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The emergence of a European-wide energy regulation

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Abstract

- In March 2011, the Agency for the Cooperation of Energy Regulators (ACER) became fully operational. ACER is the EU body in charge for coordinating the member states' national energy regulatory agencies and deciding on cross-border energy issues. In essence, it is a major instrument for achieving an internal energy market.

- The first European energy package was adopted in the late 1990s, seeking to liberalize and integrate the European electricity and gas markets. The second and third packages, in 2003 and 2007 respectively, gradually furthered that process.

- In 2000, the existing European regulatory authorities started cooperating voluntarily through the *Council of European Energy Regulators (CEER*), an unofficial information-sharing association.

- The second energy package of 2002, made mandatory the establishment of a National Regulatory Agency (NRA) for those EU countries lacking one. The NRA had to become a member of the *European Regulators' Group for Electricity and Gas (ERGEG),* which was set up as the official consultative EU body. ERGEG and CEER cooperated closely.

- The second package included mandatory *unbundling*[1] and created the figure of the Transmission System Operator (TSO): companies that own and operate networks, which are key in the functioning of the market.

- For the cross border connections, cooperation among TSOs became fundamental. The third Energy package formalized the European Networks of TSOs (ENTSO-E[2] for Electricity and ENTSO-G[3] for Gas).

[1] The separation of the transmission networks from the production, supply and commercialization operations.
[2] ENTSO-E Member companies include EU-27 Members, Iceland, Norway, the Balkans and Switzerland

- The third energy package also created the *Agency for the Cooperation of Energy Regulators (ACER),* which substituted ERGEG and enjoyed greater powers and clearer competencies. When defining and agreeing on ACER, most of the discussion related to the balance of power between the two ENTSOs and the agency. CEER continues in operation.

The emergence of a European-wide energy regulation

Early cooperation: A voluntary approach

The Council of Ministers adopted the first European energy package in the late 1990s, with an electricity directive in 1996 and a gas directive in 1998. The aim was to liberalize the electricity and gas markets and to promote the integration of the European energy market.

Before these directives were issued, some countries had established regulatory agencies, which were already cooperating among themselves. Italy, Portugal and Spain had done so since 1997. A few months later the Florence Forum for Electricity (Florence Forum), an initiative involving the three countries and the European Commission, was launched. The Florence Forum invited all member states, with or without regulatory agencies, to share experiences in the implementation of the then new directives. The Florence Forum was followed by the Madrid Forum on Gas. In 2000, Regulatory authorities from 10 European countries[4] constituted the *Council of European Energy Regulators (CEER*).

The second energy package: mandatory cooperation but no competencies

The establishment of an independent regulator by each member state became mandatory with the second energy package which was approved in 2003. As new national regulatory agencies (NRAs) were created, the number of

[3] ENTSO-G is formed by only 22 EU Members. Latvia, Estonia, Lithuania have a derogation of participation since they are unconnected to the rest of members and have a single supplier. Malta and Cyprus are exempted for not having gas in their energy mix.
[4] Belgium, Finland, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden and the United Kingdom.

participants in CEER increased, eventually including even agencies of non-EU-members: Iceland, Liechtenstein and Norway. Regulators decided also in 2003 to establish CEER formally under Belgian law and to set up a small secretariat in Brussels. The second package also established the *European Regulators' Group for Electricity and Gas (ERGEG)*, an entity closely linked to CEER. The two organizations shared secretariat, Board members, most official statements, annual reports and website. The key difference between the two organizations was the participation in CEER of some non-EU-Members, and the presence of the European Commission as a non-voting delegate in ERGEG. ERGEG acted as an official advisory body to the European Commission in relation to the integration of European gas and power markets, by both assessing the implementation of current regulation and proposing future ones. Alternatively, CEER described itself as *"a preparatory body for the work of the European Regulators Group for Electricity and Gas (ERGEG)."*[5]

One of the main contributions from CEER/ERGEG during this period was the proposal to create the Regional Initiatives, which gave birth to integrated sub-regional markets as an intermediary step to European integration.

The second package made mandatory the separation of the transmission networks from the production, supply and commercialization activities, and the so-called *unbundling*. Transmission System Operators (TSOs) are the firms which own and operate the gas and electricity infrastructures. These companies can be publicly traded, as in Spain's Enagas, where no company can hold more than 5%[6]. They can also be owned by a market player, as in France's TIGF and GRTgaz, owned by Total and Gaz de France, respectively. In 2005, an association of European Gas Transmission System operators, the GIE, was created to enhance cooperation among these companies. Electricity TSOs, on the other hand, predated the second package and had been cooperating among themselves since the creation of the European association ETSO back in 1999.

[5] Annual Repport of ERGEG and CEER 2007.
[6] Law 62/2003

Shaping the change to formal cooperation

In January 2007, the European Commission (EC) published a document entitled "An Energy Policy for Europe", setting the bases for a third energy package. It stated that national regulators lacked the "power" and decision-making capacities necessary to tackle cross-border issues, and that *"the creation of [ERGEG] and the electricity and gas regulations [had] not provided the governance required"*[7].In addition, the EC's Directorate General for Competition presented later during 2007 the results of an enquiry concluding that the energy markets in Europe remained largely national. It was "*widely recognized by the sector*" that the lack of authority at EU-level and the voluntary approach used so-far were insufficient to overcome transnational issues.[8]

The European Commission's "An Energy Policy for Europe" paper proposed three alternative solutions to the then unsatisfactory European-wide governance: the gradual strengthening of ERGEG; an abrupt reinforcement of ERGEG; or the creation of a new agency at EU-level. The latter solution mirrored the model the EC had recently proposed for the regulation of the electronic communications sector. The document also proposed to reinforce and formalize the TSOs cooperation, and to define better its authority and responsibilities. This proposal was the origin of the European Network of TSO for Gas and the European Network of TSO for Electricity (ENTSO-E and ENTSO-g, respectively).

In June 2007, ERGEG advanced a proposal for a new agency, the European System of Energy Regulation (ESER)[9]. ESER's governance would be centered on the Regulators Council, the main decision making body. All EU-27 NRAs, represented by their heads, would be a member of the Council. Decisions were to be reached by Qualified Majority Voting, a weighted vote based on each country's population size. An Administrative Board would set the budget and the

[7] Communication from the Commission to the European Council and the European Parliament - an energy policy for Europe {SEC(2007) 12}
[8] Regulation (EC) No 713/2009
[9] C07-SER-13-06-02-PD, "Legal and regulatory framework for a European system of energy regulation"

agency's internal matters, and a Secretariat-general would take care of the operational matters of the agency. Some of the decisions made by the new agency would be binding. The new organization included an Appeals Board that would consider contested decisions before escalating them to the European Court of Justice.

ESER would have had strong agenda setting and veto powers, in particular the capacity to take binding decisions involving technical issues, which ultimately had to be transposed by the TSOs under the monitoring of ENTSO-E and ENTSO-G. These technical issues included security and operating standards, and cost-allocation mechanisms for new cross-border investments. ENTSOs would have had only proposition rights.

ERGEG also proposed that ESER approve the investment plans and the exemptions from European access rules to infrastructure. In particular, such exemptions would allow for contracts involving long-term minimum usage guarantees. New infrastructures require massive capital expenditures and imply high demand risk, which discourages investments. Allowing contracts to include a minimum long-term usage clause would incentivize financing, as minimum demand and utilization would be secured. However, such contracts need an exemption as they are not in line with a market-based model of infrastructure offer and demand.

Although granting ESER strong powers, ERGEG's document acknowledged that some decisions could not be directly binding, needing the approval of the European Commission, but recommended minimizing such instances to guarantee regulatory independence.

European Commission proposal: the Agency for the Cooperation of Energy Regulators (ACER)

On the 19th of September 2007, the European Commission presented its first proposal, with a first budget estimation of € 6-7 million per year.

In the initial proposal, ACER had minimal powers over the network codes, the rules that had to be transposed by TSOs to reach coherent technical and network access mechanisms. Most of the weight in drafting and approving these codes fell on the ENTSOs and the European Commission; ACER would have only an advisory role. This was one of the points more contested by CEER/ERGEG, its position being that the "*Agency should have a much stronger role in initiating, reviewing and approving the draft measures by TSOs so as to ensure that public interest concerns are fully met and a sound climate is established for investment*"[10]. On a position paper of the 20th of December 2007, CEER/ERGEG proposed a change in the decision-making process relative to the network codes. The new process involved a first step where framework guidelines are set followed by a comitology approval process by the European Commission. This would make the frameworks binding for ENTSOs when drafting the details of the network codes.

CEER/ERGEG also complained that the definition in the scope of the areas to be regulated by the network codes was too broad, and needed to be narrowed. ENTSOs, for their part, proposed ERGEG have only an advisory role, since, according to them, the "*The Agency cannot be at the same time and for the same issues rule maker, supervisory body and judge*" [11].

Once ENTSOs detail the network codes, national TSOs should then reach a contractual arrangement among them to transpose the codes. If a contractual agreement is not achieved among TSOs, then the Commission will facilitate a comitology arbitration process.

Organizationally, the Commission's proposal was similar to ESER's. The basic structure had four bodies: A board of Regulators, an Administrative Board, a Director, and a Board of appeals. The Board of Regulators (BoR) required a simple two-thirds majority to approve proposals, instead of a qualified majority. In appointing the Director of the agency, the BoR only had an advisory role,

[10] CEER Press Release PR-07-11
[11] https://www.entsoe.eu/fileadmin/user_upload/_library/publications/etso/others/ETSO%20response%20Implementing%203rd%20package.pdf

instead of the veto power demanded by ERGEG. CEER/ERGEG argued that ACER's independence and efficiency could be improved. In particular, the independence of the Director could be questionable, since it was to be appointed by the Commission. Additionally, CEER/ERGEG demanded greater accountability of ACER vis-à-vis the European Parliament. CEER also called for greater relevance of BoR in appointing the members of the Board of Appeals.

Final decision on ACER: A solution of compromise

The definitive regulation establishing ACER was approved on 13 July 2009, with a solution of compromise and a budget estimation of € 7.6 million.

For the network codes, they have to be based on "Framework Guidelines" prepared by ACER, which define the objectives and scope, but are non-binding. The codes are drafted by ENTSOs, and then reviewed by the Agency, who must deliver an opinion to the European Commission. The Commission has then the final word.

The Agency shall as well decide on exemptions, whenever the infrastructure concerned is located in the territory of more than one Member State and either (i) the NRAs involved have not been able to reach an agreement within six months from the date the exemption was requested; or (ii) upon a joint request from the regulatory authorities concerned.

With ACER fully operational, ERGEG was dissolved by the Commission, with effect from 1 July 2011, therefore after overlapping for 3 months with ACER. Most of ERGEG's works passed to ACER (the Regional Initiatives), while some to CEER (customer issues)[12].

[12] Source: CEER's website. http://www.energy-regulators.eu

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