

**UNICE POSITION ON COMPLETION OF THE ELECTRICITY AND GAS MARKETS
IN VIEW OF THE ENERGY COUNCIL ON 4 OCTOBER 2002**

1. Executive summary

UNICE welcomes the fact that the Danish Presidency is mobilising strongly with a view to securing a common position before the end of the year on the Commission's revised proposals for completion of the gas and electricity markets (draft directive COM 2002-304 of 7 June 2002 amending directives 96/92/EC and 98/30/EC concerning rules for the internal markets in electricity and natural gas).

With regard to **deadlines**, UNICE stresses the importance of liberalisation of the markets for professional users by 1 January 2004 and complete opening of these markets by 2005. As a political minimum, it should be ensured that a specific date is laid down for complete market opening and that this aspect is not left open for subsequent decisions.

Concerning **separation of activities of integrated companies**, UNICE supports the widest possible generalisation of legal unbundling, but calls for proper evaluation of :

- the problems linked to the co-existence, in Germany, of many large, medium-sized and small operators which may own both production, transmission and distribution capacities;
- the impact of legal unbundling on small and medium-sized operators.

In view of these problems, UNICE asks that, if appropriate, arrangements should be explored which would give relevant regulatory bodies in the Member States the power to exempt small and medium sized operators from legal unbundling, at least during a transitional period, under the stringent condition that they must ensure that the stated objectives of the directive are met at least as well with other measures as via legal unbundling.

UNICE underlines that the fundamental objectives of transparency and non-discrimination must be the guiding principles for finalisation of the new regulatory framework. Adoption of the Commission's proposals for functional separation is of decisive importance in this respect.

The Commission's proposals regarding **public service obligations** in the economic and social field need to be formulated in narrower and more precise terms. The proposed new public service obligations in the area of climate change and energy efficiency could put excessively heavy burdens on operators and/or business energy users. Defining such new obligations is completely inappropriate before the policy debate planned for 2003 on services of general economic interest.

Effective gas liberalisation calls for **increased transparency** towards the Commission of take-or-pay contracts, with a view to avoid transport capacity constraints.

* see BDI footnote on page 4

2. Universal and public service obligations

In this area, the Commission's proposals suffer from the following weaknesses, which it is extremely important to correct:

- a) The scope of public service obligations in the economic and social field is defined very widely in article 3 of doc. COM 2002-304, and with very general terms. Member States have to implement, in particular, appropriate measures to achieve "the objectives of social and economic cohesion".

Such a wide definition opens the way for substantial growth in costs and prices for society, or for those elements which are thought to be most able to pay (companies). The content of article 3 could furthermore lead to conflicts with arrangements for social and economic policy in the EU and Member States.

- b) The proposal for a directive is insufficiently specific regarding principles and methods for financing public service obligations.

The directive should lay down guidelines to prevent cross-subsidies whereby missions of general economic and social interest would be financed mainly by user companies. Through its lack of precision, article 3 could lead to implementing provisions which are incompatible with the principles of competition.

With a view to facilitating correct financing of service obligations in the general economic interest, it might be useful for the directive to address the question of creation of funds or other compensation mechanisms to finance the service supply. This has already been done in some sectoral EU directives.

- c) The proposal comprises a major extension to the field of public service obligations.

The new proposal covers two new issues: climate change and energy efficiency. It suggests that it is up to the member states to impose these obligations on companies operating in the energy sector. New obligations could be put on operators that are excessively heavy and not easily manageable from an economic point of view. These increased obligations would favour other rival companies which do not have to comply with these obligations.

UNICE considers it completely inappropriate to define new public service obligations for energy before the overall Community policy for definition, financing, management and evaluation of services of general economic interest has been clarified, as envisaged in the various relevant Commission communications and in the Barcelona summit's conclusions on the subject.

- d) Due to the proposal's lack of provisions concerning mechanisms for selecting service providers, the regulation on public procurement should be applied. As regards the quality of the services provided, with particular regard to customer satisfaction, more precise mechanisms should be provided for to monitor and efficiently evaluate the public service.

Public service obligations should be kept to a minimum and be compatible with national traditions and requirements. Decision-making on public service obligations should preferably take place on the basis of subsidiarity.

3. *Unbundling*

a) *Background*

With respect to unbundling in order to guarantee non-discriminatory conditions on third party access, four solutions are in theory offered to the enterprises that run, simultaneously, monopolistic activities (infrastructures) and competitive activities (liberalised activities) through a vertically integrated structure:

- *Separate accounting* for monopoly activities;
- *Functional separation* allocating competitive activities to different divisions of the same company (**functional unbundling**);
- Separation within the company, which requires the creation of separate companies to manage monopolistic and competitive activities (**legal unbundling**);
- Separate companies with different owners (**ownership unbundling**).

Regarding the separation of activities, the proposed directive makes the following provisions (Art.7- Art.10):

- Regarding the separation of *transmission* activity from other activities, it is proposed to guarantee independent transmission through legal unbundling coupled with functional separation measures, ensuring that the network manager has effective decision-making rights, and is independent of the integrated undertaking. Moreover, as regards transmission activities, the proposed directive makes provision for member states to appoint one or more transmission network managers;
- Also, with regard to *distribution*, provision is made for legal unbundling to ensure the independence of the distribution network manager

b) **General UNICE recommendations**

It should be recalled that energy structures and the associated ownership regimes are fairly diversified in the EU.

For decades, the energy landscape in most Member States has been characterised by a limited number of electricity/gas operators, a very strong concentration of or a monopoly on production, transmission and distribution activities, and relatively simple and homogeneous legal ownership models. For these countries, legal unbundling is a regulatory reform option which commends itself spontaneously.

By contrast, in one important country, namely Germany, there is co-existence between large, medium-sized and small private, public and/or mixed operators which may own both production, transmission and distribution capacities. While aspiring to the widest possible generalisation of legal unbundling, UNICE notes that a political discussion is under way in Germany concerning the constitutional and other obstacles which could stand in the way of or render very difficult the changes to ownership rights implied by legal unbundling.

In addition, where there are small and medium-sized operators, the challenges and constraints linked to legal unbundling (risk of a loss of synergy through separation into legally autonomous units, danger of higher costs through creation of new departments in autonomous undertakings) could be disproportionate in scale.

UNICE calls for these problems to be properly evaluated in the final phase of negotiations and, if appropriate, for arrangements to be explored which would give relevant regulatory bodies in the Member States the power to exempt small and medium sized operators from

legal unbundling, at least during a transitional period, under the stringent condition that they must ensure that the stated objectives of the directive are met at least as well with other measures as via legal unbundling, notably with functional unbundling*.

c) Comments on the exemption provisions proposed by the Commission

As an element for solution of the problems outlined above, the Commission has proposed that electricity/gas distribution network operators serving no more than 100,000 customers should be exempt from the obligation for legal unbundling, compliance being necessary only for the requirements of functional separation (see article 10, doc. COM 2002-304). UNICE does not consider that this exception represents a satisfactory arrangement where the underlying assumption is adoption of legal unbundling as the basic rule. The planned threshold of 100,000 customers would mean that, in some countries, a very large number of distribution network operators (representing almost half of the market) would fall under this exception, which is not a satisfactory situation. Moreover, the threshold of 100,000 customers may have negative economic consequences if the area served comprises energy-intensive industries, and should not apply in that case. A threshold expressed in the form of total annual energy supplies would help to prevent this problem from arising.

d) Key importance of effective functional separation provisions

The essential results to be produced by the new directives are transparency and non-discrimination. From this angle, in its revised proposal the Commission has very rightly increased the requirements for functional separation in integrated undertakings between the network manager and the undertaking's other managers or activities (see doc. COM 2002-304, provisions of article 7.4 a) to d) for electricity and similar provisions for gas).

4. Particular comments on the Commission's proposed amendments to directive 98/30/EC (gas)

a) Definitions

The gas system is made up of different components: transport structures, local distribution systems, storage, re-gasification of natural gas and ancillary services. The proposed EU definitions rightly include the ancillary services necessary to serve the ultimate consumer.

b) Addressing infrastructure problems

Despite the measures adopted to guarantee access to these infrastructures, it is extremely difficult to introduce into the gas market effective competition between different players only with *third-party access* (TPA).

Real competitive market conditions are achievable through the building of new infrastructures. Therefore, it is important to favour the construction of new pipelines for the supply of natural gas, in line with the requirements of several European countries.

The existence of take-or-pay contracts could represent a barrier to new market entrants since they limit the transport capacity of pipelines for imports from producer countries. In order to ensure access for new entrants, UNICE recommends to set common standards for

* Given the specific situation in Germany, BDI insists that the Member States should be given the possibility to exempt from legal unbundling not only small and medium-sized operators but also large operators, and this under the stringent conditions defined above. Alternative arrangements to legal unbundling respecting these stringent conditions should not be limited by any transition period.

transparent evaluation of any existing residual transport capacity. These measures aimed at increasing transparency vis-à-vis the Commission (and not affecting the confidential elements of contracts) should give the Commission an overall view of transport capacity constraints and facilitate initiatives intended to prevent take-or-pay contracts from blocking the opening of new markets.

It should not be forgotten that the advent of the natural gas market involved the construction of major transport networks with the award of long-term contracts that effectively strengthened, on a binding basis, contractual relations between the producer countries and incumbents in the main European countries.

Finally, in order to facilitate the access of new entrants, networks should be strengthened at technical level (e.g. reinforcement of pressure control systems).

5. FINAL REMARKS

UNICE strongly hopes that agreement will be reached under the Danish Presidency. However, it should be pointed out that such agreement will not mark the complete opening of the internal energy market, in particular given the different levels of environmental legislation that exist in the Member States, which give rise to different unit costs for electricity production and are sources of distortions of competition between operators and, hence, between (exposed) users of electricity and gas.

Completion of the internal markets for electricity and gas also requires investments to strengthen interconnections between networks.

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