

ERGEG – Public Consultation of Best Practice Propositions

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Only the German Version is authentic

Table of Contents

I	PREAMBLE.....	2
II	ANALYTICAL FRAMEWORK.....	3
III	COMMENTARY.....	7
IV	ADDRESS FOR CORRESPONDENCE	10

I Preamble

The present commentary reflects upon the Best Practice Propositions of the European Regulators Group for Electricity and Gas (ERGEG) which refers to the opening of retail markets (household customers and small enterprises) to competition in July 2007. The propositions aim at helping with the implementation of the Electricity (2003/54/EC) and Natural Gas (2003/55/EC) Directives and accordingly the application of national legislation in practice. Ultimate aim of the ongoing activities in the field in question can only be to contribute to the creation of a workable internal energy market.

In the course of carving out priorities to realise the above objective it is aimed at taking account of the legal context as well as the underlying economics. Thereby a multifaceted approach is pursued. This course of action may be useful but also in line with the proposed ERGEG approach of looking at protecting consumers, processes of supplier switching and prices becoming transparent.

II Analytical Framework

In the light of and modelled upon basic economic concepts such as the equilibrium supply and demand model that may be used to explain the mechanism of resource allocation decisions it is aimed to comment the EREG propositions. Hereby, ideal-typical market prices – in the sense of optimal, homogenous prices – may form a theoretical framework which may not be ignored when commenting the drafting of European best practice propositions. Central may therefore be key aspects such as supply – demand and (market)prices which also seem to be enshrined in the EREG propositions.



Yet, the **danger of market failure/ market imperfections** must not be ignored in the internal energy market propositions.

- Gas and electricity distribution usually faces barriers to market entry and exit in a manner that must be accounted for in a different way than probably in a wide range of other markets;
- the danger of negative external effects is immanent, e. g. environmental pollution, and cannot be ignored when trying to fulfil the various activities as set out in Article 3 of the Treaty establishing the European Community;
- missing market transparency particularly in a market such as energy is from the consumer perspective rather evident and requires counteraction;
- incomplete and/ or asymmetric information is a general problematic in this context.
- and various other aspects such as that prices of exhaustible resources only result of actual supply and demand make consequently the following necessary ...

→ Market interventions to reach optimal resource allocation and to achieve the Treaty objectives

Only the use of incentive regulation may improve the quality and enhance the efficiency of energy regulation while minimising its burden. Incentive regulation endeavours to reduce asymmetries of information and to counter unproductive behaviour on the part of energy companies.

The general objective to open the energy market and to establish an internal European energy market necessitates in the light of market imperfections a number of regulating market interventions and various infrastructural measures. This, for instance, should lead to **supply stimulation** (e.g. through a sound and all-encompassing regulatory framework or incentive systems) but also effective control (e.g. through designated agencies) so that the intended harmonisation in the field in question can actually be achieved. In the light of market imperfections, e. g. asymmetric information, it is at the same time also crucial to **stimulate demand**, for example, through conscientious consumer laws and a focused information policy (e.g. including energy contact points, Ombudsman, etc.).

The above said may also be found as best described in point 17 of directive 2003/54/EC:

In order to ensure effective market access for all market players, including new entrants, non discriminatory and cost-reflective balancing mechanisms are necessary. As soon as the electricity market is sufficiently liquid, this should be achieved through the setting up of transparent market-based mechanisms for the supply and purchase of electricity needed in the framework of balancing requirements. In the absence of such a liquid market, national regulatory authorities should play an active role to ensure that balancing tariffs are non discriminatory and cost-reflective. At the same time, appropriate incentives should be provided to balance in-put and off-take of electricity and not to endanger the system.

In addition, it is also worth stressing point 20 of the same directive which sets forth a rather fundamental principle of Community law:

Electricity customers should be able to choose their supplier freely. ... ensure they have a real and effective right to choose their supplier.

A more thorough reading of the directives shows that in principle in a number of passages reference is made to the (micro – macro) economics as stated at the outset of this section. Yet, it must not be forgotten that this is done by way of a directive and not in form of a regulation – being binding in its entirety and directly applicable in all Member States – within the meaning of Article 249 of the Treaty. Accordingly, the best practice propositions must be of a kind that is groundbreaking in order to be taken into account by those who are affected by the directives but also to achieve a genuine harmonisation and one level playing field in the market in question.

III Commentary

Generally speaking, the ERGEG sets out a number of recommendations which may contribute to the promotion of an internal energy market. In fact, it sets out very detailed recommendations. Concerning a wide range of recommendations it is hoped (as a result of being non-binding) that they are adhered to by those concerned by the Electricity (2003/54/EC) and Natural Gas (2003/55/EC) directives.

What needs to be stressed however is that the recommendations should in any case **deal with all** the various **aspects of market imperfection/ failure** as explained in the previous section so as to become in line with the economic aspects and functioning of the market in question. Hereby, the underlying ERGEG's **analytical economic energy model** could be made known to the public upon which it bases its suggestions and recommendations with respect to the electricity and natural gas market.

Experience in implementing former directives on the topic in question has shown that benefits may certainly result from an internal market in electricity, mainly in terms of efficiency gains, price reductions, higher standards of service and in-

creased competitiveness. However, important shortcomings and possibilities for improving the functioning of the market in question remained since otherwise the follow-up actions would not have been initiated.

European consumer law and competition law is and will certainly play a major role in liberalising the energy market plus forming a competitive internal energy market. Yet, a systematic accounting for and mentioning as well as **dealing with other possible affected areas of law** on a European as well as national level is not to be ignored in this context.

The advisory mechanism for encouraging cooperation and coordination of national regulatory authorities, in order to promote the development of the internal market for electricity and gas may also be achieved by way of the European Regulators Group for Electricity and Gas going a step further and starting to work out an **energy governance codex** to which companies may stick to (possibly also with the chance of some form of certification).

Therein a summary of all the relevant legal requirements, a comply or explain and a recommendation differentiation could be made. The fulfilling of each and every criteria may be monitored through an independent body (with experts to be assigned) and published in form of **comparative European reports** which should be easily accessible and understandable for consumers but also competitors in the market.

This mechanism may *deviate (in a positive manner) from recommendation to self-regulation* by way of a system of benchmarking and direct comparison.

In most cases are the existing information to compare terms of sale, prices, pricing principles and other/ common contractual terms in a pre- and post contractual phase by far too complicated and need fundamental refinement and a genuine, comparable European/ national format – something that may remain on the agenda in order achieve a competitive, secure and environmentally sustainable market in energy, which does not discriminate between market players as regards either rights or obligations.

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