



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 04.05.1999  
COM(1999) 198 final

**SECOND REPORT FROM THE COMMISSION TO THE  
COUNCIL AND THE EUROPEAN PARLIAMENT**

**On the state of liberalisation of the energy markets**

# CONTENTS

1. **INTRODUCTION**
2. **ELECTRICITY DIRECTIVE 96/92/EC**
  - 2.1 **IMPLEMENTATION THROUGHOUT THE EU – STATE OF PLAY**
    - 2.1.1 Electricity Generation
    - 2.1.2 Opening up of the markets
    - 2.1.3 Access to the network
    - 2.1.4 Unbundling
    - 2.1.5 Public service obligations
    - 2.1.6 Transitional Regimes (“stranded costs”)
  - 2.2 **SECOND REPORT ON HARMONISATION REQUIREMENTS**
  - 2.3 **RENEWABLE ENERGY SOURCES AND THE INTERNAL ELECTRICITY MARKET**
3. **NATURAL GAS DIRECTIVE 98/30**
  - 3.1 **KEY ISSUES OF THE GAS DIRECTIVE:**
    - 3.1.1 Market opening
    - 3.1.2 Access to the system
    - 3.1.3 Unbundling
    - 3.1.4 Public service obligations
    - 3.1.5 Derogations
  - 3.2 **STATE OF LIBERALISATION**
4. **CONCLUSIONS**

## I. INTRODUCTION

Energy is a very important element of economic activity and social welfare. The creation of a single energy market based on open and competitive markets represents a great challenge for the Union as it is envisaged to have a direct impact on European industry and consumers welfare.

First, the introduction of competition in the electricity and gas sectors is a means to enhance the competitiveness of the European industry competing in the world markets. One of the critical factors for the international competitiveness of European business is the cost of energy. Compared to USA or Australia, European industry in some cases pays 40% more for electricity and gas due to isolation of national markets and lack of intra-Community trade for these products. The competitive disadvantage of higher prices is particularly marked for the energy intensive industry such as steel, paper, glass and motor vehicle industries. In the most energy-intensive sectors such as chemicals and aluminium, energy can account for 60% of production costs. It is evident that the survival and growth of these industries in the EU depends on their ability to cut production costs, including energy costs. A single electricity competitive market will also result in an improvement of the standards of service to the benefit of consumers, as the utilities will be exposed to competitive pressure

Second, the creation of a single market will also strengthen the security of supply across the EU by permitting diversification and flexibility of supplies as a result of the closer integration of the internal energy markets. It will provide for more outlets and better interconnections in the EU.

Third, the internal energy market is likely to have positive effects on the environment. For instance, liberalisation will facilitate in all Member States a switch over to cleaner energy sources for electricity generation such as gas; the operation of a single market will lead to less waste of natural resources as less reserve capacity will be needed in each country, and the single market will offer the possibility to energy consumers to choose cleaner energy sources. To ensure that these positive effects are not mitigated by the impact of more competitive prices on energy consumption, energy saving efforts should be maintained.

Over the last years very important steps have been taken to create a single energy market for the EU. Following the unanimous adoption of the electricity Directive<sup>1</sup> on December 1996, its implementation has been now completed in the majority of the Member States. The Directive lays down rules for allowing real competition between electricity producers while allowing an increasing number of consumers a free choice of their electricity suppliers. While providing for the liberalisation of the electricity markets, it gives special emphasis to public services by providing the mechanisms to pursue public service considerations in the context of a competitive market.

---

<sup>1</sup> Directive on common rules for the internal market in electricity 96/92/EC OJ L 27 of 30.01.1997.

The Directive<sup>2</sup> providing an internal market for natural gas has been adopted on 22 June 1998. Member States should implement it by August 2000. It provides for the gradual opening of the natural gas market to competition over a ten year period to reach 33% of the total gas consumption.

These Directives have provided the foundations for the creation of a single energy market. They have transformed the conditions under which electricity and gas trade will be carried out in the future with a view to lead to significant price reductions across the EU, to enhanced efficiency and to improved security of supply. To appreciate the progress already achieved, one has to look at the picture of the electricity and gas markets some years ago. In the past there was no trade for electricity and gas between the Member States of the EU and often no competition even within the Member States except for certain countries like the UK and the Scandinavian countries, which have started the liberalisation process before the adoption of the Directive. Electricity and gas generation, transmission and distribution were dominated by monopolies. Consumers inevitably had no choice of electricity supplies, and no guarantee for service standards. European energy intensive industry for which electricity represented a considerable cost was put at competitive disadvantage, as electricity prices across Europe were higher than in other areas of the World. Furthermore, the foreclosure of national markets to competition has led in the past to significant price differences in different countries and even within individual Member States as the following table illustrates:

Figure 1: Prices for electricity across the EU (domestic consumers of 3,300 kWh)

Austria	9.67
Belgium	11.87
Denmark	6.12
Finland	7.17
France	9.55
Germany	12.31
Greece	6.09
Ireland	8.47
Italy	16.34
Luxembourg	10.54
Netherlands	9.33
Portugal	12.45
Spain	10.29
Sweden	6.72
United Kingdom	9.89

Figure 2: Prices for electricity across the EU (industrial consumers of 50 GWh)

Austria	6.36
Belgium	5.1
Denmark	4.07
Finland	3.26
France	4.69
Germany	6.64
Greece	4.49
Ireland	5.69
Italy	5.49
Luxembourg	4.95
Netherlands	5.2
Portugal	5.45
Spain	5.3
Sweden	3.48
United Kingdom	5.9

Source: Eurostat. Price level as at July 1997 in ECU x100/kWh. Prices exclude taxes

<sup>2</sup> Directive 98/30/EC, OJ L 204 of 21.07.98.

The establishment of a single legislative framework applicable to all fifteen national electricity and gas systems was a very delicate task. In the electricity sector, there were highly centralised systems, such as those of France and Italy. There were, furthermore, countries which had already undergone the liberalisation process. In the gas sector, exporting countries such as the UK and the Netherlands have different systems and interests than importing countries and countries such as Portugal and Greece which had introduced gas rather recently. Market structures also varied enormously from country to country. The Directives providing for the liberalisation of the electricity and gas markets have set the framework for the creation of a single market for electricity and gas by allowing, over a period of time, consumers to choose their suppliers, and by providing for competition amongst producers. These Directives were based on three basic principles:

- First, the introduction of competition while respecting public service objectives to ensure an adequate and reliable supply of electricity and gas which is of utmost importance to all economic activity and households.
- Second, the gradual introduction of competition to the electricity and gas markets to give the necessary time to the industry to adjust to the new environment.
- Third, the Directives do not impose a rigid system to all Member States. They rather provide the framework for the creation of a single market while leaving Member States a wide degree of discretion to adopt the system which is best suited to their particular circumstances.

It is evident that this only a start and much remains to be done for the completion of an internal energy market. Ultimately, the success of liberalisation will depend on a series of measures that need to be taken during the coming months which will ensure that intra-Community trade is easily carried out. In this respect the creation of a number of trade facilitating mechanisms is essential together with the supervision of the operation of the markets in practice.

## **2. ELECTRICITY DIRECTIVE 96/92/EC**

### **2.1 IMPLEMENTATION THROUGHOUT THE EU – STATE OF PLAY**

#### **2.1.1 Electricity Generation**

Generation is one of the main components in the cost of electricity. This cost needs to be significantly reduced if EU prices are to fall to those of some of its main competitors. The Directive introduces full and complete competition across the EU for all new generating capacity. Thus, from February 1999, any producer will be able to build a new power plant and generate electricity anywhere in the Community, either on the basis of an authorisation system or a tendering procedure. The Directive permits Member States to choose between these two procedures when implementing the Directive. Under an authorisation procedure, any company may build and operate a new generation plant, provided that it complies with the planning and energy supply

criteria for authorisation specified in the Member State in question. Alternatively, under a tendering procedure, whenever there is a necessity for new generation capacity on the basis of regular long-term planning forecasts, an independent body will draw up an inventory for new means of production and the requisite capacity will be allocated by a tendering procedure. Thus, the monopolies existing until now in many Member States for electricity generation will be exposed to competition.

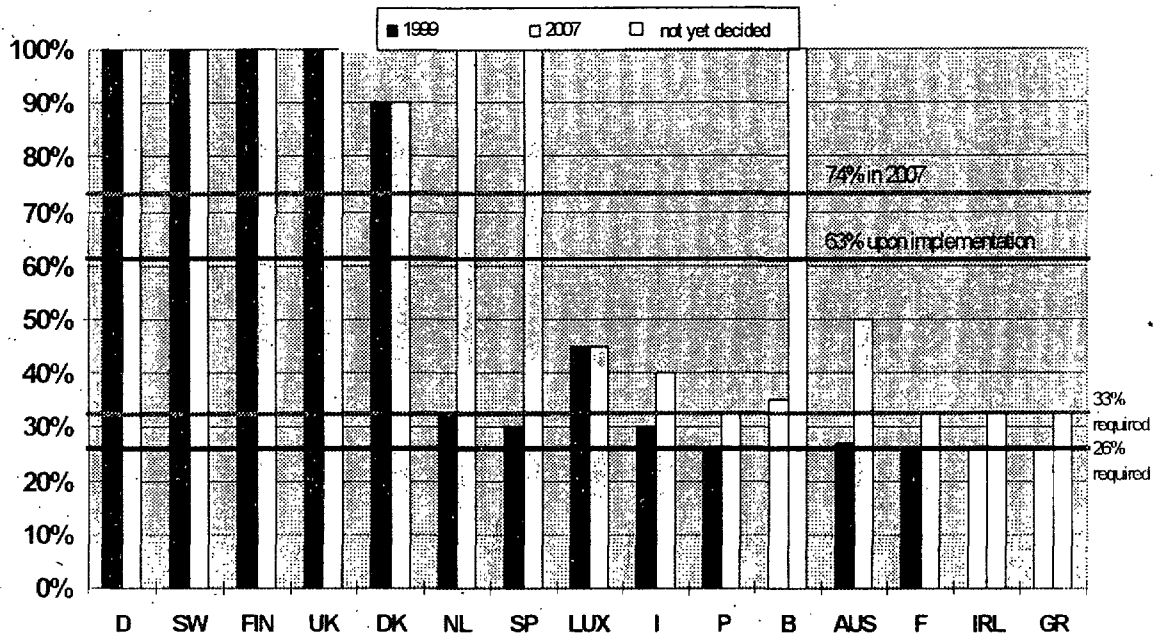
Whilst the Directive provides the choice for Member States between these two approaches for introducing competition into electricity generation, it is becoming clear that almost all Member States have opted or will opt for the authorisation procedure for the construction of new generation capacity. The reason for this trend developing in the EU is that this procedure represents the most transparent and effective mechanism to open up electricity generation to competition.

### **2.1.2 Opening up of the markets**

In order to create a competitive market that works in practice, sufficient numbers of consumers have to be free to purchase electricity from the supplier of their choice. On the other hand, liberalisation has to take place progressively. The change to competition requires major restructuring, new trading systems and mechanisms to be put into place, and time for companies to adapt to the new competitive environment. The Directive balances these two objectives, requiring Member States to progressively open their markets in three stages: 26% on 19.02.99, 28% at 2000 and 33% in 2003.

However, Member States have committed themselves to open up their electricity markets more than this minimum requirement. Countries like the UK, Germany, Sweden and Finland are committed to 100% market opening. Denmark by permitting all distributors to purchase freely is indirectly opening up 90% of its electricity market to competition. Others have also decided to go further than the basic requirements of the Directive, notably the Netherlands and Spain which will open up 33% upon implementation gradually increasing to reach 100% by 2007, Austria 27% upon implementation to reach 50% by 2003, and Italy 30% upon implementation. As a result, more than 60% of total EU electricity demand will be liberalised according to existing plans and more than nearly two thirds of consumers will be able to choose their supplier.

This is illustrated in the following graphic. The first bar gives the opening of the markets on the day the Directive has to be implemented by the Member States. The second gives the situation that according to current plans of the Member States will exist in 2007. Nevertheless it appears highly likely that in reality liberalisation will in fact have progressed even further by this date.



### 2.1.3 Access to the network

To enable the transport of electricity from producers to eligible customers, the Directive requires the owners and operators of the electricity networks, the Transmission System Operators and the Distribution System Operators, to provide access to their lines to others. The Directive provides three alternative methods of achieving this: regulated third party access, negotiated third party access, or the single buyer model. In fact, all Member States have opted for regulated or negotiated third party access ("TPA"): no country will significantly use the Single Buyer model. Access to transport wires can only be refused when there is not enough capacity to transport the electricity or when transport would make it impossible to carry out public service obligations.

It is generally considered that the system of regulated third party access on the basis of published prices is the method of permitting access to the network that will produce the most effective competitive market. Not only does the system of fixed prices for all ensure that discrimination against competitors cannot take place, it ensures that companies can plan future electricity purchases with advance knowledge of transparent tariffs. To have to renegotiate access prices and conditions at the end of each contract is also an extra burden on the companies. Regulated TPA is the option that most Member States have chosen as the table below illustrates:

Negotiated TPA	Regulated TPA
Denmark	Belgium, Finland, France, Luxembourg, Austria, Netherlands, Spain, Sweden, UK, Ireland, Italy, Portugal

(\*) Denmark has indicated that it will change to RTPA

#### 2.1.4 Unbundling

In Europe, the transmission network is largely owned by a vertically integrated electricity company, that generates, transports and sells electricity. These companies own an "essential service", the transmission network, which, under the new rules, it must offer on equal terms to its own company, and to its competitors. However, there is in reality a clear risk that such companies will be tempted to discriminate in favour of their own group companies when granting access to the network. To prevent *discrimination* occurring the Directive requires Member States to take three basic measures: (i) ensuring management unbundling of the transmission system operator, (ii) ensuring accounting separation of transmission and distributor activities from other parts of the company and (iii) ensuring that appropriate mechanisms are set up to prevent confidential information being passed by the transmission system operator to other parts of the company.

The management unbundling and confidentiality provisions of the Directive are crucial in preventing the operator of the network from discriminating against potential users of the transmission system.

Management unbundling entails in practice that the day to day management of the network by the TSO must be independent from commercial interests of the vertically integrated company. Thus:

- managers of the transmission system should not sit on the board of directors of the company. The transmission part should act independently from the interests of the vertically integrated company;
- the transmission system operator should have all the necessary means and assets to maintain, develop and manage the network, especially if the ownership of the network remains in the hands of the vertically integrated company;
- the transmission system operator must ensure that it does not disseminate any commercially sensitive information from other companies to other in his own company. Clear, "Chinese walls" have to be put in place to prevent this flow of information.

The Directive requires vertically integrated undertakings to keep separate accounts for each of the activities of electricity generation, transmission, distribution and any other non-electricity activities. These accounts should be published and be kept according to a standard accounting practice. The objective of these provisions is to ensure the necessary transparency in the operation of electricity undertakings with the view to



avoid any cross subsidies between the different activities and thereby distortions of competition. This important obligation will prevent companies disguising their allocation of costs. Transparency is seen in this light as an important precondition for the effective application of competition rules.

All Member States will respect the provisions for separation of accounts in vertically integrated undertakings. Most member States have decided to legally separate the TSO from the vertically integrated company which is the most effective approach to ensure that non-discrimination is taking place. Thus, Spain, the UK (England & Wales), Finland, Sweden, Denmark (west), Austria (east), the Netherlands, Portugal, Greece, Italy and Belgium have decided to appoint a separate legal entity as the transmission system operator. Denmark (east), Germany, France, UK (Scotland & N. Ireland), and Austria (west) will ensure that the TSO is independent in management terms without however appointing a separate legal entity. Member States plans are illustrated in the following table:

Structural unbundling of TSO (separate legal entity)	
<b>Spain</b>	Asa (Asociación Española)
<b>United Kingdom (England and Wales)</b>	National Grid Company
<b>Finland</b>	Finways
<b>Sweden</b>	Svenska Nätstäm
<b>Denmark (west)</b>	EDB
<b>Austria (east)</b>	Verbundgesellschaft
<b>Netherlands</b>	TEBES
<b>Portugal</b>	Rede Electrica Nacional
<b>Ireland</b>	
<b>Greece</b>	
<b>Italy</b>	ASST (Asociación Española)
<b>Belgium</b>	IBEL
Vertical integration (TSO has to be independent at least in management terms)	
<b>Denmark (east)</b>	EDB
<b>Germany</b>	AG companies
<b>France</b>	EDF
<b>United Kingdom (Scotland and Northern Ireland)</b>	Scottish Power, Scottish Hydro, Northern Ireland Electricity
<b>Austria (west)</b>	EWAG, Energie

### 2.1.5 Public service obligations

Liberalisation and public policy are not two contradictory imperatives. On the contrary, public service will and must play an important role in a liberalised market. This approach is clearly reflected in the electricity Directive, which provides for a mechanism enabling Member States to pursue public policy considerations without in normal circumstances limiting the liberalisation process. In this light Member States can define public service obligations in the general economic interest within five categories, related to environmental considerations, security, regularity, quality of supply constraints and pricing policy considerations. They can then take the measures necessary to achieve them. What is important is that the measures and mechanisms Member States put in place for the achievement of these objectives should not restrict trade and competition more than necessary.

Therefore, supply of electricity to geographically isolated consumers at reasonable prices, obligations to provide unprofitable services, guaranteed electricity supply to the sick and disabled, limits on the possibility of electricity companies to disconnect customers because of debt, and ensuring continuity of electricity supply are and will remain obligations that can be met in the context of a liberalised market. Governments can still impose on their distribution companies an obligation to supply their customers. Member States have the choice to impose such obligations on all operators in their country. Nevertheless, these obligations should be objective, transparent and imposed on a non-discriminatory basis on all operators equally.

There is no single definition of the concept of the public service in the Union. However, there is a common set of provisions existing in almost all Member States designed to regulate the activities of electricity companies, which can be listed in three broad categories.

The **first** category relates to the universal service and the overall protection of the consumer. In this line specific provisions exist in most Member States, (such as AUS, D, FIN, DK, UK GR, SP, POR, B and NL), laying down obligations to connect customers, and obligations to supply electricity on a regular basis to consumers. Some Member States such as Austria also lay down that consumers should be charged at reasonable prices, whereas in other countries such as France and Greece, regulated tariffs apply to captive customers. Furthermore, special provisions are laid down in some countries such as the United Kingdom to protect the elderly and disabled.

The **second** category concerns the protection of the environment. Specific environmental constraints are provided for electricity generation to ensure environmental friendly electricity production (Germany, Austria, Denmark, Greece). Support schemes for renewables and combined heat and power are common place in particular in the area of R&TD. Measures are also taken towards internalisation of external costs for instance through fiscal measures<sup>3</sup>. In addition, the role of cost effective mechanisms such as demand side management and energy services are being explored.

The **third** category relates to security of supply considerations, which entail technical specifications for all those connected to the grid, maintenance of reserve capacity, matching supply and demand, availability of capacity to meet demand, securing primary fuels for electricity generation, and maintenance of a secure and reliable system.

The Directive, therefore, gives Member States a wide margin of discretion in deciding how to ensure that public service obligations are met, and which ones to pursue. Nonetheless, the objectives and approaches pursued by the Member States are becoming increasingly similar. Experience to-date indicates that as competition takes hold, Member States require, and the companies meet, increasingly high standards in this area. Not only must companies meet the minimum standards legally required by Member States, it is often in their commercial interest to exceed them. This continued increase in the quality of public service is one of the basic underlying objectives of the Directive.

#### 2.1.6 Transitional Regimes ("stranded costs")

The introduction of competition in electricity will lead to lower electricity prices. These lower prices could lead to serious financial difficulties for producers and suppliers who are at present faced with costs based on the situation before competition was introduced.

These costs can take several forms, for instance:

- obligations imposed on electricity companies in the past, for instance for social or environmental reasons leading to extra investments that can not be recuperated;
- fuel and power purchase agreements with a duration beyond 1999, which have been concluded on the basis of the expected price level before liberalisation and would be too expensive under competitive circumstances;

Stranded costs are clearly not the costs that are a result of bad financial management of the company; they have to be clearly caused by the transition to competition. Normally these above market costs are a result of government policy, to favour certain fuels above others for instance. To deal with this issue the Directive provides for Member States to notify **transitional regimes** to the Commission. Such regimes aim to compensate companies for these extra costs, for instance by limiting the market opening to new entrants, to favour dispatch of electricity from certain fuels, or to give financial compensation. Pursuant to the subsidiarity principle it is for each Member States to decide whether, and how much, it wishes to provide for a transitional regime. It is equally for each country to decide how to meet the resultant costs. However, any such decision is subject to Commission control, either pursuant to the Directive, or the state aid rules.

Twelve notifications have been received by the Commission. Individual decisions will have to be adopted for each country during the coming months.

## 2.2 SECOND REPORT ON HARMONISATION REQUIREMENTS

According to Article 25 of the Electricity Directive, the Commission had to submit a report to the Council and to the European Parliament on harmonisation requirements in the internal market for electricity. With regard to the ongoing implementation phase the Commission decided to split the report in two parts. The first report, delivered in February 1998, dealt exclusively with the issue of promoting renewables in the competitive internal electricity market. As a consequence of this report and the following discussions, the Commission is now considering the options **to promote increased penetration of renewables in the internal market for electricity.**

The second harmonisation report<sup>4</sup> deals with a broader range of issues. First, it considers **obstacles for cross-border trade**, such as cross-border tariffication methodology and settlement, the operation of interconnectors, the management of available transmission capacity, the necessity to reinforce interconnection capacity, and the potential need for a common commercial policy towards 3<sup>rd</sup> countries. A second set of issues addresses the necessity of **ensuring a level playing field in the European electricity market after liberalisation.** This part discusses, inter alia, standards related to decommissioning of nuclear plants, environmental standards in electricity production<sup>5</sup> and taxation. It raises the question whether the different levels of environmental and other standards amongst Member states, based on EU legislation prior to liberalisation, tend to be too heterogeneous in the light of competition after liberalisation. The taxation chapter focuses on indirect taxes, in particular on energy taxes. It also covers the question of how to treat renewable based electricity and how to treat imported electricity.

The main focus of this second report is cross-border trade. This issue has been extensively discussed during the deliberations of the Electricity Regulation Forum in Florence. At the meeting of 8/9 October cross-border transmission pricing has been recognised as a key issue, and an adequate solution of this issue is the prerequisite for the functioning of a real single market in electricity. It had been agreed to encourage the independent transmission system operators to develop an adequate system of cross-border tariffication and settlement. To this end, the Commission invited the representative independent transmission system operators to Brussels on the 21 January 1999. A breakthrough in this difficult issue is needed, and, important steps can already be recognised. Otherwise, or maybe in parallel, there could be a clear need for regulation at the EU level. Thus, the second harmonisation has the function to support the rapid implementation of these industry arrangements, and, if necessary, to prepare the ground for regulatory action.

---

<sup>4</sup> COM(99)164, 16.04.1999

<sup>5</sup> Whilst the entry into force of the Directive will in itself result in environmental benefits due to the introduction of more efficient and cleaner new generating capacity, additional measures to further improve environmental standards in this area can also play an important role in achieving the EU's objectives in this respect.

## 2.3 RENEWABLE ENERGY SOURCES AND THE INTERNAL ELECTRICITY MARKET

In the White Paper on renewable sources of energy<sup>6</sup> it is stated that renewable energy sources still make an unacceptably modest contribution to the Community's energy balance as compared to the available technical potential. In 1995 the contribution of RES to the Union's overall gross inland energy consumption was somewhat less than 6%. The White Paper sets the indicative ambitious target of a doubling of the share of RES to 12% by 2010. This percentage is all the more ambitious since the major part of the current 6% RES-share stems from large hydro for which the development perspectives are very limited. The Member States have agreed that there is a need to promote a sustained and substantially increased use of RES throughout the Community and have welcomed the White Paper as a basis for the development of actions at Community level complementary to actions at national level<sup>7</sup>.

The share in electricity consumption of electricity from renewable energy sources will increase significantly over the coming years. The International Energy Agency (IEA) has, for example, in its World Energy Outlook for 1998, projected that the increase in RES-E will be far greater than in conventionally generated electricity in the Member States of the European Union.

This is confirmed by indications received by the Commission from the Member States. The following countries<sup>8</sup> have indicated targets for the growth of renewables generated electricity (excluding large hydro, unless otherwise indicated): Austria (3% in 2005), United Kingdom (10% in 2010, incl. large hydro), Denmark (25% increase by 2005, 85% increase by 2030), Finland (100 MW wind by 2005, 25% increase in bioenergy by 2005), Greece (255-355 MW by 2003), Ireland (19,7% in 2010, incl. large hydro), Portugal (837 MW by 2006), Spain (1200 MW by 2000).

To achieve an increase in the generation of electricity from renewable energy sources, the Member States have adopted different ways of supporting electricity from renewable energy sources. The European Union, with the adoption of Directive 96/92/EC concerning common rules for the internal market in electricity, is in the process of creating a single market for electricity. The integration of the electricity markets implies that the support of RES-E must be seen in the light of the internal market.

In the first report on Harmonisation requirements for the internal electricity market<sup>9</sup>, the Commission concluded that:

<sup>6</sup> Energy for the future: renewable sources of energy. White paper for a Community strategy and action plan. COM(97)599 final, 26.11.1997.

<sup>7</sup> Council Resolution of 8 June 1998. OJ C 198, 24-6-1998.

<sup>8</sup> In replies to a Commission questionnaire addressed to all Member States in 1998.

<sup>9</sup> Commission report to the Council and the European Parliament on Harmonisation requirements. Directive 96/92 concerning rules for the internal market in Electricity. COM(1998)167, 16.03.1998.

*"a clear need for common rules in this area can already be identified. The contemporaneous existence of different support schemes appears likely to result in distortions of trade and competition. The role of renewables in the EU will clearly increase in the coming years, given the Kyoto commitments. Thus, potential market distortions will accordingly increase. Whilst the trade and competition distorting effects of different renewable support schemes is rather limited at present, given the limited EU market share of electricity from renewable sources, this negative effect appears likely to significantly increase in the coming years. In this light, it is appropriate to move towards the definition of some common rules in this area as rapidly as practicable"*

It is clear that, at present, the disparate support schemes across the EU do not meet all these requirements.

In the light of the above the Commission has adopted on 13 April 1999 a Working Paper<sup>10</sup> on this issue, examining the current support schemes in the Member States and indicating in what way this issue should be dealt with in the light of the internal electricity market.

### **3. GAS DIRECTIVE 98/30/EC**

The European Parliament and the Council adopted on 22 June 1998 the Directive 98/30/EC<sup>11</sup> on common rules for the internal market in natural gas. The directive entered into force on 10 August 1998. Member States must implement it by 10 August 2000.

This Directive forms part of the framework for the internal energy market and represents a parallel of the Directive 96/92/EC.

It establishes some common rules for the transmission, distribution, supply and storage of natural gas. The Directive lays down the rules relating to the organisation and functioning of the natural gas sector, including liquefied natural gas, access to the market, the operation of systems, and the criteria and procedures applicable to the granting of authorisations for transmission, distribution, supply and storage of natural gas.

#### **3.1 KEY ISSUES OF THE GAS DIRECTIVE**

##### **3.1.1 Market Opening**

The Directive ensures that the market will be opened to competition progressively, starting with a first significant step that will guarantee that the high gas consuming industry will be given the possibility to choose freely its supplier. In a ten-year period

<sup>10</sup> SEC(99)470 final of 13 April 1999.

<sup>11</sup> Directive 98/30/EC, O.J.E.C L 291 of 21 July 1998.

the market will be liberalised for at least 33% of the total gas consumption during three steps:

1) 10 August 2000

- \* All gas-fired power generators.
- \* Final consumers with a minimum 25 million m<sup>3</sup> of annual consumption

This shall lead to at least 20% market opening in each Member State. In case where market opening would exceed 30%, Member State may introduce supplementary thresholds to limit opening to 30%.

2) 10 August 2003

- \* All gas-fired power generators
- \* Final consumers with minimum 15 million m<sup>3</sup> of annual consumption

This shall lead to at least 28% market opening in each Member State. In case where market opening would exceed 30%, Member State may introduce supplementary thresholds to limit opening to 30%.

3) 10 August 2008

- \* All gas-fired power generators
- \* Final consumers with minimum 5 million m<sup>3</sup> of annual consumption

This shall lead to at least 33% market opening in each Member State. In case where market opening would exceed 30%, Member State may introduce supplementary thresholds to limit opening to 30%.

Member States may introduce, in order to safeguard the balance of their electricity market, a threshold for eligibility of combined heat and power producers (CHP), which in any case cannot exceed the threshold for final customers.

### **3.1.2 Access to the System**

Eligible customers will have the possibility to negotiate and conclude supply contracts with any natural gas undertakings, being inside or outside the territory of the Member State. Access to the system for the execution of these contracts will be possible on the basis of two procedures (negotiated access or regulated access), the choice being left to the Member States. Both procedures must operate in accordance with objective, transparent and non-discriminatory criteria.

Where Member States opt for the negotiated Third Party Access the conditions for access to the system are negotiated with the responsible natural gas undertaking. These undertakings are required to publish the main commercial conditions for the use of the system.

Under a negotiated Third Party Access, eligible customers and natural gas undertakings have a right of access to the system, on the basis of published tariffs and/or other terms and obligations for use of that system.

Access to the system may only be refused in case of lack of capacity, when this would impede gas undertakings to carry out some public service obligations, and when this would create some serious economic and financial problems with take-or-pay obligations.

In case where a dispute would arise on the conditions for access to the system, it will be possible to refer the case to a dispute settlement authority that shall be appointed by Member States.

Member States have the possibility to establish different rules for the access to the upstream pipeline network, to take into account the possible specific economic and technical characteristics of this part of the network. Member States must ensure that these rules guarantee a fair and open access and a competitive market in natural gas, avoiding any abuse of a dominant position.

### **3.1.3 Unbundling**

The accounts of all integrated gas undertakings must be as transparent as possible, in particular in order to detect any abuse of a dominant position such as abnormally low or high tariffs or discriminatory practices for equivalent services. To this end, these undertakings must keep in their internal accounting separate accounts for their natural gas transmission, distribution and storage activities, and, where appropriate, consolidated accounts for non-gas activities. These internal accounts will include a balance sheet and a profit and loss account for each activity.

Moreover, to avoid the risk of potential discrimination between users, it is essential that transmission, distribution, storage and LNG undertakings ensure the confidentiality of commercially sensitive information in the course of their business, and thus the Directive requires that they shall not, in the context of sales or purchases of natural gas by the transmission undertakings, distribution undertakings or related undertakings abuse commercially sensitive information obtained in the context of providing or negotiating access to the system.

### **3.1.4 Public Service Obligations**

Member States have the right to impose on natural gas undertakings public service obligations in the general economic interest. These obligations must fall within the framework of five specific areas: security, including security of supply, regularity, quality, price of supply and protection of the environment. Whatever these obligations are, Member States must ensure that they are established under objective, transparent and non-discriminatory criteria. Member States will communicate them to the



Commission which will verify the compatibility of these provisions with Community law. In any case, Member States must ensure that these measures represent the least restrictive in terms of competition.

### **3.1.5 Derogations**

Under specific circumstances, the Directive establishes possibilities for Member States to derogate from the application of the main provisions. These derogations, specified under Chapter VII of the Directive, have been introduced in order to take into account potential risks or distortions that could be endangered by the liberalisation of the gas market.

#### **3.1.5.1 Take-or-pay contracts**

Today, the vast majority of the gas supply in the European Union is contracted under long term take-or-pay contracts concluded between gas supply undertakings and producers. These contracts are characterised by a clause obliging the purchaser to pay for a specific volume of gas regardless of whether the gas is taken or not.

The Directive provides that, if a natural gas undertaking encounters or considers it would encounter serious economic and financial difficulties because of its take-or-pay commitments accepted in one or more gas purchase contracts, it may apply for a temporary derogation from the requirement to grant access to the system, which can be granted by the Member States and then submitted to the final determination of the Commission.

However, a number of conditions must be applied to evaluate if it is necessary to grant a derogation from access or if other alternative measures, less restrictive of competition, can be taken. In any case, a derogation can be presented only when the overall gas sales of the gas undertaking fall below the level of minimum offtake guarantees included in the take-or-pay contract.

#### **3.1.5.2 Non-interconnected countries**

As long as Member States have no connection with the interconnected system of another Member States and have only one main external supplier (with a market share exceeding 75%) they may derogate from the application of some articles of the Directive, including authorisations for gas facilities and direct lines and the obligation in terms of eligible customers. At present, two Member States, Finland and Greece, fall under these conditions, and will have to notify the Commission of the intention to make use of this derogation. However, when these conditions would not be filled, derogations would automatically expire.

### **3.1.5.3 Emergent markets**

Countries where gas has been introduced only recently could have substantial problems resulting from the implementation of the Directive and the introduction of competition in a developing market. These countries are considered emergent markets and may therefore benefit from a derogation from the application of the main provisions of the Directive. The conditions under which Member States can be considered emergent is that the first supply of the first long-term gas contract in their market have been made not more than ten years earlier. Greece and Portugal fall at present under these conditions.

### **3.1.5.4 Emergent areas which could benefit from the encouragement of investments**

Member States have the possibility to request derogations for geographically limited areas where gas infrastructure has not yet been established or has been in operation for less than 10 years, in a view to encourage new investments and upon the condition that implementation of the Directive would cause substantial problems in such areas.

These derogations, granted by the Commission, cannot be presented in relation to investments in the distribution sector but only to other investments in the gas sector and in particular in relation to transmission infrastructure.

## **3.2 STATE OF LIBERALISATION**

The gas market will be opened to competition progressively, during a ten-year period, to reach in 2008 at least 33% of the total gas consumption. However, due to the fact that the eligibility of all power generators and of large industrial customers will result in a higher market opening in some Member States, the real level of market opening at EU level will exceed the initial minimum level of 20%. In fact, almost 33% of the total EU gas market will be liberalised from the beginning. Moreover, several Member States will not limit the opening of their gas market to the minimum thresholds established by the Gas directive.

The United Kingdom has already totally liberalised its gas market since May 1998, on the basis of a system of fixed tariffs for access (Regulated TPA). Ireland has opened the market for customers consuming more than 25 million m<sup>3</sup> per year. In Germany, since April 1998 all customers are legally free to choose their supplier on the basis of a Negotiated TPA system. Spain has adopted in October 1998 a new legislative framework that will permit it to progressively liberalise all the market in 2013, with a first 46% of the market already opened since 1998. In Belgium a law should be adopted shortly opening 46,7% of the gas market to competition. The Netherlands is planning to liberalise by 2000 45% of the market and to open it completely in 2007. The other Member States will submit shortly their proposals for implementation, but on the basis of these preliminary figures it is already possible to calculate that, as for electricity, the liberalisation of the gas market is becoming a reality throughout all Europe.

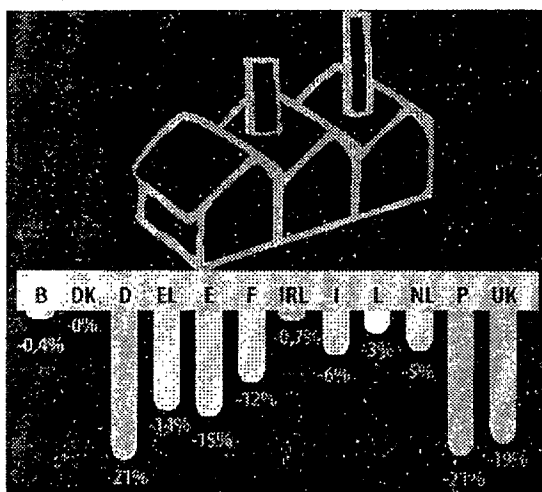
#### 4. CONCLUSIONS

At present there is every reason to be optimistic regarding the creation of a single market for electricity and gas. With respect to the Electricity Directive, most Member States have fully and properly implemented the Directive, and they have chosen structures and approaches that will ensure that competition is effective, while in most cases they liberalise far more rapidly than is required by the Directive. Already, prices in Europe are beginning to fall, as can be seen from the following graphs:

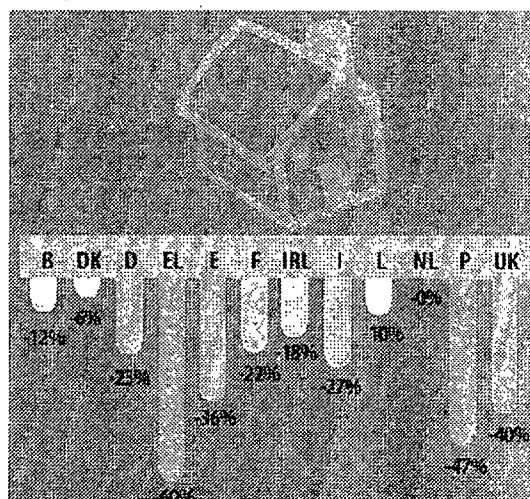
**Graph 1** % modification of 1997(2) compared to 1994 electricity prices for industrial consumers (10 Gwh annual consumption) prices in national currency/kwh, VAT excluded, prices deflated

**Graph 2** % modification of 1998 electricity prices compared to 1994 for household consumers (7500 Kwh annual consumption), Prices in national currency/KWh, tax included, prices deflated

Graph 1



Graph 2



Furthermore, the adoption of the Gas Directive represented another major step for the creation of a single energy market. Member States by August 2000 will have to open up their markets to competition for consumers representing at least 20 % of their gas market. Member States are now in the process of transposing the Directive into their national laws. The Commission is closely following the implementation process of the Gas Directive. At present no major difficulties are likely to arise.

In the future the correct implementation of the Gas Directive by Member States and monitoring the operation of the Electricity Directive in practice will be in the top priorities of the Union. It is vital to ensure that these rules are equally and fairly applied by the establishment of efficient regulatory mechanisms.

This regulatory role will be carried out in partnership between national regulators, competition authorities, and the European Commission. The Electricity Directive itself requires the Member States to set up a dispute settlement authority, independent of electricity companies. However, most Member States have chosen to establish an independent regulator, immediately and on a day-to-day basis independent of, but ultimately responsible to, Government. In any event, it is evident that a clear and increasing understanding across the EU exists of the need for effective regulation in this area, whilst subjecting companies to the minimum red tape possible.

Evidently, the implementation of the Electricity Directive is not the last step towards the creation of a single electricity market. The Directive lays down the groundwork for the *liberalisation* of 15 electricity markets. Nevertheless, much remains to be done to achieve a single market for electricity. In this line the remaining barriers to intra-community trade should be identified and eliminated. Furthermore, the Commission, in close collaboration with the Member States and the electricity industry, should establish more coherent principles concerning a range of unresolved issues that can block cross-border trade. The development of tariff systems and trade facilitating mechanisms to enable the single market to become effective is thus of utmost importance, and will be the principal challenge that the Commission, together with national authorities and Europe's transmission and distribution industries, will be dealing with in the coming months and years.

Furthermore, the Union should take action to promote electricity generated from renewable energy sources with the view to increase green electricity in a substantial and sustainable way, and increasing attention will need to be paid to the environmental dimension of the internal energy market to meet EU environmental objectives.

In addition, the employment effects of the liberalisation of the electricity and gas markets will need to be addressed by Member States and the Union in cooperation with social partners.

The Commission will also examine the consumer dimension of the liberalisation process, especially its impact on residential consumers and how the provisions put in place to guarantee universal service and the protection of consumers are functioning.

Last but not least in the prospect of enlargement of the EU in the coming years the Union should ensure the smooth transition to a wider single market for electricity and gas. In this respect the Commission will implement a specific technical assistance programme vis-à-vis candidate countries for accession to the EU with the view to ensure that the Union seizes all the opportunities from a wider single energy market and that all achievements towards European integration in the energy sector are not endangered.

ISSN 0254-1475

COM(1999) 198 final

# DOCUMENTS

EN

12 10 02 17

---

Catalogue number : CB-CO-99-194-EN-C

---

Office for Official Publications of the European Communities  
L-2985 Luxembourg