

Unfair Competition, Not missing Transmission is the Problem:

How The European Commission's Proposed Directive Will Cost Billions To The Taxpayer And Energy Consumer, Undermine Legitimate National Democratic Processes, While Neither Reducing Risks For Blackouts Nor Stopping Market Distortions.

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On 11th of December 2003, the European Commission proposed a communication and four legislative proposals on energy market regulation, the so-called security of supply package. This package was rushed through without any serious debate on a European level and despite internal disagreements within the Commission's own Directorate Generals.

Public internet consultation on one part of this package, the revision of the TEN-guidelines, (COM 2003 742 final) occurred on DG TREN's website on 25/07/2003 with the deadline set at 15/09/2003 and hence took place during the summer holidays when most stakeholders, MEPs etc. did not have the opportunity to react and express their opinion. This significantly reduces the validity of the resultant consultation.

In its draft Directive on security of electricity supply¹, one of the components of the security of supply package, which will be the main subject of this paper, the European Commission has called for an increase in cross border capacity for electricity and consequently an increased export trade.

The justifications given by the Commission for this new initiative are three fold: -

- A. The blackouts in Italy in September 2003, as the Commission have stated '*at this stage, whilst the underlying causes of the black-out are uncertain, it is clear that a lack of new generation capacity in Italy and insufficient transmission capacity are at least contributing causes*².
- B. The need to increase competition in markets where only a few or even one generator dominates³.
- C. The declaration from the Barcelona summit of March 2002, which called for electricity interconnections to reach 10% of installed generation capacity.

However, each of these arguments is fundamentally flawed and if the proposals put forward are adopted they will decrease security of supply and undermine efforts to increase the environmental sustainability of the EU's electricity sector.

¹ Proposal for a Directive of the European Parliament and of the Council concerning measures to safeguard security of supply and infrastructure investment, COM (2003) 740 final

² Information note from Mme De Palacio, SEC (2003) 1079, 30th September 2003

³ Commission Of The European Communities Brussels, 7.4.2003 Sec (2003) 448 Commission Staff Working Paper Second Benchmarking Report On The Implementation Of The Internal Electricity And Gas Market, page 15

A) Italian Blackouts

The September blackout occurred during a *low peak* time (Saturday night at 3 o'clock when most industry does not work and most people are asleep). The demand at that time was only 27 GW, compared to summer peak of 53 GW with a total installed capacity of 71.3 GW. Hence, the problem was not a lack of capacity of power production in Italy but rather the speculative behaviour of the Italian electricity system. For purely economic reasons, Italy usually reduces its own production plants (basically oil fuelled and therefore extremely expensive) when possible and relies on cheaper electricity imports, at the time of the blackout imports was around 6.6 GW.

The Union for the Co-ordination of Transmission of Electricity (UCTE) had warned the Italian authorities about the dangers of the high levels of electricity import and in its report of the blackouts highlighted the impact of phase angle difference⁴, caused by the bulk transport of electricity, as a root cause of the blackout.

The Commission's proposal as drafted by DG TREN suggests adding 4 GW of new interconnections facilities between Italy and the rest of Europe. This will act as a disincentive to build new production capacity in Italy and will increase the technical problem of phase angle difference due to even bigger flows of electricity into Italy.

B) Increase in Competition.

The European Commission claim that increased electricity export will aid competition as it will allow new entrants into markets that are dominated by a few incumbents. However, it is the same utilities that are dominant in most EU countries that are also those involved in exporting electricity. Therefore the import of electricity will often just strengthen the position of already dominant utilities.

Furthermore, it is these dominant utilities, which are often vertically integrated, that distort the market and thus create areas of low electricity prices. This in turn increases the pressure on the interconnectors. Analysis produced in December 2003, John Bower from the Oxford Institute for Energy Studies concluded that *'the real cause of transmission congestion, in most cases, is that regulatory failures have resulted in significant interregional and intertemporal wholesale price differentials that artificially increase demand for transmission capacity, beyond what is available, as traders attempt to exploit the arbitrage opportunities on offer'*⁵. This is borne out by experience in existing Member States and in particular in Italy where there is overcapacity but it is redundant due to cheaper imports. Furthermore the UK has one of the lowest ratios of installed generating capacity to interconnectors, but yet has one of the lowest wholesale electricity prices.

C) 10% Target of Interconnections.

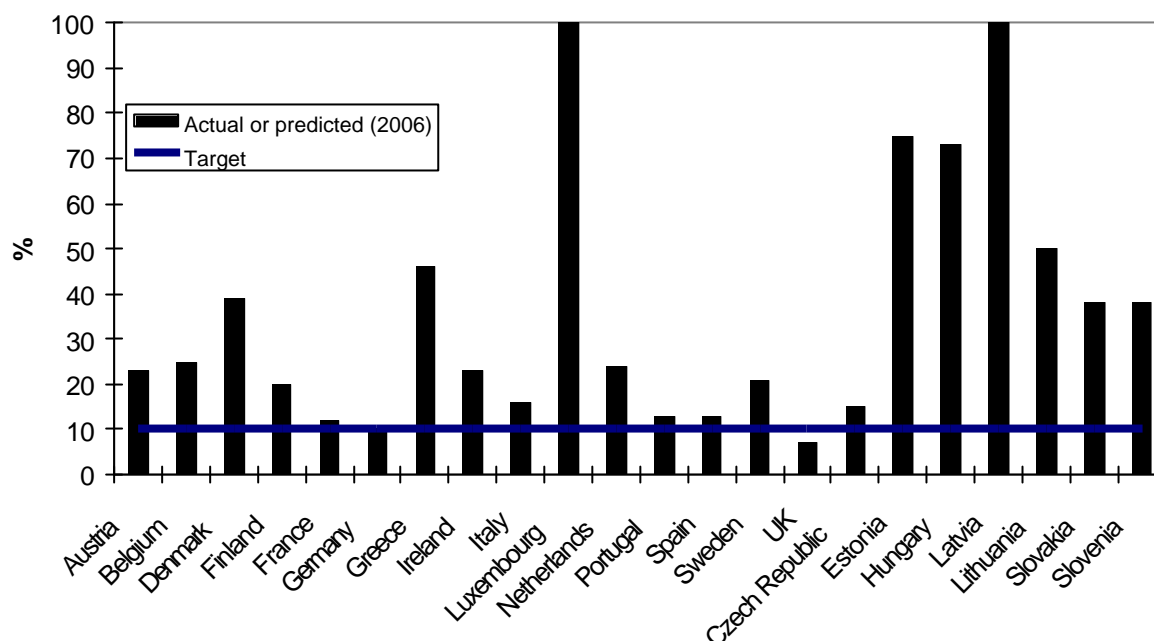
According to the European Commission's own data only the UK will not met the 10% target for interconnectors within the next three years for existing Member States. As the expenditure plans outlined in the draft Directive do not start until 2005 most if not all of these are in addition to those project the Commission has already identified as likely to occur between 2003-6. Therefore the projects identified in the draft directive have nothing to do with meeting the 10% interconnection

⁴ Phase angle difference appears when alternate currents (AC) are transported over long distances,. Due to the unilateral flow to Italy from Central Europe and the subsequent induced phase angle difference it was technically not possible to quickly relaunch the tripped Swiss/Italian line and thus caused the extensive blackout.

⁵ Cross-border Electricity Transmission Capacity: Should Governments Invest? John Bower, Oxford Institute for Energy Studies, EL 03, December 2003

target. Furthermore, all continental accession countries current far exceed the 10% guideline. This can be seen in the graph following.

EU Connector Capacity in EU and Accession Countries



Source: European Commission, Second Benchmarking Study 2003

In summary it can be concluded that the justifications put forward by the European Commission for an €800 million expenditure on further interconnections are not valid. However, the proposed unnecessary expenditure is only one part of the problem raised by the proposals of the draft Directive.

Not only Unnecessary but also Dangerous

A recent analysis prepared UCTE of the blackouts in Italy concluded that *'Today's market development with its high level of cross-border exchanges was out of the scope of the original system design. It has led the TSOs to operate the system close to its limits as allowed by the security criteria⁶'*. This same report went on to state that *'though the event had no severe consequences apart from in Italy it should be mentioned that even the whole UCTE main grid was in an endangered condition⁷'*. In a more recent briefing prepared in response to a questionnaire from the European Commission, UCTE, stated that the first priority for setting up new infrastructure is maintaining the reliability of the grid on both national and international level, but warned that *'this should not lead to a dramatic increase in long distance and bulk power transmissions⁸'*. This leads to the conclusion that the proposal to further expand the long distance transfer of electricity may lead to further grid instabilities and endanger the whole European network.

Efforts must be made to reduce the impact of bottlenecks in the existing transmission system. However, this does not have to be done through the construction of new high voltage systems,

⁶ Interim Report of the Investigation Committee on the 28th September Blackout in Italy UCTE: November 2003, page 9

⁷ *ibid*, page 34

⁸ EC Communication on infrastructure and Internet - based Consultation in View of the Revision of the TEN-E Guidelines Comments by UCTE September 15, 2003

rather Bower makes a number of recommendations on how to avoid transmission congestion, including: -

- To reduce interregional price differences that are caused by the market power of some dominant generators.
- Maximise the availability of existing capacity by increasing unbundling between generators and transmission system operators.
- Efficient allocation of transmission capacity.

Given the empirical evidence of the current situation and the recommendations of the technical experts responsible for overseeing Europe's electricity network it is somewhat surprising that the Commission have put forward this Directive. However, there are other factors that are influencing the Commission's proposal.

The Hidden Agenda: Aiding Profits For Large Utilities Through Import And Export.

The large electricity generating companies are rapidly increasing their corporate power across continental Europe. Both in current Members and accession countries, the three major European utilities, Electricité de France, RWE and E.ON have been aggressively purchasing generation and grid companies. This will result in the regional domination of the energy sector by a handful of companies in a few years. DG Competition to date has not addressed some of these key mergers and acquisitions, despite complaints being raised⁹. The Commission is failing to address the fundamentals of the problems that these oligopolies are creating and instead are seeking to exploit the situation to further benefit the dominant companies.

In 2003 about 20% of European electricity production was subject to cross border exchanges. The largest electricity exporter was France and the larger importer was Italy as can be seen in the table below. What is most remarkable is that France is producing over 80% of the total net electricity exports of Europe.

Imports and exports in **2002** in billion kilowatt-hours

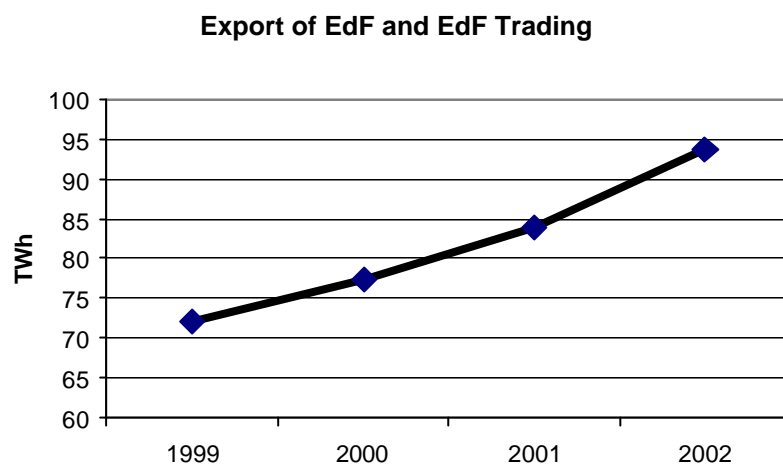
	Imports	Exports	Net balance
France	3.0	79.9	- 76.9
Norway	5.3	15.0	- 9.7
Switzerland	47.1	51.6	- 4.5
Denmark	8.9	11.0	- 2.1
Ireland	0.6	0.0	+ 0.6
Germany	46.2	45.5	+ 0.7
Austria	15.4	14.5	+ 0.9
Portugal	5.3	3.4	+ 1.9
Greece	4.6	1.7	+ 2.9
Luxembourg	6.5	2.9	+ 3.6
Spain	12.5	7.2	+ 5.3
Sweden	20.1	14.8	+ 5.3
Belgium	16.7	9.1	+ 7.6
Great-Britain	9.2	0.8	+ 8.4
Finland	13.5	1.5	+ 12.0
Netherlands	20.9	4.5	+ 16.4
Italy	51.2	0.9	+ 50.3
Total	287.0	264.3	22.7

Sources: Eurostat; German Electricity Association (VDEW)¹⁰

⁹ I formally asked Commissionaire Monti to investigate the merger of Eon and Ruhrgas in 2002, but the Commission failed to intervene.

¹⁰ [Http://www.strom.de](http://www.strom.de)

The proposals are likely to increase the regional strength of the major companies, as it will enable them to export more electricity to other markets. Europe's largest electricity company, Electricité de France has plans to increase its electricity exports. The graph below shows the rise in export from the EdF group over the past three years, with a 30% increase in this period, including a 12% rise in 2002.



Source: EdF annual report 2002¹¹

To enable greater export to occur more capacity is required, as in 2001 the total interconnectors capacity was only 11 GW with a maximum export volume of only 96 TWh¹². The list of priority projects in the draft directive of TENs (COM 2003 742 final) includes three new interconnectors from France, which will increase the EdF's direct export potential to Spain and the Benelux countries and indirectly to Italy and Germany.

To enable these new lines to be built the Commission has proposed in new legislation on Trans European Energy *'there is the need to streamline as appropriate the authorisation procedures for cross-border priority projects of high European interest, when several Member States are involved. To help to solve this problem, a Declaration of European Interest is introduced in this Decision'*¹³. This can be used to decrease public consultation and accountability and overrule national or local planning rules. Commissioner De Palacio made clear her intention for this legislation in the press release accompanying the Directives, which states *'The current situation, whereby the necessary investment is held up in interminable disputes on planning issues cannot be allowed to continue'*¹⁴.

¹¹ <http://www.edf.fr>

¹² EdF Gathering Strength: Stewart Grey and Johana Rodriguez, Wood Mackenzie, Platts Power in Europe, Western European Electricity Review 2002.

¹³ Proposal for a Decision Of The European Parliament And Of The Council Laying down guidelines for trans-European energy networks and repealing Decisions No 96/391/EC and No 1229/2003/EC, December 2003, 9. Declaration of European Interest.

¹⁴ Energy: Commission proposes decisive action on Infrastructure and Security of Supply, 10th December 2003; IP/03/1694

Conclusion

The problem with the European energy market is that competition is decreasing as mergers and acquisitions are concentrating power in a small number of companies. This is the natural progression of liberalised markets and can be seen in many sectors. However, the unique properties of electricity, namely that it cannot easily be stored and the fact that it is used constantly, mean that supply interruptions and price manipulations are more likely and their impact is greater than with other commodities. Consequently special measures must be taken to effectively regulate the market.

The lack of competition in the electricity market is aided by the distortions in the single market between different generating types. For example nuclear generators are still not required to pay the full accident insurance while operators of other generating sources such as wind turbines are. There is further distortion between generators, which brings significant economic advantages for example, nuclear utilities in France and Germany are not barred from accessing their decommissioning and waste management funds. These funds can be used for mergers and acquisitions and the companies concerned have become the dominant players in the European market.

The Commission is proposing to address security of supply problems by increasing high voltage cross border capacities. To facilitate this on a national level, the Commission have produced legislation that would enable current planning rules on a national or regional level to be over-ruled and thus undermine local democratic processes.

Instead of increasing security of supply the proposals are likely to have the reverse effect, as it will both increase grid instability from a technical perspective and increase market concentration – as cheap imports weaken the financial position of incumbent utilities. As UCTE points out further investment is needed in localised power production not further transmission capacity. Therefore a drastic revision by the European Council and the European Parliament of the proposed Directive is essential.

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<http://www.eu-energy.com>