

CO-OPERATION AMONG ENERGY REGULATORS IN THE EUROPEAN UNION

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0. INTRODUCTION

This paper discusses “Co-operation among energy regulators in the European Union”. It will address the following two basic questions:

- Why do European energy regulators co-operate?
- How do they co-operate?

Ten years ago, these questions would have been “nonsense”, for the simple reason that energy regulators did not exist in Europe¹. Therefore, it seems appropriate to start by explaining why they have been created and who they are, in institutional terms. To explain the role of energy regulators, however, it is necessary to briefly describe the structure and the development of the energy sector in the European Union (EU).

The present paper is divided into five Sections. Section 1 describes the legal frameworks and the market structures of electricity and natural gas in the EU. Section 2 explains why energy regulators have been introduced by most Member States and why different institutional formats have been adopted. Section 3 shows why co-operation among energy regulators is necessary. Section 4 indicates the main objectives of the recently created Council of European Energy Regulators. Finally, Section 5 briefly discusses the role of regulators within the political and institutional framework of the EU.

¹ Offer, the UK electricity regulator, started its activity on the 1st of September 1989. It was the first energy regulator in Europe; in other Member States, energy regulators were appointed some years later, mainly during the second half of the 1990s.

1. ELECTRICITY AND NATURAL GAS IN THE EU

Until 1990, electricity and natural gas were *de facto* or *de jure* monopolies in all European countries. With just a few exceptions, energy companies were public, i.e., they were owned by the State and controlled either by central government or by regional and/or municipal administrations. In the electricity sector, most companies were vertically integrated, i.e., they were present in generation, transmission, distribution and supply of electricity. Only a few companies sold both electricity and gas. Interaction between the two sectors was very weak since the use of natural gas in power stations was limited by a EC directive from 1975.

During the 1990s, the legal framework of the energy industry changed considerably in Europe, both at national and at EU level. The two major key words describing this process are liberalisation and integration. Member States decided to liberalise both electricity and natural gas and they agreed on some common rules (unbundling, open network access, etc.) and on some minimum thresholds. At the same time, Member States decided to increase the degree of integration of their national energy markets, with a view to creating a true internal energy market. These agreements were translated into the “electricity directive”² and the “gas directive”³, respectively.

For different reasons, several Member States also decided to privatise the energy sector, selling the existing public energy companies and attracting new private investors.

The 1975 EC directive was removed and natural gas became the major input fuel for power generation.

² “Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity”, published in the O.J. No. L 27 of 30 January 1997.

³ “Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas”.

These changes triggered a process of industrial restructuring, still in the beginning. Although it is difficult to imagine the future European energy landscape in full detail, some important features may be already observed:

- Competition in generation and supply increases with time.
- Transmission and distribution remain monopolistic activities.
- Transmission and network operation becomes a totally independent industry; “horizontal” interaction among Transmission System Operators (TSOs) from interconnected networks is crucial and leads to the establishment of European TSO associations for electricity and gas.
- Organised markets, both physical and financial, become the focal point of electricity trade; such international markets are open to agents from several countries.
- Many companies have changed ownership, size and scope over the last ten years; increasing activity in mergers and acquisitions will further redesign the map of energy companies.
- The political will to speed up liberalisation and integration of energy markets is growing, as shown by the conclusions of the Lisbon European Council (March 23/24), by the “Communication from the Commission to the Council and the European Parliament – recent progress with building the internal electricity market”⁴, by the conclusions of the last Energy Council meeting⁵ and by several decisions recently taken at national level.

⁴ COM (2000) 297 final of 16 May 2000.

⁵ 30 May 2000.

2. THE INTRODUCTION OF INDEPENDENT ENERGY REGULATORS IN EU MEMBER STATES

The introduction of some degree of competition in the electricity and gas sectors created the need for appropriate regulation, granting, *inter alia*, non-discriminatory access to networks and efficient dispute settlement mechanisms.

According to national law, administrative tradition, market structures and political choice, each Member State introduced energy regulation in a different way. For the moment, only Germany decided not to set up a specific energy regulator, sharing supervision functions among the Federal Anti-trust Authority (Bundeskartellamt), the Federal Ministry of Economic Affairs and State administrations.

Ireland, the United Kingdom, Norway, Sweden, Finland, Denmark, Belgium, France, Spain, Portugal, Italy and Greece have created specific electricity and/or gas regulators. In the Netherlands, the energy regulator is a specific part of the Anti-trust Authority.

3. SOME REASONS FOR CO-OPERATION AMONG EUROPEAN ENERGY REGULATORS

Co-operation among energy regulators may be justified by two orders of reasons:

- Because it improves the performance of individual regulators and therefore it has a direct positive impact on the markets regulated by the involved regulators.
- Because the lack of co-operation would hinder the development of the regulated markets or it could harm some market agents.

In the first case there are several examples, more or less trivial, that can be given:

- ◆ Exchange of experiences among regulators, especially in the start-up phase, can improve:
 - The management quality of the regulatory authorities.
 - The transparency and efficiency of the regulatory process.
 - The efficiency of the incentives and of the regulatory formulae adopted, as well as the effectiveness of implemented enforcement and supervision mechanisms.

- ◆ Exchange of information among energy regulators is important for several purposes, namely:
 - Supervision of multi-national companies, especially in a period of industry restructuring through mergers and acquisitions.
 - Benchmarking.

Cross-border electricity trade provides a good example of the second type. In the past, electricity exchanges within the Western European network were performed by the undertakings responsible for high-voltage transmission grids, according to the technical and economical rules defined by their association ⁶. Cross-border transactions were limited to wholesale exchanges among the owners of the high-voltage grids, either on a bilateral or on a multilateral (transit) basis; final customers had no access to the interconnections. The “Council directive of 29 October 1990 on the transit of electricity through transmission grids”⁷ had limited direct impact on electricity trade between Member States and the part of total exchanges related to consumption of the Western European system was about 10%.

The “electricity directive” allows Member States to shape their energy markets in several ways; in particular, it gives them the possibility of implementing different systems of network access, including access to interconnections. Looking to the way legislators and/or regulators

⁶ UCPTE: Union pour la Coordination de la Production et du Transport de l'Électricité, created in 1951.

⁷ Directive 90/547/EEC, published in the O.J. No. L 313 of 13 November 1990.

started making use of this freedom, it was soon recognised that implementation of the “electricity directive” could lead to incompatible trading arrangements and block cross-border trade if nothing was done. In fact, parallel liberalisation of 15 energy markets does not ensure the compatibility – and even less convergence or integration – of these markets. This implies that diversity must be compatible not only with the principles of transparency and non-discrimination, but also with the primary goal of achieving European energy markets in electricity and gas.

The need for some degree of institutional co-ordination was recognised by Member States and by the European Commission, who decided in 1998 to set-up the “European Electricity Regulation Forum”. This Forum, the so-called “Florence Forum”, meets twice a year in Florence and brings together national regulators, Member States and the European Commission, as well as a large number of interested parties – system operators, market operators, consumer associations, power producers, traders, etc.

The first challenge faced by the “Florence Forum” was to create a simple, low transaction-cost mechanism for cross-border electricity trade while, at the same time, keeping different national market structures. To set up such a mechanism requires considerable efforts. First of all, it is necessary to define some common access and pricing rules and to introduce some degree of harmonisation in existing national rules. Then, it is necessary to adapt the existing mechanisms for technical co-ordination and settlement to the new rules.

The “Florence Forum” working programme was defined in October 1998 in a paper presented by three regulators⁸. Through voluntary co-operation among system operators, the European Commission and national regulators, in dialogue with all interested parties, a solution was agreed in March 2000. Among other things, a mechanism was agreed that grants network users effective access to the full continental European grid (UCTE) from October 1, 2000. Later on, this mechanism will be improved and extended to other EU and non-EU

⁸ “Transmission and trade of electricity in Europe - discussion paper”. Autorità per l’energia elettrica e il gas, Comisión Nacional del Sistema Eléctrico, Entidade Reguladora do Sector Eléctrico.

interconnected systems. The new system being implemented now will apply between October 1, 2000 and September 30, 2001. It represents the first step towards the largest integrated electricity market in the world. Meanwhile, a more efficient system for the period after October 2001 will be proposed by regulators and discussed by the Florence Forum.

Another important result from the “Florence Forum” was the stimulus for creating European associations: system operators (ETSO), market operators and regulators (CEER), all have recognised that representative associations facilitate the debate at European level.

4. THE COUNCIL OF EUROPEAN ENERGY REGULATORS

The Council of European Energy Regulators (CEER) was created on the 7th of March 2000 by energy regulators from 10 European countries: Belgium, Finland, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden and United Kingdom. Since then, two more countries have joined the Council: France and Denmark. Greece will join soon. CEER is also considering the inclusion of new members with observer status.

The CEER objectives expressed in the Memorandum of Understanding signed by the European electricity and gas regulators are as follows:

1. Promote the development of efficient electricity and gas markets in Europe through the establishment of appropriate mechanisms.
2. Co-operate in order to achieve competitive European markets in electricity and gas, in which the principles of transparency and non-discrimination are ensured. The Members will reinforce and follow up the processes of liberalisation in the electricity and gas markets.
3. Set up co-operation, information exchange and assistance amongst The Members, with a view to establishing expert views for discussion with the institutions of the European

Union, and, in particular, with the European Commission, and representative international organisations as other sectors which may be involved.

4. Establish coherent and expert knowledge and analysis such that the institutions with which Members wish to hold discussion naturally consult the Members at a formative stage in policy development.
5. Provide a framework for the discussion of regulatory issues and exchange of experience.
6. Provide the necessary elements for the development of regulation in the fields of electricity and gas.
7. Develop joint approaches vis-a-vis transnational energy utilities and companies that operate in separated regulated utility markets (multi-utilities).
8. Where possible work to establish common policies among Members towards agreed issues.

CEER is particularly interested in contributing to the achievement of the internal markets in gas and electricity, joining the common efforts of its members with the European institutions, particularly with the European Commission, as well as with representative associations of consumers, system operators, market operators and market agents.

CEER's decision-making process is driven by consensus. It meets at least twice a year and non-members may be invited to attend all or part of these meetings.

For the time being, the main organisation of CEER is the rotating Presidency, whose first appointment was for two years. The Presidency is supported by a local secretariat and coordinates the activities of several Working Groups.

5. NATIONAL AND EU REGULATION: HOW WILL THEY INTERACT?

The example described in Section 3 and concerning cross-border electricity trade clearly illustrates the need for some kind of institutional co-operation and co-ordination, not only among national regulators, but also between these and the European Commission.

In the United States of America, inter-State electricity trade is regulated by the Federal regulator (FERC), while intra-State trade is regulated by State regulators.

In Europe there are no federal regulators, although the European Commission plays some regulatory functions. Which institutional design will be more appropriate for Europe – a federal regulator ⁹, reinforced co-operation between national regulators and the European Commission ¹⁰, reinforced regulatory powers to the European Commission, any other scheme?

The answer to this question is important for the short-term development of the internal energy market and therefore it is important for energy consumers. But clearly this question has to be considered in the context of the new European institutional architecture. ¹¹

⁹ This has been sometimes suggested by the European Commission.

¹⁰ This is suggested, for instance, by Jean Bergougnoux, Michel Matheu, Luc Baumstark and Nicole Jestin-Fleury in the recent report for the *Commissariat Général du Plan* “Services publics en réseau: perspectives de concurrence et nouvelles régulations”. La documentation Française, Paris, April 2000.

¹¹ See Fritz Scharpf, “Gouverner l’Europe” Presses de Sciences Po, Paris, 2000, in particular the last chapter – La gouvernance multiniveaux en Europe.