

EURELECTRIC's Initial Comments on the Strategic Energy Review

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INTRODUCTION

Union of the Electricity Industry - EURELECTRIC, the association representing the electricity industry at pan-European level, welcomes the package of energy policy papers published by the European Commission on 10 January, as a move towards greater coherence in European energy policy.

The European electricity industry has repeatedly and unequivocally expressed its commitment to the objectives of improving energy security, combatting global climate change and helping to ensure the competitiveness of the EU economy through the provision of a reliable and competitive power supply. Electricity has a key role to play in reducing Europe's dependency on hydrocarbons and meeting the challenge of climate change. We strongly believe that accelerating the creation of energy markets that function efficiently and formulating an energy policy based on keeping all options open are key elements in achieving these objectives.

Our preliminary analysis of the Strategic Energy Review (SER) shows that it contains many positive elements and provides a solid basis for progress provided that a number of approaches set out in the Review are improved. Two major issues here are:

- The creation of a Europe-wide level playing field for energy business expressed in terms of predominantly national energy and environmental policies is a key obstacle that remains to be addressed
- Political will to ensure proper implementation of existing EU rules and to work for progressive practical integration of the markets are prerequisites for progress and cannot be substituted by endless new rounds of legislation.

DEVELOPMENT OF THE INTERNAL ENERGY MARKET

Preliminary Considerations

1. The creation of a European electricity market cannot be seen in terms of creating a never-ending stream of new electricity market rules. There will never be an efficient **European** electricity market if appropriate steps towards market integration are not taken and an overall level playing field created, together with a stable and market-oriented business climate.

In a European Union of 27 Member States, factors inhibiting the creation of a European market include:

- different energy policies
- different objectives and support schemes for renewable energy sources (RES), often without a market orientation
- different objectives and support schemes for combined heat & power (CHP), often without a market orientation
- different systems of (rapidly increasing) taxes, charges and levies of all kind;
- different allocation plans for carbon dioxide (CO₂) emissions
- lack of a global and long-term view on climate change policies
- lack of coherence between different areas of EU environmental policy
- persistent authorisation problems, especially for the expansion of transmission infrastructure

With the exception of a proposal regarding authorisations for international interconnectors and some indications of a long-term perspective on climate change, the package does **not** provide substantial progress on these elements.

2. The European electricity industry fully supports

- regional markets as a stepping stone to a European market
- seamless cooperation between regulators
- seamless cooperation between transmission system operators
- effective independence of network operators
- the development of interconnection where economically justified

Existing instruments and possibilities should be used in full. New regulation can never be a substitute for thorough implementation of existing regulation, nor for lack of political will and cooperation within the existing framework. It is essential that any new legislative measures should be able to foster further market development and a rapid route to market integration.

3. The electricity industry, through EURELECTRIC, has proposed a detailed roadmap to a well-functioning European electricity market, based on integration of regional markets and the furthering of wholesale markets.

The regional initiatives provide a real and unique opportunity for the development of the market, as all involved parties are brought together and the list of issues to be solved is clear - ie access to transmission networks; optimisation of planning and operation of transmission from a regional perspective; implementation of practical rules on unbundling; market transparency; transmission transparency; balancing and intra-day markets.

Preconditions for success are:

- an action- and implementation-oriented work programme
- constructive cooperation with the industry

The current process, led by regulators, does **not** respond to these preconditions.

If the regional initiatives are to have a real chance of delivering the desired results, we need:

- much greater involvement and steering by the European Commission
- a more ambitious and concrete agenda
- an approach based on dialogue and cooperation with the electricity industry through the relevant sector associations, perhaps cemented via agreements with the industry

The package does **not** provide any proposals to make the regional initiatives successful.

Key issues addressed in the strategic energy review

1. Unbundling (*Comments based on ongoing discussions within EURELECTRIC; a definitive position has not yet been adopted*)

The Commission has expressed a preference for forced divestment of transmission assets by vertically-integrated electricity groups, termed “ownership unbundling”, also outlining a second option based on the Independent System Operator (ISO) model.

EURELECTRIC wishes to point out that “ownership unbundling” will not of itself bring about any further integration of electricity markets and may well even confirm or reinforce the current excessive national focus. The right solution is to put in place a mechanism at regional level where TSOs will act as one as a driving force for the development of regional markets. Provided that existing legislation is properly and strictly applied, this approach will also ensure independence of TSO operations from any particular generation company.

2. Organisation of Regulation (*Comments based on ongoing discussions within EURELECTRIC; a definitive position has not yet been adopted*)

The SER looks at three options:

- 1) improving cooperation between national regulators (which the Commission sees as inadequate)
- 2) an “EREG-plus” solution conferring EU-level decision-making powers on national regulators
- 3) a European regulator.

The poor results of cooperation to date tend to confirm the judgement that the first option is insufficient and also raise doubts about the regulators' ability to act under an ERGEG-plus model. This second option only makes sense if in addition the Commission is endowed with strong steering and intervention powers, including the right to take decision if ERGEG-plus fails to do so. This move is **not** sufficiently provided for in the SER. It is indeed difficult to see how conferring greater powers on national regulators could solve the apparent lack of cooperation.

A European regulator is an interesting concept but it is unclear how such an institution could be implemented in practice within a short period of time. The practicalities of such an option therefore need to be further investigated.

3. Regulated Prices

The persistence, and currently even the expansion, of regulated prices set below market price level is a very serious obstacle to the creation of a level playing field and to the expansion of liquid competitive markets. In some countries, these regulated tariffs are by far the single most significant obstacle to competition, erecting barriers to market-entry and creating an unacceptable source of distortion in competition at retail level

The Commission has expressed its intention to deal with regulated tariffs but it remains to be seen whether there is sufficient political will to eliminate them. EURELECTRIC calls for **strong action** on the issue to immediately remove regulated tariffs, with a priority on those set below market price.

ENERGY POLICY IN RELATION TO SECURITY OF SUPPLY AND CLIMATE CHANGE

Preliminary Considerations

General priorities are:

- to ensure a sufficiently stable regulatory framework
- to set out a long term vision on climate change policies
- to allow the market to function without price interventions
- to engender a generally investor-friendly business climate
- to keep all options open and encourage a rational energy policy debate
- to foster a research policy geared to preserve and pursue all energy options

Key Issues of the Strategic Energy Review

1. Greenhouse Gas Reduction Targets

The Commission is proposing an EU unilateral target of -20% versus 1990 level by 2020, together with an international objective of -30% by 2020 for developed countries and a global goal of -50% by 2050, rising to -60 to -80% for industrialised countries; and also wants emissions trading to remain the main mechanism for driving this action.

EURELECTRIC:

- agrees there is a need for a transition to a low-carbon world economy
- believes that the first priority for the EU is to achieve a post-2012 agreement with other major emitters worldwide
- supports emissions trading as the key mechanism for achieving climate change policy goals
- calls for a long term (e.g.2050) target to trigger the massive investments required, accompanied by non-binding milestones. A horizon of 2020 is in or view too short to deploy the needed investments to have real impact.

2. Energy efficiency

The SER confirms the goal of the Energy Efficiency Action Plan (-20% by 2020).

EURELECTRIC has given basic **support** to the Action Plan, although the -20% by 2020 target seems extremely ambitious, again in view of the short horizon. EURELECTRIC recognises that the electricity sector can contribute to energy savings, but emphasises that greater electricity use can also raise efficiency by displacing fossil fuels.

3. Renewable Energy Sources

The Commission is proposing to set a binding target of a 20% share of total EU energy demand for RES by 2020, to be implemented through national action plans, together with a 10% target by 2020 for biofuels.

The EURELECTRIC position has consistently been that:

- RES must provide a growing proportion of the overall energy mix, and support is needed to achieve this objective
- the aim should be to achieve a steady expansion of RES, avoiding “boom and bust” or “stop-go” situations triggered by unrealistic targets or unsustainable levels of support. Although Europe is today a world leader in developing RES, the main message being transmitted to our citizens is all too often that “Europe is failing to reach its targets”
- targets should be based on thorough assessment of renewables technologies, including costs, limitations to trade and network impacts, aspects that are not fully analysed in the SER; and the aim should be to develop European synergies and minimise cost
- much greater emphasis should be placed on technologies that are close to market reality and do not create the problems mentioned above, ie thermal solar power and extraction of ambient heat by heat pumps
- There should be a transition to a Europe-wide market-based instrument, as jointly proposed by EURELECTRIC and RES-certificates body RECS

We conclude therefore that:

- the proposed time horizon to achieve a binding target is **too short** from an industrial perspective, requiring RES output to increase by a factor of 2.5 compared to the 2000-2010 period
- **A valuable opportunity to create European synergies and take a market-oriented approach should not be missed.** There is also some contradiction between the goals of fully competitive energy markets and binding targets
- The 27 national RES targets will translate into a multitude of sector- and technology-targets; there are strong arguments for placing the focus squarely on greenhouse gas (GHG) emissions rather than working with a multiplicity of sub-targets.

4. Coal and Carbon Capture & Storage (CCS)

The SER calls for 12 demo plants by 2015, plus the incorporation of CCS in the Emissions Trading Scheme (ETS). The Commission envisages mandatory CCS by 2020 for new coal plants, followed by progressive retrofit for other plants.

EURELECTRIC:

- welcomes the proposals to remove regulatory obstacles to CCS and to promote the construction of demo-plants
- stresses that it is too early to impose deadlines such as 2020 for compulsory use of CCS, when the practical availability and relative costs of the technology are not yet clear. EURELECTRIC underlines that **market** signals must be preferred to a command-and-control approach.

5. Nuclear Energy

The SER recognises the advantages of nuclear energy in terms of CO₂-emissions, costs and oil & gas dependency issues and proposes the setting up of a High Level Group on Nuclear Safety and Security.

EURELECTRIC:

- welcomes the positive language on nuclear, but notes that **no real action proposals** accompany these statements
- underlines that nuclear safety and security are important, but not particularly problematic, issues in the EU, which raises the question whether the envisaged HLG should not work with a broader mandate

CONCLUSIONS

The Commission's clear intentions to accelerate the creation of a functioning European energy market, to enforce implementation of existing directives, and to crack down on regulated tariffs are welcome, but must be put into practice.

The EURELECTRIC roadmap to a functioning European electricity market remains entirely valid. **Market integration** should be set as a clear objective, with a fast-track approach to making the regional initiatives deliver results, bearing in mind that any new legislation will take years to deliver.

Transmission asset separation ("ownership unbundling") does not provide the necessary integrated approach to networks*. An ISO model - provided it is organised at regional level - has the advantage of not only guaranteeing the independence of TSOs, but also ensuring that TSOs will act as one to develop a regional European approach to networks. The proposed TSO-cooperation structure for network planning is a step in the right direction, but might alone be too weak a basis to achieve a real regional/European approach to networks.

With regard to regulation, the poor results of cooperation to date tend to confirm the judgement that the first option is insufficient and also raise doubts about the regulators' ability to act under an ERGEG-plus model*. There is a need for a more European-oriented approach to regulation, including a strong role for the Commission, that improves on the currently disappointing level of cooperation between national regulators.

EURELECTRIC strongly supports the principle of a balanced approach to energy provision that envisages a role for all demand side and supply side options. The SER's recognition of the advantages of nuclear energy is a notably positive step, but must be followed up at EU and national level. A wider role could be envisaged for the proposed High Level Group on Nuclear Safety and Security.

The European electricity industry fully agrees on the need for transition to a low-carbon economy. Long-term signals are required to steer the massive investments required in the next decades. A time horizon of 2020 for binding GHG reductions is too short to deploy the needed investment to have real impact.

Regarding CCS, demo projects and integration into the ETS should be initiated with all speed. However, a command-and-control approach to CCS with a 2020 deadline is premature and likely to prove counter-productive when it comes to securing investor-commitment.

Likewise, EURELECTRIC supports the increased deployment of renewable energies, but questions whether binding targets are compatible with the desire to promote a competitive European market and to achieve climate change goals in the most cost-effective way. The proposed 2020 deadline for mandating a 20% energy share for RES does not correspond to the reality of industrial timelines. At this crucial moment for EU energy policy, the opportunity to introduce a Europe-wide market approach to RES-development should not be missed.

If CO₂-reduction is the underlying aim of policies designed to foster energy technology, an approach geared to CO₂, rather than one that will tend to multiply sub-targets at EU and national level, should be taken.