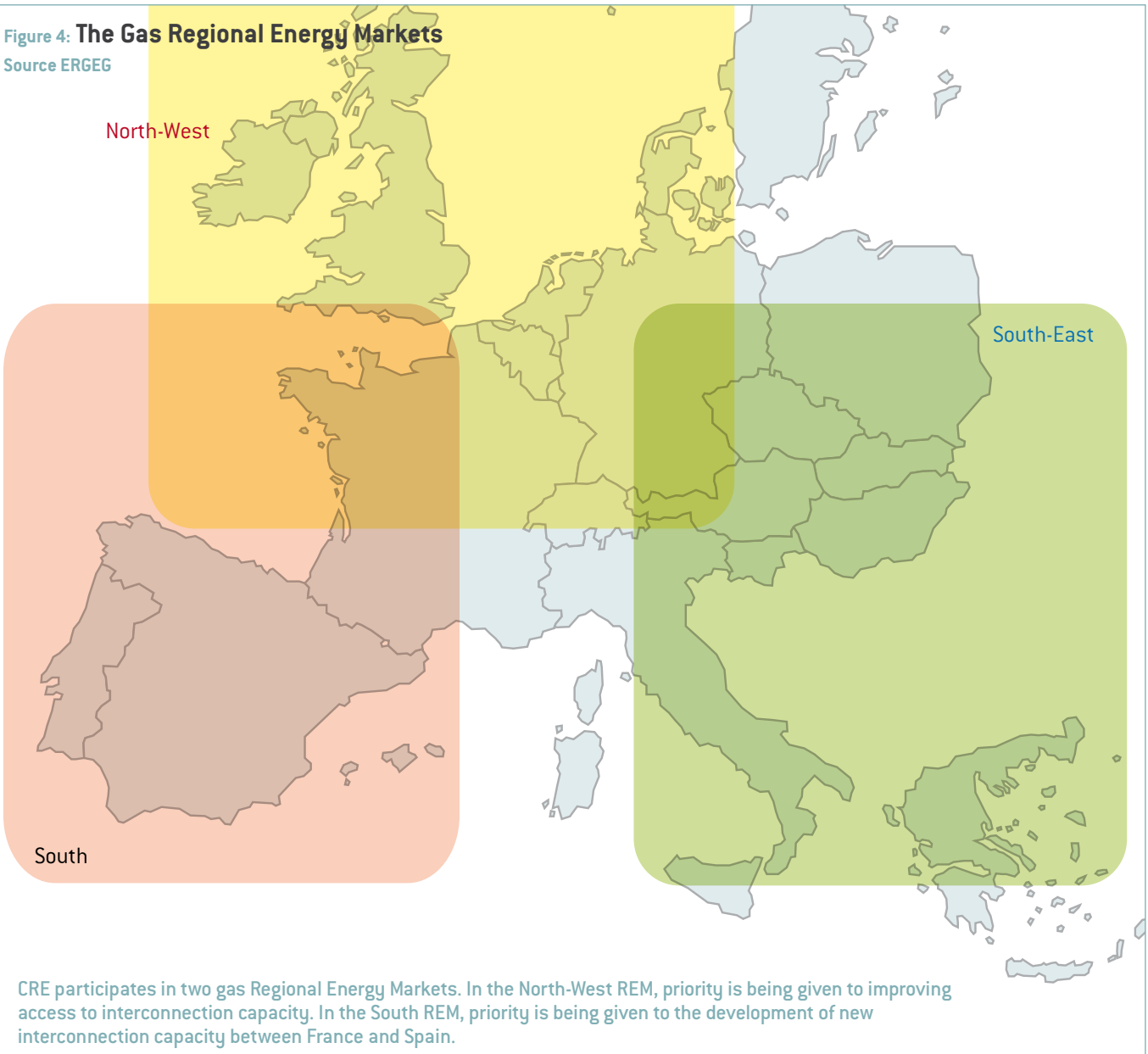
Britain, Northern Ireland and the Republic of Ireland, the Netherlands and Sweden; the South region, including France, Portugal and Spain;

- the South-East region, including Austria, Greece, Italy and the Central and Eastern European Member States (the Czech Republic, Hungary, Poland, Slovakia and Slovenia).

Since 1 January 2008, working in cooperation with Ofgem, the British regulator, CRE has chaired the ERGEG task force that coordinates the three gas REMs. This task force aims chiefly to supervise the progress of each of these markets and the overall co-

herence of their development. A *Convergence and Coherence* report is produced annually to check that the progress being made in each of the regions is contributing to achievement of the future internal gas market. Additionally, to guarantee convergence in the progress made by each region, the task force organises joint feedback sessions so that projects that produce good results in one region can be implemented in the other two.

**Figure 4: The Gas Regional Energy Markets**  
Source ERGEG



CRE participates in two gas Regional Energy Markets. In the North-West REM, priority is being given to improving access to interconnection capacity. In the South REM, priority is being given to the development of new interconnection capacity between France and Spain.

## 2.2. The North-West region: interconnections and access to capacity

In the North-West Regional Energy Market, CRE co-chairs the working group on cross-border interconnections with BNetzA, the German regulator. This working group decided to focus on eight interconnection points that are key to market integration in the North-West region. Three priority interconnection points were selected in 2007: Taisnières/Blarégny, Mendelsheim/Obergailbach and Bunde/Oude Statenzijl.

Two of these three priority points directly concern France: Blarégny/Taisnières, on the Franco-Belgian border, and Mendelsheim/Obergailbach, on the Franco-German border. Following the kick-off meeting in May 2007, a second meeting was organised in Paris on 5 February 2008 with the TSOs and regulators concerned, as well as many shippers. The network operators made a number of commitments, and as they are fulfilled, improvements are observed in interconnection operation.

German and Belgian TSOs have increased transparency and now publish more detailed information on reserved capacities and flows.

Fluxys is expected to bring in an interruptible transit product in the second half of 2008. Fluxys and GRTgaz launched two coordinated open seasons for the first time in Europe (see p. 85). The most visible result of these improvements was an increase in the number of active shippers at Taisnières between December 2006 and December 2007 (from six to twelve).

A consultation with shippers preceded the February 2008 meeting in Paris, aiming to improve operation of the Taisnières and Obergailbach interconnections.

The following firm commitments were made by the TSOs:

- Fluxys and E. ON Gastransport (EGT) agreed to improve the transparency of their products and their procedures for managing congestion;
- Fluxys and Gaz de France Deutschland Transport (GDFDT) should shorten reservation times;

- EGT, GDFDT and GRTgaz announced that they would look into a specific method of improving gas transit from Germany to France;

- GRTgaz proposed the introduction of a daily capacity product that could be reserved two days in advance, on interconnections where it would be useful.

The following difficulties were being experienced by shippers:

- the lack of firm transmission capacity was a major obstacle to newcomer business in the French market: for the two interconnections in question, no firm capacity was available for the next three years upstream on the Belgian and German transit networks;

- the differences between the capacity products sold by the TSOs on a single interconnection complicated their task and considerably hindered gas flows to these interconnections. This was particularly true for interruptible capacity products. The use of these products at the interconnection was hampered by interruptibility criteria and different interruption conditions for TSOs operating on different sides of the border;

- the congestion management mechanisms used by the TSOs were not coherent;

- the products and transparency of adjacent TSOs – the Belgian TSO Fluxys and German TSOs EGT and, to a lesser extent GDFDT – were criticised. For example, these TSOs do not offer any unused or short-term capacity products, or use-it-or-lose-it (UIOLI) procedures.

Additional proposals aimed at improving the operation of these two interconnections were presented by the shippers:

- the introduction of combined capacity products by adjacent TSOs;
- the adoption by all TSOs of the open subscription period for allocating capacity;
- the extension to adjacent TSOs of the short-term product and the long-term UIOLI procedure of GRTgaz;
- the generalisation and coordination of open seasons.

Most of these proposals were supported by CRE.

Some of the problems experienced by shippers cannot be solved at interconnections, such as the lack of transmission capacity at other places in the North-West region. For this reason, partly at CRE's initiative, this issue has been made the main priority of the 2008-2012 roadmap. This roadmap defines the targets to be met by the North-West Regional Energy Market by 2012 for setting up a regional gas market and identifies action to be taken to meet these targets.

A two-stage solution exists for solving the problem of access to capacity: first it is necessary to optimise the use of existing capacities and then investment is needed to create new capacity. Accordingly, the 2008-2012 roadmap provides for the development of short-term and long-term capacities and reservation procedures that are compatible on both sides of interconnection points. It also demands the development of principles allowing the coordination of open seasons, which are now proving essential.

The investment required to create new capacity must be coordinated regionally to ensure optimal development of transmission systems in North-West Europe. More specifically, open seasons, which should serve as a basis for investment projects, have consequences for adjacent networks. That is why open seasons must be coordinated at interconnection points, to prevent capacity from being developed by one TSO on one side of the border but not on the other side by the neighbouring TSO.

During the past year, a number of open seasons were launched in the North-West region. The first coordinated open season in Europe, launched by GRTgaz and the Belgian TSO Fluxys in April 2007, should have come to an end in the summer of 2008. Nevertheless, because of disagreements between CREG, the Belgian regulator, and Fluxys about the level of future transit tariffs in Belgium, this open season was suspended in February 2008 in a coordinated manner by Fluxys and GRTgaz at the request of the shippers, who are demanding sufficient visibility on tariffs before committing themselves to transit capacity reservations for the future. This coordinated open season will resume once these tariff disputes have been resolved. In

parallel with this open season, Gas Transport Services (GTS), the Dutch TSO, also launched its own open season on part of its network, including the Gravenvoeren interconnection point with Fluxys. Finally, at the beginning of 2008, E.ON Gastransport (EGT), the main German TSO, launched an open season across its entire network.

The Fluxys, GRTgaz and GTS open seasons demonstrate how the coordination of calendars, products offered, capacity allocation methods, works and provision of capacities can be accomplished. The EGT open season shows, on the other hand, how coordination needs to be organised systematically. This particular open season was launched without warning the adjacent TSOs, and its first phase was much too short to enable them, including GRTgaz, to develop satisfactory coordination. CRE did not manage to secure an extension of the first phase because of the lack of authority of BNetzA, the German regulator, in this area. This episode demonstrates how much European, or at least regional, principles for coordinating open seasons are necessary.

The 2008-2012 roadmap also focuses on one of the most well-advanced and useful areas of action of the North-West Regional Energy Market: transparency. In 2007, under the aegis of Ofgem, eleven TSOs from the North-West region, including GRTgaz, Fluxys, EGT and GTS, made a commitment to significantly improve transparency. At the latest by the end of 2008, they agreed to publish daily flows, interruptions and their history, and aggregate day-ahead nominations.

### 2.3. The South region: interconnection development

In the South region, progress has been observed in the five areas of work agreed upon within the framework of ERGEG in February 2007.

Top priority has been given to developing interconnections between France and the Iberian Peninsula. Currently flows are physically limited and commercial development has not shown much drive. They run almost exclusively from France to Spain.

At the beginning of 2007, TSOs in the southern region (Enagas, TIGF and GRTgaz) presented a joint medium-term investment plan. The plan was then extended to 2015, and now covers investments agreed by the TSOs plus a series of additional planned investments. These projects involve future upgrades to the interconnection points at Larrau and Biriadou, as well as the creation of a new interconnection point in the eastern part of the Pyrenees.

The investments already approved will generate capacity that will have to be allocated transparently and in a non-discriminatory, coordinated way. In November 2007, TIGF and Enagas put forward an allocation procedure that was reviewed and approved in March 2008 by CNE, the Spanish regulator, and CRE. The long-term capacity will be put on the market in October 2008 and the short-term capacity in November 2008. The procedure to be used will be similar to the coordinated open subscription period (OSP) introduced nationally in December 2007 for allocating link capacities between the TIGF and GRTgaz systems.

Once the OSP has been completed, the market will be interrogated on investments that have not yet been agreed. An open season similar to the one used at the Belgian interconnection point of Taisnières/Blarégny is currently being developed. A joint call for subscriptions should be launched in the first quarter of 2009.

The second area of work for the South Regional Energy Market is interoperability. There are significant differences between the technical standards governing the Spanish network and European standards, which TIGF and GRTgaz have already adopted for their systems. These standards, known as Common Business Practices EA-SEE-Gas (CBPs), concern key issues such as nomination, matching, units and pressure at the interconnections. To make it possible to manage more consistent and dynamic flows, Spain has begun a process that will lead to adoption of the CBPs. A royal decree authorises the use of open subscription periods on the Spanish side.

The third area of work is the development of hubs. To create a proper gas market in

southern Europe, a number of reforms are necessary. To exchange gas with the other European virtual hubs, Spain needs its own hub. A proper entry/exit system is therefore necessary, backed up by an efficient secondary market and guaranteeing the firmness of transactions. CRE declared that it was in favour of a system of this kind during the consultation on the Iberian gas market launched by CNE, the Spanish regulator, and ERSE, the Portuguese regulator, at the end of 2007.

The harmonisation process CRE is engaged in is tricky because of its purely voluntary nature, but is starting to produce results. At the second high-level meeting on the South Regional Energy Market, organised by the European Commission in Madrid on 19 February 2008, governments, administrations, TSOs and regulators acknowledged the progress made towards coordination in the region and highlighted the need for the future Iberian gas market, Mibgas, to develop in coordination with the rest of Europe.

Transparency levels and the application of Regulation (EC) No 1775/2005, the fourth and fifth work areas of this regional initiative, were judged satisfactory by the surveys conducted on the subject by shippers.

### 2.4. CRE's contribution to ERGEG's activities

In 2007-2008, ERGEG began reflection on the European codes proposed by the European Commission in its draft Third Legislative Package. These codes concern issues such as transparency, capacity allocation and balancing. They are meant to apply to the entire European gas network and therefore represent an extremely important challenge. As the proposals currently stand, the codes would be developed by the European Network of Transmission System Operators (ENTSOG); however, it seems essential that the regulators supervise this activity by proposing the general structure of the codes, and that they be allowed to demand modifications where necessary.

Within the ERGEG task force, CRE is responsible for proposing the code on capacity allocation and congestion management rules. It is also responsible for the code on ENTSOG's 10-year investment plans. CRE is also co-chairing a larger ERGEG task force on the treatment of regulated investments exempt from third-party access. These issues are particularly important for newcomers because, as the sectoral analysis by DG Competition pointed out, access to existing capacity and the development of new capacity are essential for the development of competition to benefit consumers.

CRE and the French TSOs have acquired expertise in allocating capacity and investment, to the benefit of their European partners. Whether it is a question of open season periods for existing capacity or managing congestion, France has developed innovative systems, such as long-term use-it-or-lose-it. As regards new capacity development, CRE's competence has grown with the experience acquired during the past year in open seasons and the approval of investment programmes.

CRE is also participating in other ERGEG task forces: those responsible for the other European codes and those examining transparency, transmission tariffs, balancing, LNG and storage, issues on which CRE's role in preparing the ERGEG guidelines has been appreciated.

### 3. Integration of electricity markets

In February 2006, the development of cross-border exchanges was reinforced as ERGEG launched the Electricity Regional Initiative (see Figure 5). The objective of this Initiative is to identify barriers and obstacles to regional market integration and to quickly implement concrete, practical improvements without losing sight of the

end goal of creating an integrated European market.

CRE is intensely involved in this market integration process. It participates in four of the seven Regional Energy Markets defined by the European Commission (Central-West, Central-South, South-West and France-UK-Ireland regions).

Three priorities were defined for all seven regions:

- harmonisation and improvement of congestion management at interconnections (calculation of available interconnection capacity and capacity allocation process);
- harmonisation of market transparency (see Inset 4);
- development of balancing exchanges at borders.

#### 3.1. Towards a target model for managing congestion at interconnections

Apart from the concrete progress made with managing congestion at interconnections, the past year was mainly marked by the emergence of a growing consensus at European level on a common target model for calculating and allocating interconnection capacity (see Inset 5).

This consensus is the outcome of hard work and numerous discussions conducted within the electricity Regional Energy Markets. The outline of this target model was defined in the first ERGEG report entitled *Electricity Regional Initiative Convergence and Coherence Report*, submitted for public consultation on 20 July 2007 and presented at the 14<sup>th</sup> Florence Forum on 24 and 25 September 2007.

First, as regards capacity calculation, the use of a common network representation by TSOs would be an essential step towards maximising available capacity.

Moreover, capacity should be calculated by TSOs by measuring the impact of overall cross-border flows on the networks using influencing factors (known as the 'flow-based' or 'PTDF-based' method) and not bilaterally on each interconnection (known as the 'ATC-based' method).

Second, according to the general principles on which there is a consensus in Europe, interconnection capacity should be allocated according to three timescales: long-term (monthly and annual products, or even longer term), day-ahead, and intra-day.

For allocating long-term capacity, the target mechanism is an explicit auction mechanism harmonised throughout Europe, with:

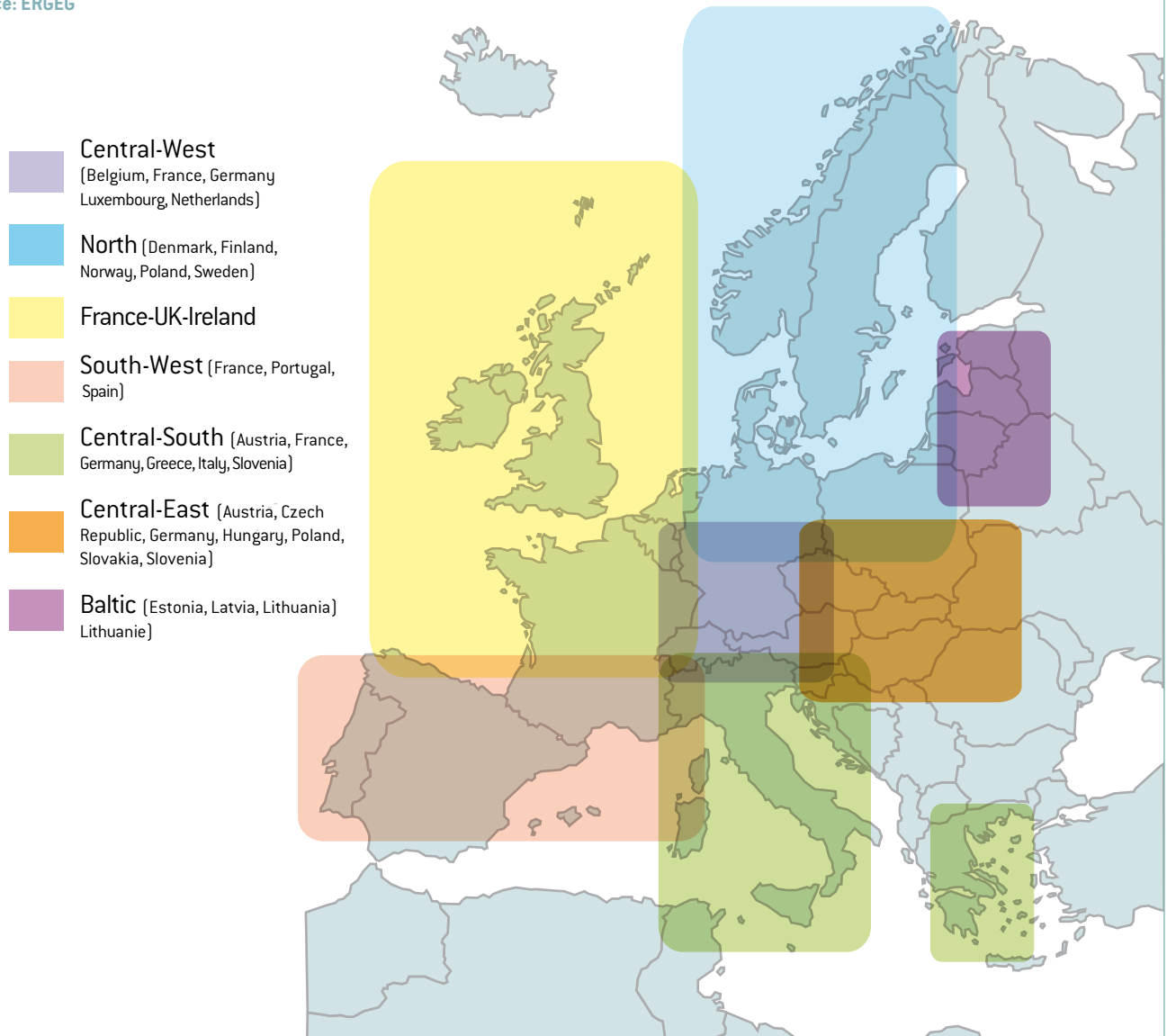
- a single set of rules;
- identical products on all interconnections;
- a single interface for participants.

Discussions are in progress on the details of the rules and the nature of the products to be allocated.



Figure 5: Electricity Regional Initiatives

Source: ERGEG



**Inset 4: Transparency in electricity Regional Energy Markets (REMs)**

- Almost all REMs have identified transparency as one of the priorities of their action plans for accelerating the regional integration process.

- In 2007, regulators in the Central-West, France-UK-Ireland, North, South-West and Central-East regions produced a comparative analysis of the current level of transparency within the different countries in each REM and consulted market players on improving the scope of application of transparency.

- These public consultations identified the

need for harmonisation of transparency requirements within each region and between regions, particularly the need to improve the supply of data on production, consumption, networks and electricity exchanges at borders.

- Regulators in the North, Central-West and Central-East regions have published transparency reports providing the basis for harmonisation of transparency rules within these regions. These reports provide a common, regional-level interpretation by regulators of the transparency requirements

defined in Article 5 of the new guidelines in the Annex to Regulation (EC) No 1228/2003.

- These reports give a detailed list of harmonised definitions, and a list of requirements for the publication of information about demand, production, transmission, interconnections, balancing and wholesale markets.

- Compliance with the guidelines for congestion management will be monitored on the basis of this common interpretation by regulators.



For day-ahead capacity allocation, the implicit methods allow optimal use of capacity in function of price on the different markets. The target mechanism that has achieved a European consensus is therefore market coupling organised on a day-ahead basis, and in the long run, the merging of these markets, with separate price zones (market splitting) depending on congestion.

For allocating intraday capacity, Europeans have agreed on continuous implicit capacity allocation. This consists of a single platform that would allocate capacity implicitly whenever the electricity supply in one Member State corresponds to demand for electricity in another Member State.

**3.2. Regional Initiatives: different rates of progress**

Although within each of the seven Regional Energy Markets priorities are focused on effective congestion management at interconnections, the development of balancing exchanges and transparency, REMs are not progressing at the same rate (see Insets 6 to 9).

There are various reasons for this, noted in the conclusions of the ERGEG *Electricity Regional Initiatives Convergence and Coherence Report*:

- one problem is the necessarily limited human and financial resources of the TSOs. This problem is aggravated when a given country is involved in several regional markets (as in the case of France and Germany, which are involved in four different REMs). In its Third Legislative Package proposal, the European Commission proposes the introduction of market integration incentives for TSOs;
- lack of harmonisation in the powers of the different national regulators, which in some cases allows a few TSOs to block the introduction of measures to improve market functioning;
- differences in “market architecture” within a given region;
- lack of consensus on the timetable for implementing regional priorities.

**3.3. Actions towards market integration**

**3.3.1. Guaranteeing coherence and convergence between the different Regional Energy Markets**

CRE continues to co-chair the Electricity Regional Initiative Task Force. This task force is responsible for:

- monitoring the progress of work being conducted by the various Regional Energy

Markets;

- making sure there is coherence and convergence between the different regions;
- defining a shared vision for the future European energy market.

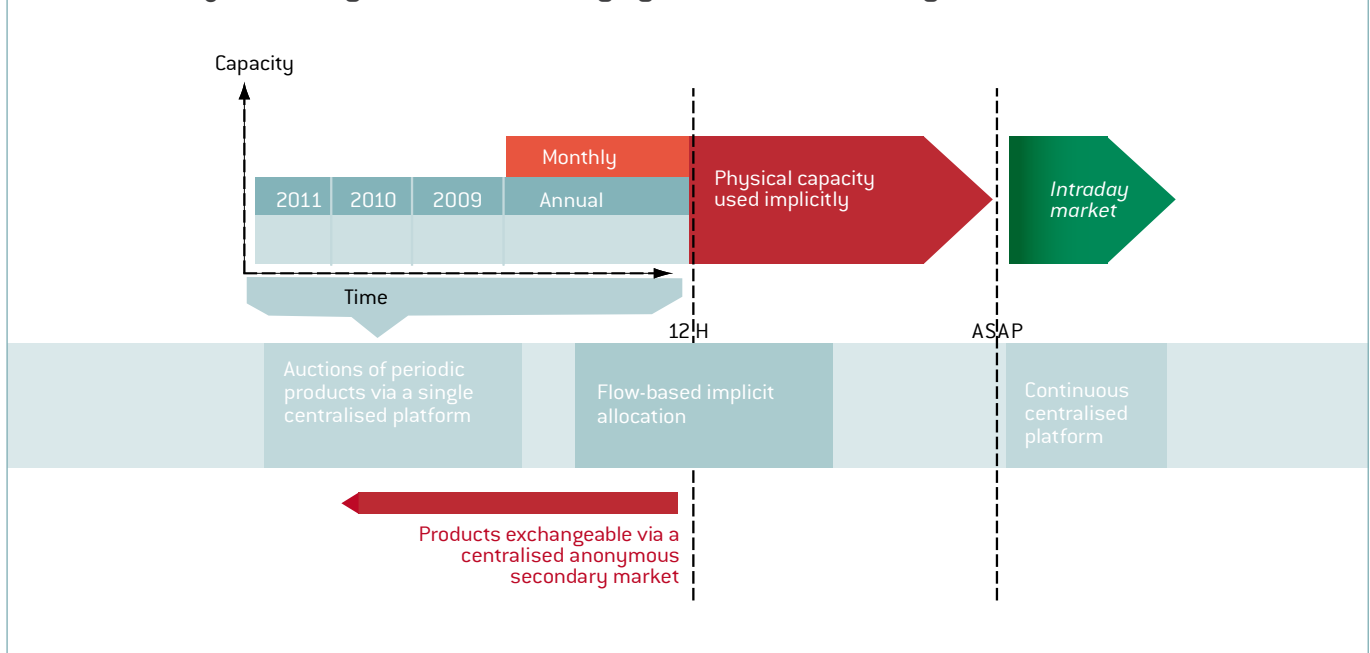
The task force must therefore identify any obstacles to the introduction of the target model within each region, and propose action plans to remove them.

Even though the regional initiatives are not making progress at the same rate, these action plans ensure that they are all heading in the same direction.

The ERI Task Force will also seek to improve coordination of the various tasks in order to prevent certain regional projects from being mutually incompatible (see the regional market coupling projects in particular), with a view to constant, harmonious development towards a European electricity market.

These updated action plans will constitute the basis for the second *Coherence and Convergence Report*, to be presented at the next Florence Forum.

**Inset 5: Summary of the target model for managing interconnection congestion**



### 3.3.2. Evaluating the effectiveness of congestion management at French interconnections and their compliance with European regulations

To evaluate the progress of the congestion management mechanisms introduced on 1 January 2006, and in compliance with the European regulation of 26 June 2003, in May 2007 CRE published its first annual report on the management and use of electricity interconnections in 2006. This work continues in 2008 with the publica-

tion of the report analysing changes that occurred in 2007 (see Inset 10).

In the Central-West Regional Energy Market, this assessment is also being conducted by the five regulators, and the first joint report should be published by the end of 2008.

Within ERGEG, in 2007 the Electricity Network and Market Task Force began examining obstacles to the development of cross-border exchanges related to differences in

market architecture between the different Member States (amount of information available to the market players, exchange rules, distribution of expenses resulting from security of supply obligations). This work will continue in 2008 with the publication of a second Compliance Report analysing in detail to what extent the rules for congestion management at interconnections comply with European regulations.

#### Inset 6: Progress in the Central-West region

A single set of rules for allocating long-term capacities, which will come into force at the end of 2008, is currently being drafted by all TSOs within the region. At the same time a single platform for long-term auctions will replace the three interfaces currently used in the region.

- An ambitious regional flow-based market coupling project is also under way, which will extend trilateral market coupling between France, Belgium and the Netherlands to Germany. It should be implemented by early 2009.
- Since May 2007, intraday exchanges have

been made between France and Belgium with pro rata allocation. A project is also in progress on the Dutch borders with Germany and Belgium.

#### Inset 7: Progress in the Central-South region

• A major harmonisation drive was undertaken in 2007, enabling allocation of capacities for 2008 according to a single set of rules, although there are still a

number of rules specific to each border. This effort to harmonise and improve rules will continue in 2008.

- Discussions on the future introduction of

market coupling are in progress.

#### Inset 8: Progress in the South-West region

• To develop electricity exchanges, facilitate integration of the Iberian market into the European electricity market and improve grid safety, a project to build a new line between France and Spain, announced by

the French President and the Spanish Prime Minister, is now in the design stage.

- Work to improve and harmonise the interconnection management rules within the region will continue in 2008.

• A project to introduce a real-time electricity exchange mechanism between France and Spain and a market coupling project are being studied.

#### Inset 9: Progress in the France-UK-Ireland region

• Work started in 2007 has led to a firm project to develop balancing exchanges within the region. This project is based on the following principles:

- greater competitiveness and, for balancing bidders, more opportunities to see their bids activated by exchanging standardised balancing offers between TSOs that are compatible with the market architecture on both sides of the interconnection;

- exchanging available reserves between TSOs, beyond the reserves required to maintain system safety in each country;
- no reservations of interconnection capacity, so that cross-border balancing exchanges only take place if the interconnection capacity remains unused by market players;
- transparency guaranteed by the publication of the methods used to calculate bids exchanged by TSOs, bids

exchanged, and bids activated (price and volume). An intermediate stage will be observed from mid-2008. This measure will be fully operational starting mid-2009.

- New rules for allocating interconnection capacity, compliant with European legislation and harmonised with the rules in force on French borders, will be introduced at the end of 2008.

### 3.3.3. Preparing the balancing market integration guidelines for submission to the European Commission

CRE is taking part in preparing the guidelines for balancing market integration, as part of the Electricity Network and Market Task Force. These guidelines were submitted for consultation for the first time in 2006. Many stakeholders shared the view that interaction between balancing markets on one hand and the intraday market and automatic reserves on the other should be taken into account. Consequently, ERGEG with the European Commission commissioned a study on this subject from consultants. The results of the study are expected at the end of August 2008. They will be taken into account in the new version of the guidelines, which will once

again be subject to public consultation before being submitted to the European Commission. The Commission can then make the guidelines legally binding through the comitology process.

### 3.3.4. Initiating a discussion on the introduction of market integration incentives

Discussions are in progress on introducing incentive mechanisms, particularly as regards infrastructure investment, optimisation of existing networks and implementation of target mechanisms.

CRE is taking part in the study on electricity infrastructures, launched by the European Commission in order to identify barriers to investment in new interconnection infrastructures.

The task of setting up ad hoc incentive mechanisms to maximise interconnection capacity and accelerate the introduction of target mechanisms has been given to a dedicated subgroup of the Electricity Network and Market Task Force, where CRE is an active participant.

## Inset 10: Interconnection capacity use in 2007 and assessment of the introduction of coupling on French, Belgian and Dutch markets

- In general, the daily capacities sold by explicit auction were inadequately used given the price differentials with the day-ahead markets. Because of the many steps involved in separating the energy and transmission markets ("explicit" auctions), capacities were not used to their maximum extent in the direction of the price differential, and were even used in the opposite direction.

		Capacity used in opposite direction to price differential (MW)	Proportion of hours concerned	Capacity not used in the price differential direction (MW)	Proportion of hours concerned
Germany	Export	298	80 %	843	83 %
	Import	732	86 %	2 159	88 %
England	Export	317	69 %	612	73 %
	Import	110	27 %	1 150	97 %
Spain	Export	350	97 %	86	28 %
	Import	13	13 %	127	42 %
Italy	Export	336	81 %	91	13 %
	Import	24	9 %	849	94 %

- On the other hand, on the France-Belgium interconnection, the implicit allocation method currently in force (trilateral market coupling, including the Netherlands) resulted in optimal use of capacity. Moreover, there was strong price convergence on the three organised markets, with total price equality throughout 60% of the year.

- The loss of social benefits caused by the lack of market coupling on the other borders was large:

		Estimate of loss of social benefits (M€)	Total (M€)
Germany	Export	45	110
	Import	65	
England	Export	22	57
	Import	34	
Spain	Export	3	21
	Import	18	
Italy	Export	18	47
	Import	29	

- Details of these analyses are presented in CRE's annual report on interconnections, published in June 2008.

## 4. Operation of the European interconnected electricity grid and security of supply

### 4.1. The 4 November 2006 power cut: recommendations not implemented

On 4 November 2006, an incident on a very-high-voltage German network plunged 15 million Europeans into darkness. The recommendations formulated in the wake of the power cut by ERGEG and CRE have for the most part still not been put into effect.

Investigations conducted by ERGEG and CRE in France show that the 4 November 2006 power cut was mainly the consequence of a failure to apply safety rules properly by the German TSOs. Moreover, lack of coordination between TSOs caused the initial power cut to spread to a large-scale power outage. As with the power cut in Italy on 28 September 2003, the regulators' recommendations highlighted the need to improve safety on the European grid by introducing new technical rules that are more precise, harmonised and legally binding. To achieve this, an authority independent of the TSOs must check compliance with these rules.

The best authority to do this would be the Agency for the Cooperation of Energy Regulators (ACER), as proposed by the European Commission in its Third Legislative Package on energy. By providing national regulators with an institutionalised cooperation framework, the Agency should permit appropriate supervision of cooperation between TSOs and establishment of the necessary decision-making procedures to deal with cross-border issues.

But for an Agency of this kind to be able to execute its missions properly, it is necessary to give priority to external regulation over self-regulation when defining the agency's powers. The origins of the last two power cuts were in countries (Switzerland and Germany) where the TSOs are subject only to self-regulation. The planned reinforcement of regulatory power and the independence of national regulators should therefore be applied across the boards in the European Union.

### 4.2. The need to upgrade UCTE operating rules

During a conference held in Brussels on 25 January 2008 in the presence of representatives from ERGEG and the European Commission, UCTE presented a first round of feedback on implementing the Compliance Monitoring and Enforcement Process (CMEP), which checked that TSOs are applying the rules in the Operational Handbook (OH). The results show that the level of compliance declared by the TSOs was inadequate when it came to certain rules regarding operational safety.

On this occasion, the regulators recommended that the Third Legislative Package should provide for the opposability of the operational rules of interconnected electricity grids. They proposed that ACER should have the authority to put forward guidelines to be adopted by the European Commission through the comitology process. This would mean that the writing of technical and commercial codes by the TSOs could be supervised by ENTSO and would ensure the opposability of key provisions.

## 5. Opening up markets to benefit consumers

Opening up markets to benefit consumers is an issue handled with special attention by ERGEG. A working group dedicated to this matter, the Customer Focus Group (CFG), was set up in 2005. Its activity is organised into two task forces:

- the Customer Protection Task Force (CPR-TF), which deals with consumer information and protection. CRE chaired this group from the time it was set up until the end of 2007.
- the Retail Market Functioning Task Force (RMF-TF), which handles the way retail markets function.

Since January 2008, CRE has chaired the Customer Focus Group.

All its publications are available on the CEER and ERGEG joint website ([www.energy-regulators.eu](http://www.energy-regulators.eu)).

### 5.1. Consumer information and protection

As markets open up to competition, consumers gain the right to choose their supplier. To exercise this right consumers have to be fully informed and know what to do. This is the aim of two European Commission initiatives: the "You Choose!" information campaign; and the communication of 5 July 2007 entitled "Towards a European Charter on the Rights of Energy Consumers".

In June 2007, the "You Choose!" information campaign was launched. Deployed throughout Europe, its aim was to promote full opening of electricity and gas markets to competition on 1 July 2007, by informing household customers on the ability to choose their supplier and their rights on these markets.

There were two intended audiences for the campaign message: households and "vulnerable customers", defined as those needing particular protection in their relationship with electricity and gas suppliers.

The "You Choose!" message was publicised by a series of posters and by the

“Agathe Power” website. This site ([www.agathepower.eu](http://www.agathepower.eu)) shows a person entitled to choose her electricity and gas supplier in various scenarios. It also gives information tailored to each Member State in order to inform consumers about the situation in their place of residence. ERGEG and CRE contributed to this campaign by providing the European Commission with the information it needed to update the website.

On 5 July 2007, the European Commission submitted a draft charter for public consultation. In its response, ERGEG explained that it shared the European Commission’s views on the objectives to be achieved: to assist “vulnerable customers”; to make commercial information easier to understand; to reduce paperwork when changing suppliers; and to protect customers against unfair or misleading commercial practices.

However, doubts persisted as to the nature and scope of the European Charter on the Rights of Energy Consumers, and the idea came to nothing. Following the draft charter, which was considered too remote from consumers’ real concerns, an easy-to-use guide was produced for consumers. ERGEG contributed to the preparation of this document as advisor to the European Commission. The Member States will ensure the information it contains is correct.

The guide covers nine areas: information obligations, contracts and billing, tariffs and monitoring, free choice of supplier, network connections, complaints, consumer

representation, social measures, and unfair commercial practices. It is presented in the form of frequently asked questions and will be used as the basis for work by national authorities, which will be invited to complete it and add specific local information. It will then be made available on European and national websites promoting awareness of the opening of energy markets to competition and consumers.

The first version of this guide was presented at the joint conference held on 6 May 2008 by the European Commissioner for Consumer Protection and the European Commissioner for Energy. The conference, which brought together Member States, consumer representatives, supplier representatives and national regulators, was a chance for suppliers to present their voluntary commitments in terms of best practices for consumer protection. It also provided an opportunity to announce the autumn 2008 launch of a forum dedicated to retail market functioning and consumers, similar to the Florence and Madrid Forums (see Inset 11). CRE will take part in this forum as national regulator and also as chair of the regulators’ group on opening markets to benefit consumers.

In parallel with these initiatives, on 31 January the European Commission announced the introduction of the Consumer Market Watch.

Each year, a few sectors seen as consumer priorities will be examined using indicators that are standardised throughout Europe and applicable to all sectors in question.

These indicators are:

- the number and nature of complaints;
- price levels;
- safety of products and services;
- satisfaction;
- willingness to switch supplier.

The aim will be to identify any problems. This identification phase should lead to a more detailed study, providing information to complement the data collected during the sectoral competition inquiries. On the basis of this study, the European Commission is proposing to take measures in the interest of consumers to eliminate any problems that have been observed. For the launch of the Consumer Market Watch, 20 sectors (such as fixed and mobile telephony, water supply services and banking services) have been identified as priorities, including electricity and gas supply. CRE took part in the European Commission’s reflection on the structure of Consumer Market Watch and on drawing up the key indicators for the French electricity and gas retail markets.

### Inset 11: The Citizens’ Energy Forum

This forum is being held at the initiative of the European Commission. The first session is planned for the autumn of 2008.

The forum has been organised to facilitate discussions between the Member States, consumer organisations, industry representatives and regulators and to define recommendations designed to

promote competition in retail markets and protect consumer interests.

Certain topics have already been put forward by the European Commission: checking that existing legal provisions and those in the Third Energy Package are being properly applied, identifying obstacles to consumer involvement in the retail market

(switching supplier, billing, commercial practices, handling of complaints), sharing experience on different retail market models and the introduction of smart metering systems.

**5.2. Retail price regulation**

At the European Commission's request, in 2005 ERGEG began a process of surveying the functioning of retail markets for the purpose of identifying any obstacles preventing them from functioning correctly and formulating recommendations. In 2007, one of the issues dealt with in this process was retail price regulation.

A review of this question had already been published by ERGEG on 14 June 2007 (*ERGEG Status Review on End-User Price Regulation*). It enabled ERGEG to publish its recommendations on 18 July 2007

(*End-User Price Regulation, An ERGEG Position Paper*).

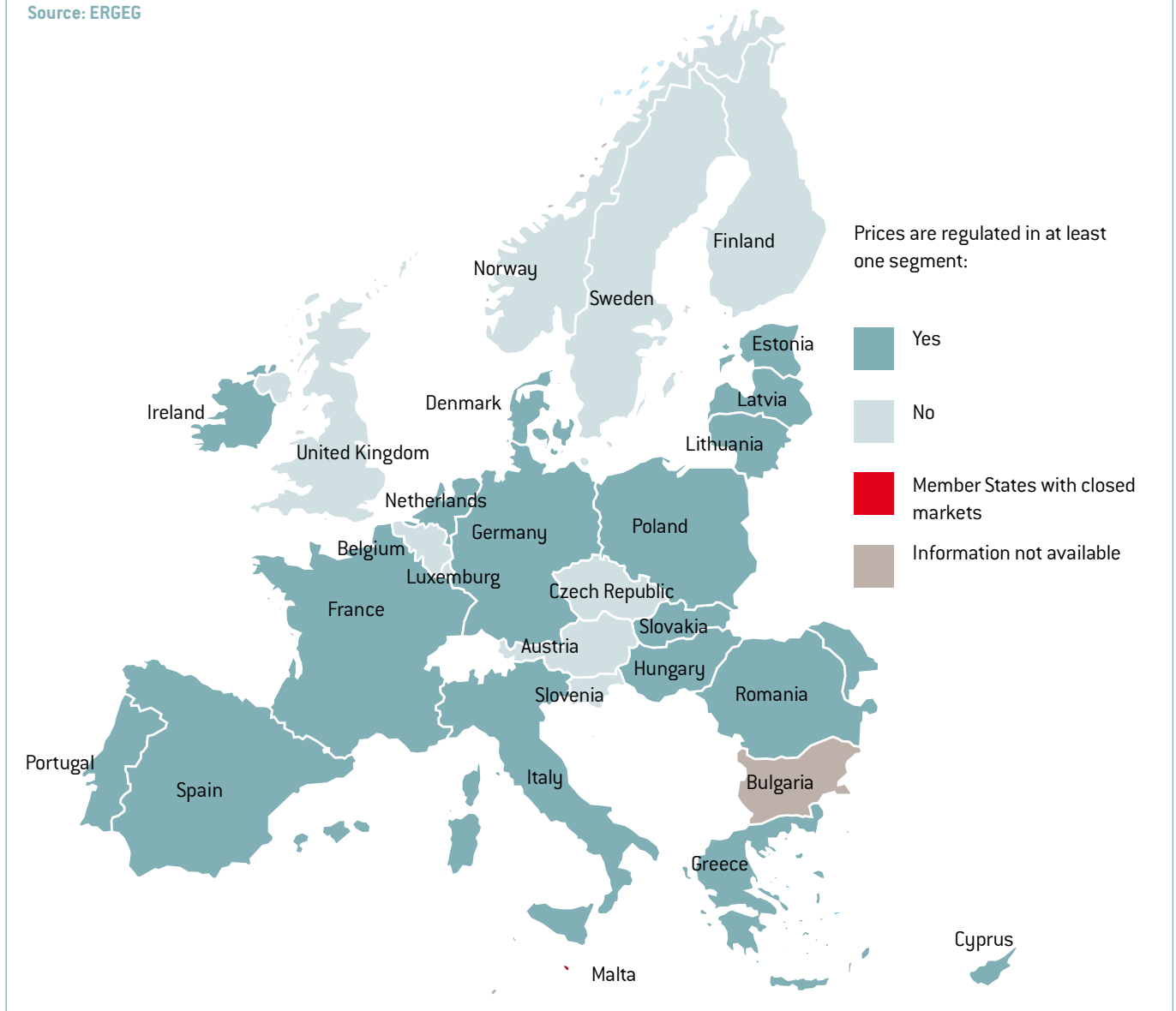
On that date, several EU Member States had already opened their energy markets and 14 Member States (including France) were going to open their markets up to competition completely. Several Member States were regulating some retail prices. As it had already stated in the results of its sectoral survey (published on 10 January 2007), the European Commission was concerned that Member States were keeping regulated prices below market prices, consequently excluding newcomers from

retail markets or reducing investment in new electricity production capacity, and thereby ultimately threatening Europe's security of supply. Given the context, ERGEG was led to take position on the impact of end-user price regulation on the functioning of these markets.

Regulating prices is the opposite of allowing prices to be determined solely by supply and demand. Retail price regulation is where a public authority intervenes in price setting. The authority can set prices itself, approve prices proposed by suppliers, set limits on price rises, or

**Figure 6: Electricity: regulated retail prices in Europe on 14 June 2007**

Source: ERGEG



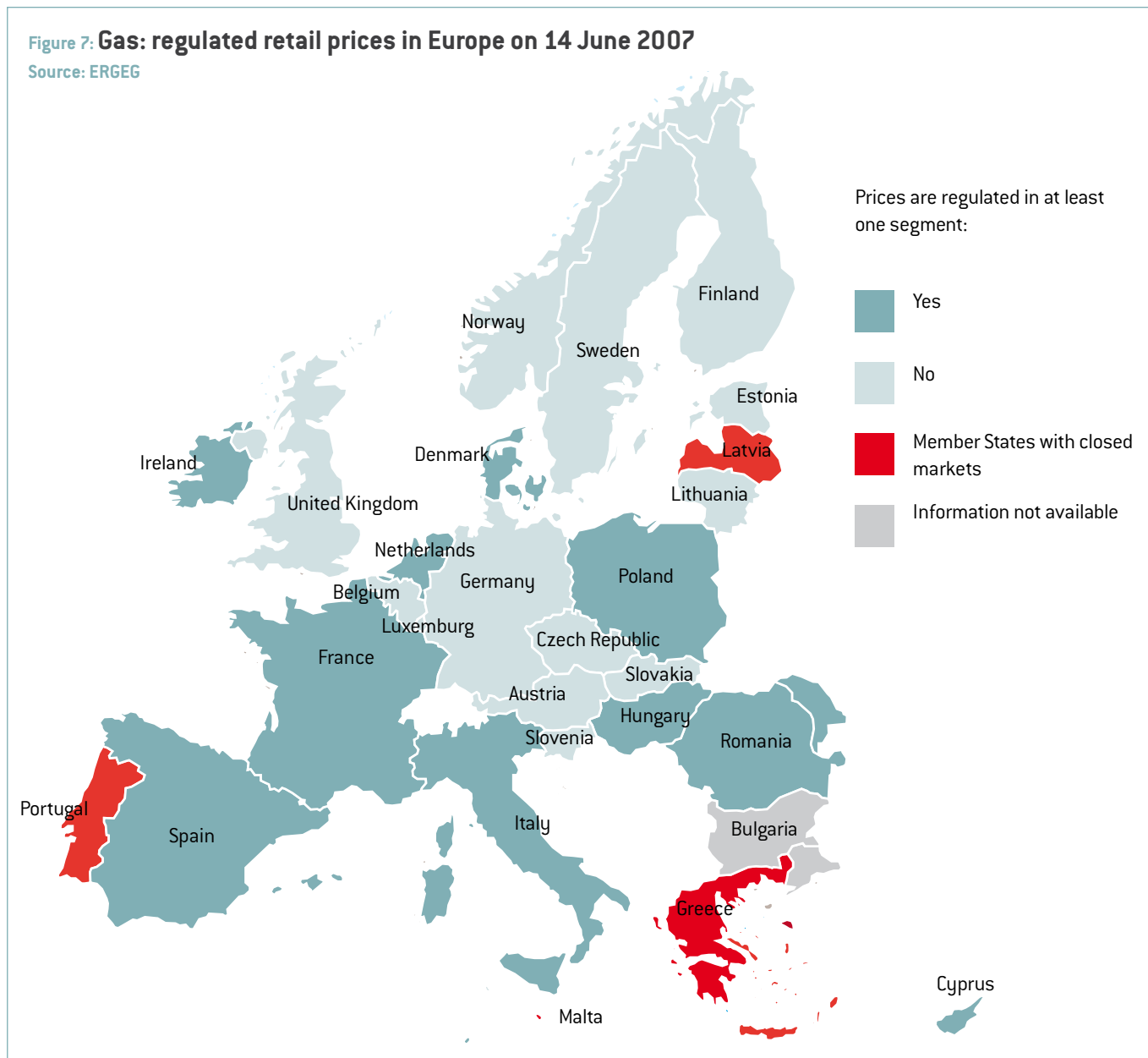
use a combination of these methods. In France, regulated retail prices for electricity and gas are called “tarifs réglementés de vente”.

Before markets were fully opened on 1 July 2007, 17 countries regulated retail prices for electricity (see Figure 6) and nine countries regulated retail prices for gas (see Figure 7) (out of the 28 countries studied: European Union and Norway). In most of these countries, the regulated prices co-existed with market prices in all market segments open to competition.

This means that all consumers could be supplied at regulated prices, and that retail price regulation was not intended solely for household customers. In all the countries studied, 80 to 100% of consumers had a regulated price contract. Only large non-household customers did not in some countries. In its report, ERGEG noticed that at the time only France did not allow household customers to go back to regulated prices once they had signed a market price contract (the non-reversibility principle). Since then, French law has been changed on this point (see p. 98).

**Figure 7: Gas: regulated retail prices in Europe on 14 June 2007**

Source: ERGEG





In the same report, ERGEG identified different methods for regulating retail prices in Europe. For example:

- In France (on the advice of CRE) and in Spain, the competent ministers fix the prices themselves, which must cover the suppliers' costs; these are "all-inclusive" prices, i.e. they include transmission, distribution (and storage costs in the case of gas) and the cost of the energy source.
- In Denmark, the regulator puts an upper limit on the margins that can be made by suppliers with supply obligation licences (which make these suppliers default or last resort suppliers – should other suppliers fail); these suppliers can adjust prices as long as they remain below the upper limit and within the profit margins they wish to make; only the cost of the energy source billed to customers is regulated (i.e. transmission and distribution costs are not regulated).
- In the Netherlands, the regulator decides the maximum reasonable price for household customers. This price is not made public so as not to distort the market price fixing mechanisms.

In June 2007, in the 17 countries that were regulating retail prices for electricity and gas:

- responsibility for setting these prices lay with the regulator, except in France, Greece and Spain;
- the rules for calculating these prices were published, except in Cyprus, France, Greece, Hungary and Spain.

In France, on the advice of CRE, the competent ministers set the regulated retail prices for electricity. They approve the proposed regulated prices of the incumbent gas suppliers, except for Gaz de France, in which case they set the prices that apply to customers connected to the distribution network.

In its recommendations, ERGEG states that regardless of considerations concerning the method of regulating retail prices, the very existence of regulated prices has an impact on the way retail markets function. According to ERGEG, maintaining retail prices that do not automatically reflect prices on the wholesale markets distorts the retail markets by making it more diffi-

cult for suppliers to gain equal access to all customers. In this case, suppliers that do not have their own capacity or a long-term contract offering them stable and predictable supply conditions are not able to offer prices that are competitive and allow them to cover their own procurement costs. This hampers the development of liquid wholesale markets, which would in turn attract newcomers or encourage new supplies offering greater choice to customers. In the absence of any alternative competitive offer, there is no incentive for customers to switch supplier. Therefore, maintaining conditions that prevent the emergence of new competitive offers to encourage customers to switch supplier obstructs the development of competition in retail markets.

In addition to its impact on the functioning of retail markets, ERGEG notes that keeping regulated prices artificially low is likely to compromise both security of supply in Europe and the fight against climate change.

Prices that do not reflect the relationship between supply and demand, and that do not reflect the cost of the product, do not send out the correct signals on product scarcity, the status or availability of production capacity, or the environmental impact of electricity and gas consumption. Consequently, none of the information needed to promote energy efficiency measures, a reduction in consumption or investment in additional capacity is reflected in these prices.

This survey of the situation has led ERGEG to state that retail price regulation leading to some prices being systematically lower than market prices cannot coexist in the long term as markets open to competition. ERGEG recommends the removal of retail price regulation in countries where it is still practised, while implementing a roadmap. This roadmap should provide for the following: a transitional period, the length of which would be fixed in advance and as short as possible, during which different methods of determining retail prices would coexist; the introduction of information campaigns for end-users about their rights and the options available to them; and the transfer to national regulatory au-

thorities of extensive powers to supervise the markets and ensure compliance with competition rules.

According to ERGEG, scheduling the end of end-user price regulation is entirely separate from the question of protecting "vulnerable customers". ERGEG is concerned about the confusion that sometimes surrounds end-user price regulation and the protection of "vulnerable customers", and reaffirms the need to protect "vulnerable customers" in markets open to competition.

In Community law, the term "vulnerable customers" applies to those likely to be particularly exposed to unfair practices by suppliers, and who therefore need extra protection competitive markets. It is up to each Member State to define what a "vulnerable customer" is (according to place of residence, differences in weather conditions, household income, etc.). According to ERGEG, the protection of "vulnerable customers" is primarily the responsibility of government, not regulators. These measures should not involve end-user price regulation or other measures that would affect proper market functioning. ERGEG explains that personalising the way customers are treated (through tax incentives, for example) according to their income or place of residence is the best way of protecting "vulnerable customers".

### 5.3. Practical aspects of retail market functioning

The efficiency of retail market operations can be assessed by examining the practical aspects of choosing a supplier. In the wake of the study by ERGEG on obstacles to supplier switching in gas retail markets (*Obstacles to Switching in the Gas Retail Market*, 18 April 2007), an identical study was conducted for electricity. This study led ERGEG to recommend the adoption of best practices in a document published on 10 April 2008.

To give consumers the possibility of exercising their right to choose quickly and securely, the study suggests improving consumer access to reliable information on supplier switching, existing offers and the



suppliers offering them, and procedures for switching.

ERGEG recommendations also cover the standardisation of relations between distribution system operators, suppliers and consumers (including data exchange), and reducing the time required to switch supplier to less than a month, as is already the case in practice in six countries (Czech Republic, Estonia, Finland, Luxembourg, Sweden and the UK) out of the 21 participating in the study. In France, it takes one to two months to switch supplier.

#### 5.4. Electricity metering systems

As part of its survey of retail market operating conditions, ERGEG studied smart metering systems to determine whether installing them for household customers would be an appropriate solution.

Smart metering systems are different from conventional metering systems because of the amount of data they can measure (such as load curves and supply interruptions) and because they can send

data using different forms of remote communication (via a suitable information and communication system). European legislation encourages the deployment of these systems. Article 13 of the Directive of 5 April 2006 on energy end-use efficiency and energy services states, for example, that “billing on the basis of actual consumption shall be performed frequently enough to enable customers to regulate their own energy consumption”. Meeting these requirements assumes that smart metering systems have been installed.

These factors spurred ERGEG to write a report published on 31 October 2007 entitled *Smart Metering with a Focus on Electricity Regulation*.

The survey conducted by ERGEG shows that the extent to which these metering systems have been installed varies widely from one Member State to another. In the next few years, three countries will finish installing smart metering systems for all their household customers (Italy, the Netherlands and Sweden); three others will have introduced regulation on

the subject (Austria, Ireland and the UK); and most (including France) will have conducted experimental trials and public consultations.

ERGEG recommends that before adopting a policy encouraging the introduction of smart metering systems, or even making it compulsory, a study should be conducted to demonstrate that the long-term advantages of this policy outweigh the costs.

The expected advantages are important, not only for customers but also for the distribution system operators, metering system operators and suppliers. Smart metering systems make it possible, for example, to eliminate costs associated with manual meter readings and site visits, to detect fraud, to increase the diversification of supply offers, and to improve network management by providing more fine-grained information about demand and network availability. They ensure customers are billed according to their actual consumption (and not estimates), and that they have access to the information they need to change their behaviour and control consumption.

The costs that need to be taken into consideration include investment costs, operating costs, stranded costs (for the removal of old meters), meter installation costs (which could vary from one country to another depending on manpower costs), and the cost of explaining the new meters to customers. ERGEG invites national regulators to take account not only of the cost breakdown for the entire operation, but also of the cost distribution among the various stakeholders involved, and how the costs will be recovered, to establish a cost estimate that covers all aspects of the retail market.

Certain factors could influence the results of this analysis, such as the characteristics and functionalities of available technologies, as well as the regulatory context, i.e. whether metering systems are managed by a legal monopoly (as is the case in most European countries such as France) or through a deregulated system.

Regarding the metering system features, from the retail market point of view, it is essential that the operator who collects metering data also makes this data avail-

able indiscriminately to all market players, as well as any customers who request it. This will enable suppliers to propose more diversified offers and customers to react to these offers. For this purpose, ERGEG recommends giving national regulators the task of defining the minimum requirements for smart metering system specifications.

These minimum requirements should include:

- the installation of an information and communication system, or Automated Meter Management, using standardised communication protocols to allow all recorded data to be transmitted as requested to all authorised third parties;
- the ability to read and configure meters remotely so they deliver information on load curves and the supply pricing periods;
- the obligation to provide meters with the same minimum functionality to an entire category of customers; these meters should also be able to provide price information relevant to the moment when electricity was actually consumed.

The kind of action that can be taken by national regulators depends on the regulatory framework governing metering systems. In the most common scenario – the monopoly – ERGEG notes that introduction of these systems could be driven at a pace set by the regulator (through various incentive schemes or by making installation compulsory). In deregulated systems, the regulator has fewer options. However, ERGEG recommends that, in all cases, the regulator sets minimum targets to guarantee a minimum metering service level for all customers.

# III. European Community activities

## 1. The European Commission's proposals for the internal energy market: the Third Energy Package

Taking into account the conclusions of the European Council of 8 and 9 March 2007, the European Commission has confirmed that, in spite of the progress made, the internal market is far from being completely achieved.

On the basis of various reports from DG TREN and DG COMP, it considers that vertical integration of supply, production and infrastructures prevents equitable access to infrastructures, that pricing mechanisms are not very transparent and that retail markets are still not very competitive.

Consequently, the European Commission published on 19 September 2007 the draft Third Energy Package comprising five proposals to supplement and improve the provisions of Directives 2003/54/EC and 2003/55/EC of June 2003 laying down the common rules for the internal electricity and gas market: two directives modifying the aforementioned directives, two regulations modifying Regulations 1228/2003 [electricity] and 1775/2005 [gas], and a new regulation creating an Agency for the Cooperation of Energy Regulators.

These proposals are supplemented by an impact study, which concludes that ownership unbundling between transmission system operators on one hand and the

production and supply business on the other, reinforcing the role and coordination of regulators, and greater transparency in wholesale markets would be the best guarantees for improving the competitive situation in Europe.

This series of measures aiming to improve operation of the internal market has been the subject of sustained debate in both the European Parliament and the Council. This has led several Member States, including Germany and France, who are opposed to ownership unbundling, to propose a "Third Way" aimed at "efficient and effective unbundling" of networks without jeopardising vertical integration of companies in the sector.

In order to move towards an agreement, the European Commission and most Member States have agreed to discuss a significantly reinforced Third Way.

### 1. 1. Effective unbundling of system operators

The Third Package proposals aim for a more distinct unbundling than the current legal unbundling defined to separate transmission from the other activities of integrated companies.

Two options are proposed (see Figures 8 and 9):

#### 1. 1. 1. Ownership unbundling

Transmission system operators would become separate entities in terms of capital

ownership, and would no longer be simple subsidiaries of the parent company. This is the option that is clearly preferred by the European Commission.

In this option, each company that has a transmission network must be designated as a TSO by the Member State concerned. A TSO is designated by the European Commission once it has successfully passed the certification procedure conducted by the national regulatory authority.

No person or company (public or private) with direct or indirect control over the system operator can have shares in a supply company or control of such a company, and vice versa.

No person or company (public or private) with direct or indirect control over the system operator can appoint members of the board of trustees or board of directors in a supply company, and vice versa.

TSOs can no longer be affiliated with or belong to a group active in producing or supplying gas or electricity.

In addition, the proposed electricity and gas directives specify that transmission system operators must not be controlled by persons originating from third-party countries, unless there is a bilateral agreement between this third-party country and the EU.

To justify this solution, the European Commission bases its judgement mainly on the impact study it carried out, which indicates that:

- "the experience of a certain number of Member States shows that ownership unbundling leads to investment in infrastructures, thereby correcting distortions in terms of investment incentives inherent to vertically integrated companies";
- "the share of congestion revenue reinvested in interconnection capacities is twice as high among operators of non-integrated systems as that reported among vertically integrated operators";
- there is no negative effect on the valuation of companies and the study shows on the contrary that "shareholders have in fact benefited in nearly all cases from an increase in share prices during and after ownership restructuring".

**1. 1. 2. Independent System Operator**

The European Commission has proposed that Member States may depart from ownership unbundling rules and opt for an independent or "ISO model" system operator scheme.

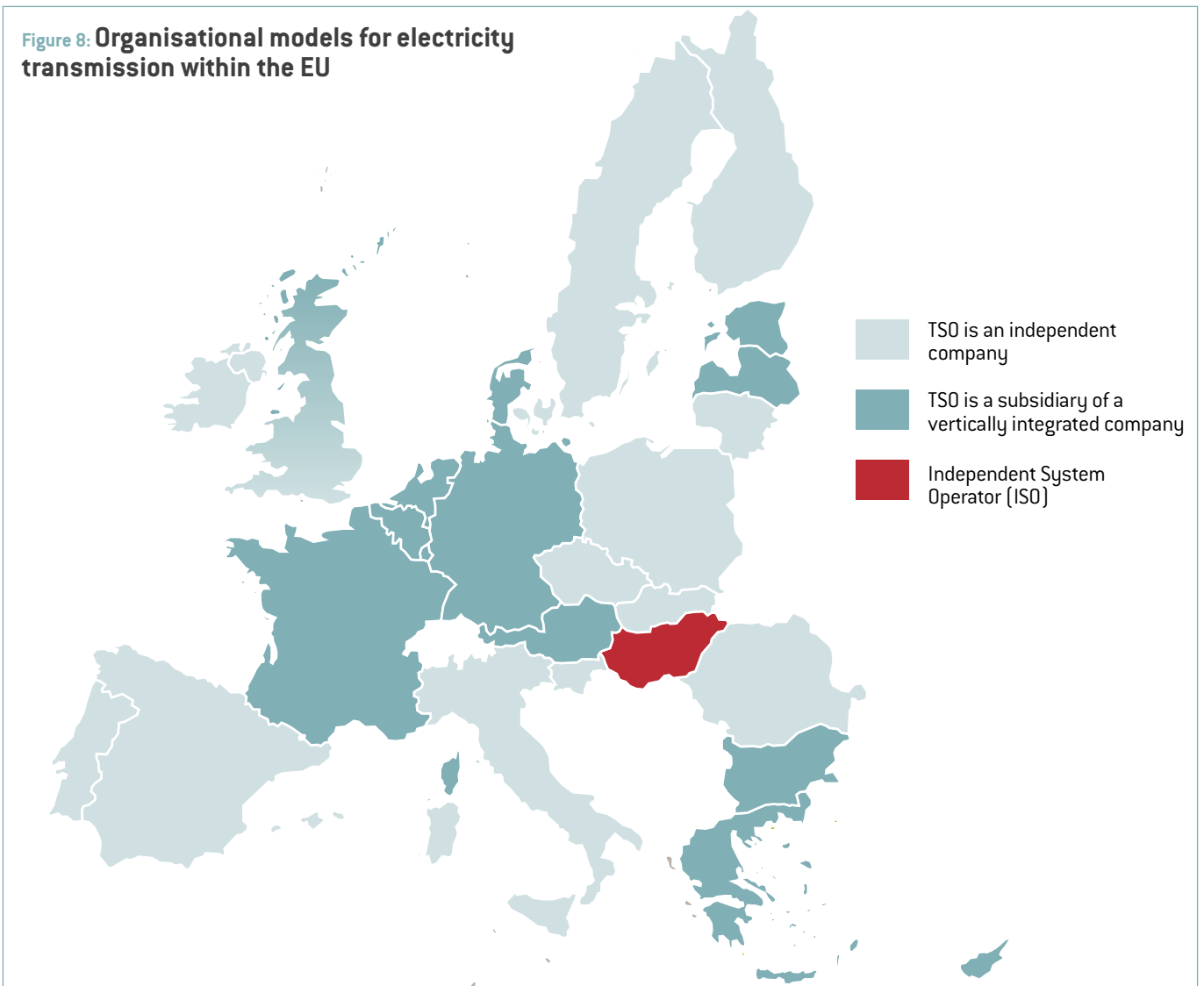
In this case, the vertically integrated company continues to own grid/network assets, and receives a return on these assets, but is not in charge of operation, maintenance, or development of the grid/network.

This is entrusted to an independent operator appointed by the Member State. This appointment is approved by the European Commission.

This option involves greater control on the part of the regulator and additional requirements to guarantee independence of the system operator (absence of direct or indirect control over supply activities, sufficient financial, technical and human resources, ability to comply with the obligations of Regulation 1228/2003 on cross-border trade, etc.).

The independent system operator option is generally considered to be the most complex to manage. This is also the opinion of the European Commission, which sees it only as a potential exemption from the principle of ownership unbundling.

**Figure 8: Organisational models for electricity transmission within the EU**



## 1.2. Reinforcing and harmonising the authority of national regulators

The authority exercised by national regulators today varies to a great extent, depending on both their nature and their scope of activity. To harmonise and reinforce regulator authority, European Commission proposals provide that regulators be given incorporated status and financial and managerial independence. They also provide for giving them effective powers of sanction comparable to those which CRE already has.

48

Texts also give regulators authority beyond that defined in the directives currently in force, such as approval of investments made by transmission system operators,

and the ability to impose Gas Release and Virtual Power Plant programmes where necessary. Lastly, regulatory authorities would have the power to set up incentive-based regulation mechanisms.

## 1.3. Creation of an Agency for the Cooperation of Energy Regulators (ACER)

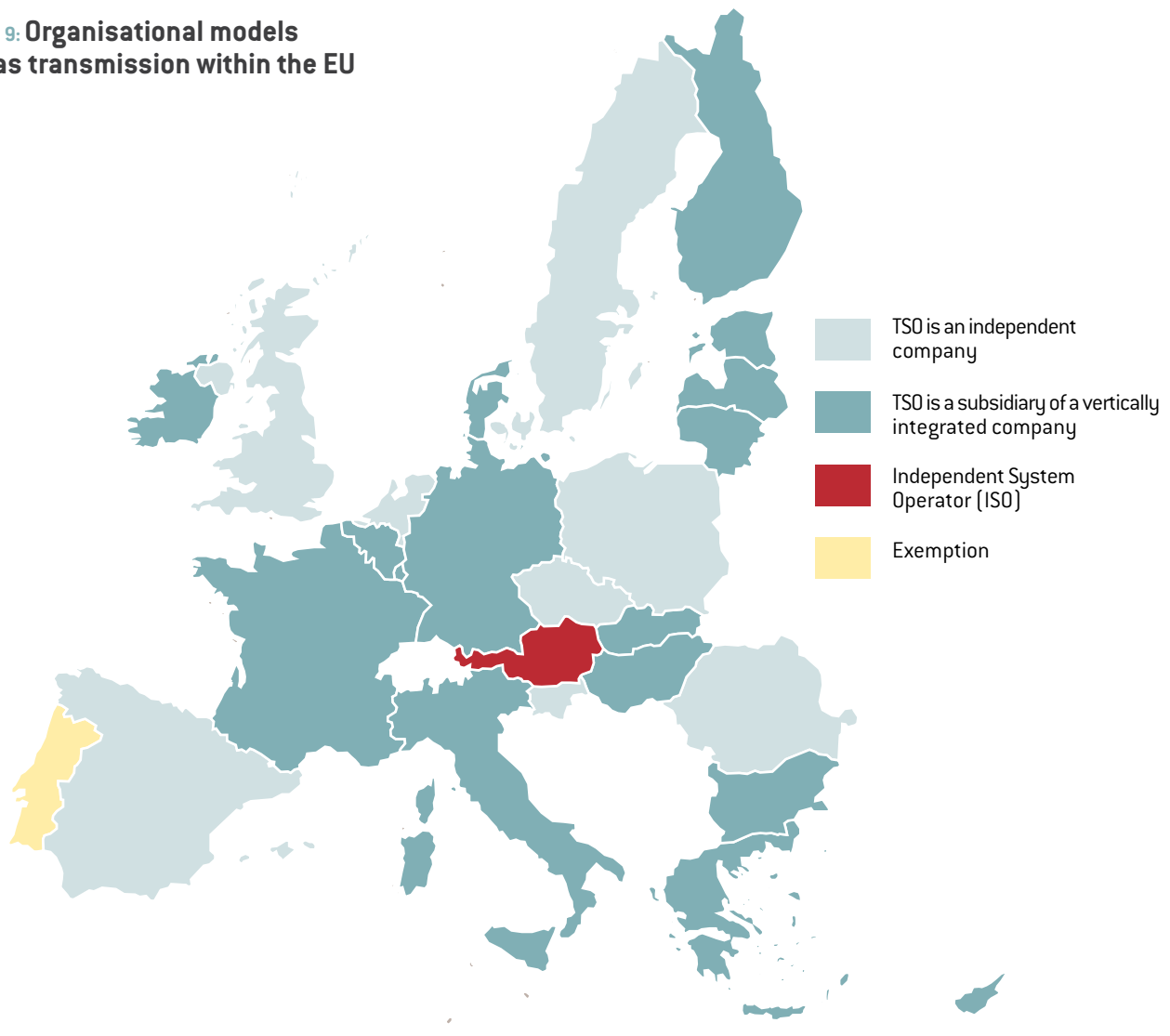
The proposed regulation to set up the Agency for the Cooperation of Energy Regulators (ACER) aims to improve efficiency in the work conducted by national regulators and to constitute an organisation at the European level to which the European Network of Transmission System Operators (ENTSO) for electricity and gas can address its questions. The organisation and authority of ACER are based on com-

mon rules already applied to certain Community agencies in other sectors, such as rail transport and air safety, but adapted to the energy field.

### 1.3.1. Organisation and members

In the European Commission's proposals, ACER consists of a council of regulators made up of the chairs of the 27 national regulatory authorities of the Member States, and an administrative board made up of six Member State representatives and six European Commission representatives, responsible solely for budget and administrative issues. A court of appeal is also appointed for decisions relating to regulation. A director will be appointed by the administrative board from two candidates proposed by the European Commission.

Figure 9: Organisational models of gas transmission within the EU



### 1.3.2. Missions

The agency would be responsible mainly for giving opinions:

- on the work programme and priorities for cooperation between transmission system operators;
- on technical and market codes prepared by the European Network of Transmission System Operators;
- on the European 10-year system development programme which is also submitted to it by TSOs at European level.

These opinions, which are intended for transmission system operators, national regulation authorities and the European Commission, would not be legally binding. Nevertheless, if the Agency considers that legally binding rules concerning cooperation between transmission system operators are necessary, it could draft appropriate recommendations to the European Commission.

ACER would also be responsible for setting up procedures to handle cross-border issues efficiently.

Lastly, it would have individual decision-making power in two fields: certain techni-

cal issues relevant to electricity and gas, as well as the exemptions to access by third parties provided for in Article 22 of the Gas Directive of 26 June 2003, where they involve cross-border infrastructures.

### 1.4. Creation of structures uniting European transmission system operators

According to the European Commission's proposals, the exact form and terms of this cooperation, designed to achieve the best possible coordination of electricity and gas system business at European level, are left to the discretion of transmission system operators on the basis of existing associations (ETSO for electricity and GIE for gas). The European Commission will formalise this cooperation and officially designate the proposed organisation, which must also receive the approval of ACER.

Transmission system operators will be entrusted with:

- drafting technical and commercial codes. These codes, designed to facilitate Europe-wide harmonisation and compatibility of operational procedures and third-party access conditions to networks, consist

mainly of rules for connection and access to the network, interoperability, security and reliability, balancing, etc. They are not compulsory, but could become so if necessary through the comitology process; coordinated management of transmission systems;

- Europe-wide coordination of investment in networks and development of transmission capacities, in accordance with the European investment plan approved by ACER.

### 1.5. Improving transparency

The European Commission's proposals reinforce the current rules for transparency in order to enable effective access to the networks by making timely information available for all.

For example, it provides that supply companies archive relevant data concerning commercial transactions (supply contracts) for gas and electricity, as well as any by-products (futures markets), to be made available to regulatory authorities as necessary.

## 2. The European Commission's proposals for fighting climate change: the Climate Package

On 23 January 2008, the European Commission presented a set of proposals for fighting climate change. This "Climate Package" comprises three sections: promotion of renewable energy sources, development of carbon capture and storage technologies, and increasing energy efficiency.

The Climate Package includes a draft Community decision on the work to be carried out by Member States to reach greenhouse gas (GG) reduction targets. The published texts include several communications by the European Commission as well as three draft directives concerning respectively geological storage of carbon dioxide, revision of the GG Emission Trading Scheme, promotion and use of renewable energy sources [see Inset 12].

### 2.1. European Council objectives

Generally speaking, the proposed measures aim to implement the objectives agreed on by the European Council on 8 and 9 March 2007. These objectives aim to achieve the following by 2020:

- a 20% reduction in greenhouse gas emissions compared with 1990 levels;
- a 20% improvement in energy efficiency within the Union compared with 1990;
- raising the share of renewable energy sources to 20% of the European Union's total energy consumption, including a minimum of 10% biofuels in the composition of transportation fuels.

By comparison, the reduction in greenhouse gas emissions compared with 1990 was 6.5% in 2005 for the entire European Union. The share of renewable energy sources in total consumption reached an average of 8.5% in the same year. Progress targeted by the 27 Member States represents an overall reduction of 14 additional points of greenhouse gas emissions and an increase of 11.5% in the share of renewable energy sources between 2005 and 2020, i.e. almost double the effort made over an equivalent period between 1990 and 2005.

### 2.2. Five proposals by the European Commission

The Climate Package presents five challenges to Member States:

- reform the Carbon Emissions Trading Scheme through Communitisation of the emission rights allocation mechanism, extension of the scheme to high energy

- consuming industries and setting up an emission certificate trading market;
- share the burden of greenhouse gas emission reduction among all Member States in sectors not concerned by trade in emission quotas, such as transport, buildings, agriculture and waste management;
- set up a renewable energy development plan that defines a national target for the percentage of renewable energy sources to be achieved, this objective being proportional to GDP per capita in each Member State; Community support for investment; and a system of certificates of origin that can be traded between Member States;
- promote carbon capture and geological storage technology for producers using fossil fuels;
- enable recourse to State aid for environmental protection projects by allowing exemptions to rules fixed by the Treaty of Rome.

The overall cost of this package of measures is estimated by the European Commission at 60 billion euros by 2020, using a reasonable assumption based in January 2008 on a barrel of oil at USD 61. According to the European Commission, this total amount represents 1/10<sup>th</sup> of the "cost of inaction" that would penalise the community if no large-scale measures were implemented to fight climate change.

#### **Inset 12: Article 14 of the proposed directive on promoting the use of renewable energy sources deals with access to the electricity grid by the relevant production facilities.**

Article 7 of Directive 2001/77/EC of 27 September 2001 already outlines a framework for incorporating electricity generated from renewable sources into the grid. However, the European Commission notes that the current level of integration in the grid varies considerably from one Member State to another. For this reason, it considers that the framework must be reinforced and that it would be advisable to check regularly that it is applied at national

level [Recital 32 of the draft Renewable Energy Directive]. Reinforcing the existing framework is accomplished mainly by obliging Member States to take measures so that "electricity produced from renewable energy sources has priority access to the grid", which, in regulations currently in force, is only an option that has not been included in French legislation. If it were adopted, the principle of priority access would have to

be reconciled with the principle of non-discriminatory access. The European Commission also recalls that connection costs for new electricity producers using renewable energy sources must be objective, transparent and non-discriminatory, and should take due account of the benefits brought to the grid by these producers.

### 2.3. Implementation planned for 2010

Negotiations at the European Council and Parliament began in February 2008. The European Commission hopes to reach a political agreement by the end of 2008 to enable adoption of regulations in 2009 so that they can enter into force in spring 2010 after transposition by Member States.

### 3. Infringement proceedings initiated against France by the European Commission

On 4 April 2006, the European Commission addressed letters of formal notice to Member States, the first step in initiation of infringement proceedings.

With regard to France, the grievances held by the European Commission related to various matters, including regulated sale tariffs for electricity and gas. Only the latter remains in dispute, which could lead the European Commission to refer the case to the Court of Justice of the European Communities, which it has not done for the time being.

Moreover, on 13 June 2007 the European Commission opened a formal examination procedure relating to state aid that would include, on one hand, regulated sale tariffs for electricity in their yellow and green components (sites with power over 36 kVA) and, on the other, the TaRTAM (transitional regulated tariff for market adjustment) in its yellow and green components. The inquiry opened by the European Com-

mission focuses on state aid to companies, not regulated tariffs applicable to low consumption sites, particularly household customers and small businesses.

The government presented its observations on 10 August 2007. It maintains that these tariffs do not constitute public subsidies to large and medium-sized enterprises.

Since then the proceedings are pending.