

THIRD ENERGY PACKAGE

EUROGAS POSITION ON PROPOSED REGULATORY POWERS AND THE RESPECTIVE ROLES OF THE NATIONAL REGULATORS, THE AGENCY, THE COMMISSION AND THE EUROPEAN NETWORK OF TRANSMISSION SYSTEM OPERATORS FOR GAS

EXECUTIVE SUMMARY

Regulatory powers

Regulation of network industries traditionally focuses on that part of the industry which is subject to a natural and/or legal monopoly (in the case of the gas sector the transmission and distribution networks) because strong regulation of this industry segment is crucial to guarantee transparent and non-discriminatory access to the network for all suppliers and the creation of conditions which allow gas suppliers to compete on a level-playing field. Supply companies traditionally face substantially less regulation; the focus being on consumer protection.

The Commission's proposal for a Directive amending Directive 2003/55/EC marks a shift in the traditional pattern of segmentation between the regulated infrastructure business and the competitive, non-regulated supply business. Under the terms of the proposed Directive, regulatory authorities will be granted wider powers in the interest of ensuring a well functioning and competitive market, without a clear accompanying framework.

To ensure that the process is transparent and non-discriminatory, it is essential that a clear policy framework is established within which the national regulatory authority can implement the additional powers to promote effective competition and to ensure the proper functioning of the market.

The policy framework for the regulatory authorities' work should include at least the following elements:

- **a duty for the regulatory authority to consult with market participants;**
- **a duty for the regulatory authority to publish clear and fully reasoned decisions;**
- **decisions by the regulatory authority should be proportionate, with due account taken of the views of market participants, the existing contractual obligations of the parties concerned as well as the expected costs and benefits of the decision;**
- **a memorandum of understanding at national level that sets out the process for cooperation between the national regulatory authority and the national competition authority, based on the principle that competition law compliance is mainly the responsibility of the competition authority, while the regulatory authority plays an assisting role, consisting, for example, in providing sector-specific information.**

The Third Energy Package introduces powers for the Commission to adopt Guidelines on a wide range of subjects.

For example, it is proposed that the Commission shall adopt guidelines on public service obligations and customer protection; on regional solidarity cooperation; on the implementation by the regulatory authorities of the accorded powers; on the extent of the duties of the regulatory authorities; on the methods and arrangements for record keeping; on the certification of transmission system operators; on the independence of the transmission system owner, on Third Party Access; on tariff methodology; on balancing rules...

Although Parliament and Council still have a measure of control, the negative power to oppose draft guidelines means that the democratic procedure is exercised differently from the co-decision procedure for approving legislation. This is particularly relevant if one considers that in key areas covered by the basic instruments concerned, binding rules will be adopted by means of Guidelines after the normal legislative process for the adoption of those basic instruments has come to an end.

There is a real risk that a discussion will arise on what are essential and non-essential elements of the basic instruments concerned.

Taking into account the wide range of subjects where the adoption of Guidelines is proposed, the imprecise meaning of the term *non-essential elements* and the inherent limitations of the democratic legitimacy of the *comitology* procedure, it is proposed:

- to define and prioritise the list of subjects where Guidelines may be adopted by the Commission in the areas which will clearly benefit from the adoption of Guidelines and to set-out in detail the specific non-essential elements to be treated by the Guidelines;
- that said list of subjects should be developed in cooperation with the proposed Agency for the Cooperation of Energy Regulators (ACER), with a focus on the development of a European gas market (regional markets constituting an intermediary step);
- that all Guidelines should be subject to regulatory impact assessments by the Commission and ACER;
- that market players have a defined role in commenting on and participating in the development of any proposed Guidelines; and
- to explicitly mention in the relevant basic instruments the fact that the implementation by the Commission of the legislative measures contained in said instruments, through the adoption of Guidelines, should by no means imply policy choices which are not clearly reflected in the basic instruments themselves.

Roles of the national regulators, the Agency, the Commission and the European network of transmission system operators for gas

Eurogas endorses the proposal to establish **single independent energy regulatory authorities with harmonised powers in each Member State.**

National and European **competition authorities should keep end-responsibility in competition matters.**

The creation of the **ACER constitutes a step in the right direction**, but the proposed powers and duties of ACER are likely to prove to be too weak to accelerate market integration. Most importantly, **the degree of independence of ACER from the Commission and national energy regulators is unclear.**

ACER should be empowered:

- to create adequate incentives for regional market integration;
- to coordinate the process of adoption of harmonised technical rules, initiated by ENTSOG and including a structured consultation process of stakeholders;
- to enforce compliance with harmonised rules; and
- to review and overrule decisions of national energy regulators that have an adverse impact on other national markets or regional market integration.

Generally, the **Third Energy Package is focused on national markets** and, although it speaks of regional developments, it **does not sufficiently stimulate (regional) market integration. Improvements should be introduced.**

The Third Energy Package introduces powers for **ENTSOG** to establish and adopt technical and market codes. The interrelation between basic instruments and guidelines on the one hand and codes on the other hand should be clarified and any overlap or inconsistency should be avoided.

Market codes could have an impact on market organisation or market functioning and the question is whether ENTSOG is best placed to take the initiative in this area. Market players should have a formally defined role in commenting on and participating in the development of any proposed codes.

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A. The increase in the powers of the national regulatory authorities

1. Increased powers without a proper accompanying framework

Increased powers

Regulation of network industries traditionally focuses on that part of the industry which is subject to a natural and/or legal monopoly (in the case of the gas sector the transmission and distribution networks) because strong regulation of this industry segment is crucial to guarantee transparent and non-discriminatory access to the network for all suppliers and the creation of conditions which allow gas suppliers to compete on a level-playing field. Supply companies themselves traditionally face substantially less regulation; the focus being on consumer protection. In addition, both national and European competition authorities closely monitor the functioning of the competitive market segment.

In line with the above, Directive 2003/55/EC states in preamble 13 that *the existence of effective regulation... is an important factor in guaranteeing non-discriminatory access to the network*. In addition it is stated that *it is important that the regulatory authorities in all Member States share the same minimum set of competences*. In setting out the responsibilities of the regulatory authorities, the Directive also says that *they shall at least be responsible for ensuring non-discrimination, effective competition and the efficient functioning of the market* (article 25(1)). This general responsibility is not developed in detail in the text of the Directive. The role granted to the national regulator, focuses on access to infrastructure, i.e. conditions for access to the network, allocation of capacity, remedies for network congestion, and unbundling of infrastructure activities on the one hand and supply/production activities on the other.

As the energy markets in Europe have developed, new issues have been identified for which new solutions must be found. In the proposed Third Energy Package, the Commission states that *the right to sell gas in any Member State on equal terms and without discrimination or disadvantages cannot be guaranteed to any company in the Community. In particular, non-discriminatory network access and an equally effective level of regulatory supervision in each member State do not yet exist, since the current legal framework is insufficient* (preamble 3 of the proposed Directive amending Directive 2003/55/EC). The Commission's response to this identified failing in the energy market is the introduction of stronger regulation.

Regulatory Framework

The Commission's proposal for a Directive amending Directive 2003/55/EC marks a shift in the traditional pattern of segmentation between the regulated infrastructure business and the competitive, non-regulated supply business.

Whereas the national regulatory authorities are attributed greater powers and a range of additional tasks to improve the quality of regulation in the market, the proposals do not include a similar increase in the degree of regulatory transparency. Better regulation depends on the quality of regulation, which inevitably involves the participation of companies involved in the market.

To ensure that there is confidence in the actions of the market regulator, it is essential that market participants have full visibility of its work. This should include the opportunity to participate via public consultation processes as well as through greater transparency in the decision making. In order to give comfort to the market, the exercise of regulatory authorities' powers must follow due process.

As an example, **Article 24 c §3 (b)**¹ of the proposed Directive is analysed hereafter in more detail. The proposed article not only confirms the energy regulator in its role of monitoring competition and market functioning, but also backs this role up with powers to adopt any measures aimed at promoting effective competition and ensuring good functioning of the market.

Powers not accompanied by an appropriate framework

The adoption of any measures (including structural measures) aimed at promoting competition depends on if and how the national regulator decides to exercise its powers. As set out above, the quality of regulation also depends on the ability of market participants to interact in the regulatory process, be this through consultation processes, the right to approach the regulator or to appeal a decision. This is not included in the current proposals.

By way of comparison it should be emphasised that where a structural measure such as the separation of ownership is introduced through European legislation it has to be discussed and laid down in detail in a directive and adopted by co-decision by the Community legislative bodies. This is quite different from introducing measures decided and imposed by a regulatory authority on a national scale in a single Member State.

When acting against specific anti-competitive behaviour, competition authorities act according to formalised procedures, often involving several well-defined stages. These procedures afford scope to the rights of the defence, and provide for recourse to the courts. It is essential that a similar set of rights is available to parties affected by a decision of the national regulatory authority.

One key difference is that competition authorities tend to act following an investigation into infringements of competition law. Article 24c §3 (b) appears to provide regulatory authorities with power to intervene to address market failings even where there is no breach of competition law.

Such a power should only be exercised within a clear framework of competition policy.

Finally, there are already discrepancies between Member States regarding the scope of the powers attributed to energy regulators under national legislation. The Third Energy Package aims to correct this discrepancy by harmonising the level of powers given to national regulators. This should therefore improve the degree of harmonisation between national regulators' actions and build a more level playing field across European markets. However, the absence of a framework for the exercise of the abovementioned powers in the draft Directive could accentuate disparities and create a potential source of legal uncertainty and divergent decision making.

2. Increased legal and regulatory uncertainty

Significant differences in treatment between operators in the various Member States could develop

As the introduction of appropriate measures necessary and proportionate to promote effective competition and ensure the proper functioning of the market depends on the exercise of the proposed regulatory powers, it is possible to foresee a difference of approach between Member States. A solution is needed to ensure that harmonisation across the European internal market does not suffer.

If it is decided by the European co-legislators that it is for national energy regulators to adopt any appropriate measures necessary and proportionate to promote effective competition and ensure the proper functioning of the market, one solution could be to require a national regulatory authority which plans to impose measures against a market participant to notify its fellow European regulators of its proposal. This offers the opportunity for sharing best practice between national

¹ Member States shall ensure that regulatory authorities are granted the powers enabling them to carry out the duties referred to in paragraph 1 and 2 in an efficient and expeditious manner. For this purpose, the regulatory authority shall have at least the following powers:

b) to carry out in cooperation with the national competition authority investigations of the functioning of gas markets, and to decide, in the absence of violations of competition rules, of any appropriate measures necessary and proportionate to promote effective competition and ensure the proper functioning of the market, including gas release programs.

authorities thus assisting in the harmonisation of decision making and consistency of approach. It also helps to check that the development of the internal market is not distorted and that no single company faces an undue burden due to the actions of its national regulatory authority. Such a role could be given to the Agency for the Cooperation of Energy Regulators, whereby any national authority contemplating an action under article 24c §3 (b) could be obliged to notify its fellow regulators via the Agency and use this as a platform for seeking suitable solutions to promoting effective competition and ensuring the proper functioning of the market.

A power struggle between the energy regulatory authorities and the competition authorities could develop

The Third Energy Package requires national regulators to cooperate with national competition authorities in their investigations into the functioning of the market (article 24c §3 (b)). Further, the Commission states that it may adopt guidelines on implementation of regulatory powers (article 24c(14)). This does not explicitly refer to the interaction between national regulatory authorities and national competition authorities. Whether guidelines are determined at European level or not, it is essential that Member States establish at least a memorandum of understanding to cover the interaction between the regulatory and competition bodies. This should explain the cooperation process, how powers are assigned, shared or devolved between the authorities concerned. This is essential to avoid a situation where an operator could turn to a second authority if it obtained an unfavourable result from the first authority. Such a situation could lead to a "race for competency" and thus damage the legal and regulatory certainty that is essential for the good functioning of the market.

3. Summary

Under the terms of the proposed Directive, regulatory authorities will be granted wider powers in the interest of ensuring a well functioning and competitive market, without a clear accompanying framework. The decisions concerned may be taken against individual companies (for example gas release obligations or bans on carrying out certain operations (e.g. participating in calls for tender)), or they may be of a more general nature, introducing measures aimed at a certain category of operators or all operators together.

The powers introduced via article 24c §3 (b) provide the regulatory authority with powers which, in the absence of any contravention, could be used to organise the structure of gas market. Currently, in many Member States, this power is devolved not to an independent regulatory body but is the prerogative of the executive. Thus the proposed Directive is likely to intervene directly in the institutional division of powers in some Member States.

To ensure that the process is transparent and non-discriminatory, it is essential that a clear policy framework is established within which the national regulatory authority can implement these additional powers to promote effective competition and to ensure the proper functioning of the market.

This policy framework should include at least the following elements:

- a duty for the regulatory authority to consult with market participants;
- a duty for the regulatory authority to publish clear and fully reasoned decisions;
- decisions by the regulatory authority should be proportionate, with due account taken of the views of market participants, the existing contractual obligations of the parties concerned as well as the expected costs and benefits of the decision;
- a memorandum of understanding at national level that sets out the process for cooperation between the national regulatory authority and the national competition authority, based on the principle that competition law compliance is mainly the responsibility of the competition authority, while the regulatory authority plays an assisting role, consisting, for example, in providing sector-specific information.

C. Guidelines

The Third Energy Package introduces powers for the Commission to adopt guidelines on a wide range of subjects.

For example, it is proposed that the Commission shall adopt guidelines on public service obligations and customer protection; on regional solidarity cooperation; on the implementation by the regulatory authorities of the accorded powers; on the extent of the duties of the regulatory authorities; on the methods and arrangements for record keeping; on the certification of transmission system operators; on the independence of the transmission system owner, on Third Party Access; on tariff methodology; on balancing rules...

These powers enable the Commission to adopt binding Guidelines in areas where it would otherwise only have the option to issue non-binding Guidelines/Interpretative notes.

Both the proposals to amend Regulation 1775/2005 and Directive 2003/55 stipulate in their recitals that powers should be conferred on the Commission in particular to establish or adopt the Guidelines necessary for providing *the minimum degree of harmonisation* required to achieve the aim of the Directive/Regulation. Since those measures are of general scope and are designed to amend *non-essential* elements of the Directive/Regulation and to supplement the legislative texts by the addition of new non-essential elements, they should be adopted in accordance with the regulatory procedure with *scrutiny* provided for in Article 5a of Decision 1999/468/EC² (a so-called *Comitology* procedure³). The term *non-essential* appears in Council Decision (1999/468/EC), but is not defined in EU law. Several commentators on the subject of comitology have noted that the Council will decide what is essential and non-essential.

Art 5a introduces a *negative* control. Each proposal of new guidelines by the Commission has to be submitted to a committee, who can approve, disapprove or express no opinion regarding the draft guidelines. Consequently the draft guidelines will be sent to the Council and the Parliament. Both the Council and the Parliament can oppose the draft guidelines. Depending on whether the Committee approved the draft guidelines, a different majority is needed for the European Parliament to oppose the guideline at stake.

Although Parliament and Council still have a measure of control, the negative power to oppose draft guidelines means that the democratic procedure is exercised differently to the co-decision procedure for approving legislation. This is particularly relevant if one considers that in key areas covered by the basic instruments concerned, binding rules will be adopted by means of Guidelines after the normal legislative process for the adoption of those basic instruments has come to an end.

There is a real risk that a discussion will arise on what are essential and non-essential elements of the basic instruments concerned.

Taking into account the wide range of subjects where the adoption of Guidelines is proposed, the imprecise meaning of the term *non-essential elements* and the inherent limitations of the democratic legitimacy of the comitology procedure, it is proposed:

- to define and prioritise the list of subjects where Guidelines may be adopted by the Commission in the areas which will clearly benefit from the adoption of Guidelines and to set-out in detail the specific non-essential elements to be treated by the Guidelines;
- that said list of subjects should be developed in cooperation with the proposed Agency for the Cooperation of Energy Regulators (ACER), with a focus on the development of a European gas market (regional markets constituting an intermediary step);
- that all Guidelines should be subject to regulatory impact assessments by the Commission and ACER;
- that market players have a defined role in commenting on and participating in the development of any proposed Guidelines; and
- to explicitly mention in the relevant basic instruments the fact that the implementation by the Commission of the legislative measures contained in said instruments, through the adoption of Guidelines, should by no means imply policy choices which are not clearly reflected in the basic instruments themselves.

² As amended by Council Decision 2006/512/EC.

³ This procedure involves scrutiny from both the Council and Parliament and is therefore the strictest of the comitology procedures.

C. National regulators, the Agency for the Cooperation of Energy Regulators, the Commission and the European network of transmission system operators for gas

National energy regulators

Eurogas endorses the proposal to establish single independent energy regulatory authorities with harmonised powers in each Member State.

National and European competition authorities should keep end-responsibility in competition matters.

Policy objectives concerning the development of regional markets, the promotion of market integration and the suppression of restriction of trade between Member States are mentioned but national regulatory authorities are not empowered/stimulated to create incentives and to effectively contribute to this objective; no clear result is required.

The Agency for the Cooperation of Energy Regulators (ACER)

The creation of the ACER constitutes a step in the right direction, but the proposed powers and duties of ACER are likely to prove too weak to accelerate market integration. Most importantly, the degree of independence of ACER from the Commission and national energy regulators is unclear.

ACER should be empowered:

- to create adequate incentives for regional market integration;
- to coordinate the process of adoption of harmonised technical rules, initiated by ENTSOG and including a structured consultation process of stakeholders;
- to enforce compliance with harmonised rules; and
- to review and overrule decisions of national energy regulators that have an adverse impact on other national markets or regional market integration.

Commission

The Commission's duties and powers should be focused on the promotion of a single European market. The Commission should monitor if the national energy regulators, the Agency and the European Network of Transmission System Operators for Gas (ENTSOG) act in the interest of a single European gas market.

Generally, the Third Energy Package is focused on national markets and, although it speaks of regional developments, it does not sufficiently stimulate (regional) market integration. Improvements should be introduced.

The European network of transmission system operators for gas (ENTSOG)

The Third Energy Package introduces powers for ENTSOG to establish and adopt technical and market codes (cfr art. 2 of the draft Regulation amending Regulation 1775/2005).

The interrelation between basic instruments and guidelines on the one hand and codes on the other hand should be clarified and any overlap or inconsistency should be avoided.

Market players should have a formally defined role in commenting on and participating in the development of any proposed codes.

Market codes could have an impact on market organisation or market functioning and the question is whether ENTSOG is best placed for taking the initiative in this area. Again, market players should have a formally defined role in commenting on and participating in the development of any proposed codes.

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