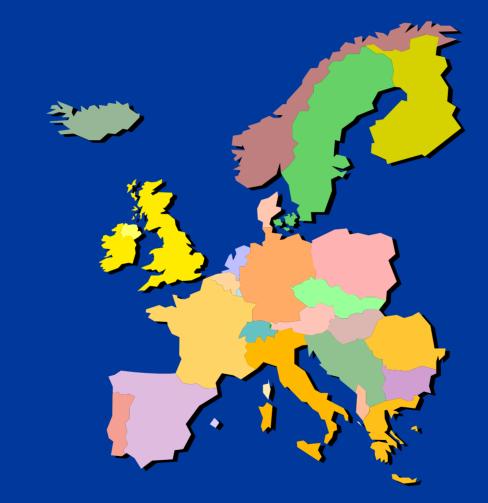
C/M/S/ Cameron McKenna

A SINGLE ELECTRICITY MARKET IN EUROPE – or FIFTEEN?

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THE EU FRAMEWORK

The origins of the single market initiative, rooted in Article 95 of the EC Treaty

- The EC Treaty is based on the concept of subsidiary
- EC Directives do not guarantee an identical outcome in all member states
- The EC Commission is not a federal regulator
- EC regulations do have "direct effect"

Main Features of the IME Directive I

Competition in generation free market entry with authorisation process competitive tendering Retail competition negotiated third party access single buyer model eligible customers with annual consumption > 100 GWh progressive market opening to c.35%

Main Features of the IME Directive II

Unbundling (functional only) TSO/DSO "independent at least in management terms" broad responsibility for operations, maintenance and "if necessary" expansion in order to "guarantee security of supply" non-discrimination obligation can give priority to renewables and indigenous funds (up to 15%) (Not very prescriptive)

Main Features of the IME Directive III

Negotiated TPA based on published "indicative range of prices"

Regulated access adopted in most member states

Single buyer access based on published non-discriminatory tariff but eligible customers can contract directly

Dispute resolution procedures

Main Features of the IME Directive IV

Grandfathering of public service obligations (PSOs)*

Derogations for stranded cost recovery*

Negative reciprocity clause

* Subject to notification

The IME Directive 96/92/EC

- Effective on 19 February 1999 in most member states (not Belgium, Ireland or Greece)
- Very different outcomes (e.g. max. opening : Germany, min. : France)
- EC proposals to amend the Directive and for a Regulation (first in the energy sector) published in March 2001
- Failed to reach political agreement in Stockholm in Spring 2001 (France and Germany)

Proposals for Amendment I

Corporate separation of TSOs

TSOs to exercise full control over all assets necessary to operate, maintain and develop the network

TSO compliance program

TSOs may be required to meet minimum levels of investment

Proposals for Amendment II

Further market opening to cover all nondomestic customers by 2003 and domestic customers by 2005

- Regulated TPA for all
- Response to access requests within 2 weeks
- Detailed PSOs, notification system and benchmarking
- Tendering system for new generation only as last resort

Article 22 of the Directive

Makes a national regulator compulsory

Appears to preclude market-based transmission prices and merchant interconnectors

Regulation on Cross-Border Networks - the Problem

Difficult to choose a supplier in a different member state

Variety of pricing structures

Pricing not cost-reflective

Can result in pancaking

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Regulation on Cross-Border Networks - Objectives

- Cost-reflective charges avoiding "excessive transaction costs"
- Transparent non-discriminatory rules for allocation of scarce interconnector capacity to avoid long-term reservation contracts
- Efficient economic signals to market participants and TSOs

(DG Comp. paper indicating reservation contracts only permitted to raise finance)

Regulation on Cross-Border Networks - Principles I

- EC allowed to set level of compensation payments between TSOs
- EC can issue guidelines "detailing further relevant principles and methodologies" for e.g. cost calculations or powerflow measurements
- TSOs compensated for hosting transit flows (including loop flows) based on long-run average incremental costs

Regulation on Cross-Border Networks - Principles II

- Access charges to be cost-reflective and no distance-related
- Access charges recouped mainly by charge on consumption
- Tariffs to provide locational signals as to losses and congestion
- General principles of congestion management
- Congestion rents to be applied to reduce expansion costs
- No pancaking

Organisation of Discussions





Florence Forum

EC Commission

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Relevance to US Debate

More prescriptive as to powers of TSOs/RTOs (and a tendency towards the design) Regulation is a critical issue at member state and federal level Focus on seams and interconnections: pricing expansion Not yet trying to impose larger markets Long way to go