

Power in Europe

Gloves come off on unbundling

Siobhan Hall

France and Germany remain on the warpath against the European Commission's proposals to separate out grid businesses from integrated energy companies. But instead of debating the formal legal proposals, the two have focused on discrediting the EC's accompanying impact assessment of them.

The assessment, published with the EC's third package of EU energy law proposals in September, compared different indicators, such as prices, investment and market concentration, in member states with and without ownership unbundling – the full separation of networks from supply businesses. It concluded that, in general, member states with ownership unbundling performed better.

But the French government, in an internal note circulated November 20 ahead of the EU council of energy ministers December 3, and German members of the European Parliament energy committee in debate November 21, challenged this conclusion.

The impact assessment "is not a rigorous, objective and complete analysis of all possible options for achieving an effective separation" of networks, said the French note, and "does not justify giving priority to ownership unbundling or to the ISO [independent system operator] model as put forward."

The French government was also skeptical about the EC's choice of datasets and the member states compared, describing them as "partial" and intended to show ownership unbundling "in a more favorable light."

These sentiments were echoed in an EP energy committee debate November 21 where EC representatives were given a roasting, mainly by German members. "The EC's [impact assessment] is full of mistakes, is selective and one-sided," said German conservative member Herbert Reul. He challenged the data, the way data was compared and the conclusions. "It's sloppy work," he said.

The EC is standing by its assessment. "We believe we have produced an impact assessment which is well-argued, cogent and holds water," EC director of conventional energies, Heinz Hilbrecht, told journalists in a hastily-called press briefing November 23.

And EU energy commissioner Andris Piebalgs issued a statement the same day in response to "companies" opposed to the proposals questioning the assessment. "The impact assessment clearly lays down . . . the reasons why the specific proposals are necessary," he said. "Our citizens have every right to expect that the prices they pay are set by

effective competition and not by dominant companies operating in markets that they protect via their control of the network."

EC asked for more data

But the EC will still have to provide more detailed explanations on particular issues after the European Parliament's energy committee called for written answers on why the EC mainly used data up to 2005 – which would not take account of Germany's summer 2006 energy law supporting fair access to networks.

It has also asked for new and detailed analysis on how far price and network investment trends in EU member states could be attributed to unbundling, rather than other, unrelated factors.

The EP's energy committee chairwoman Angelika Niebler wants the EC to provide a detailed response before the next committee debate on the package December 18-20 (see box). If the EC's response is unsatisfactory, she said, the committee could decide to use an external consultant to evaluate the impact assessment – a decision which would likely delay the debate and jeopardize the EC's hopes to have the package adopted by the EP and EU Council by early 2009. "It's a German game to delay the proposal," said an EC source. "They're doing the same in the council – they haven't discussed the proposal, they just attack the impact assessment."

EC needs EP support

The embarrassment for the EC is that until now, it saw the EP as its ally in getting its controversial unbundling proposals through. In July the EP as a whole voted to back ownership unbundling for the power sector, but wanted the EC to address concerns about the effect on the EU gas sector which relies on imports.

At the same time it urged the EC to present a detailed cost/benefit analysis of the planned unbundling proposals, including for both ownership unbundling and the ISO model, and what problems or costs there would be without ownership unbundling.

But the French government's note is particularly scathing about the lack of information about the ISO model in the EC's impact assessment. The model raises a number of troublesome issues, said the note, including "entering assets in the accounts, the infrastructure owner's control of investments, allocation of remuneration between the infrastructure owner and ISO, responsibility, etc."

Niebler's queries

In a November 22 letter to EC commissioner Andris Piebalgs, the European Parliament's ITRE chairwoman Angelika Niebler asked for further analysis from the EC on several aspects of the Impact Assessment. Here are the key questions:

1. What taxes and levies are included in the power price comparisons between bundled and unbundled member states?
2. To what extent can power prices be taken as an indicator of the merits of ownership unbundling?
3. Can we be sure that comparisons of investment levels in bundled and unbundled markets are not distorted by factors that have nothing to do with unbundling?
4. Why have different time periods been used for different countries when comparing price and investment levels?
5. Why have you mainly used datasets which end in 2005, given that the 2nd energy package was not fully implemented by that date?
6. Why is Germany excluded from the comparison of the number of power interruptions and level of market concentration?
7. Who invested more in network infrastructure – bundled or unbundled member states?

France and Germany do not by themselves control enough votes in the EU council to block the EC's proposals, but in practice it is very rare for a proposal which they both oppose to be adopted.

PSIRU's critique

Another analysis of the EC's impact assessment of the third energy package, meanwhile, has been produced by Steve Thomas, Professor of Energy Policy, PSIRU, University of Greenwich, London.

On the perceived benefits to investment of transmission unbundling, Thomas' report, sponsored by the European federation of public service unions EPSU, says the Commission's analysis "is based on a fundamental misunderstanding of the forces that lead a network company to invest."

The EC says vertically integrated companies have a disincentive to invest in their networks, and that congestion revenues are often higher than expected profits from building new links. "However, not carrying out sufficient investment in the network makes no business sense for a network company," Thomas says. "Under-investing in the network would tend to lead to poorer network reliability. Allowing this to happen would be extremely risky for the network company as it would invite severe sanctions (fines and loss of reputation) from the regulator and perhaps ultimately risk having the concession to own the network taken away."

Regulated network companies make investments for two main reasons, the PSIRU report says: to improve the reliability of the network; and because under most forms of regulation, the more money the company invests, the higher its profits.

"In addition, significant investment in the network almost invariably takes place with the explicit approval (generally ex ante) of the regulator. So the suggestion implicit in the Commission's analyses that network companies take autonomous and independent decisions on how much to invest and in what facilities totally misrepresents decision-making in regulated network industries."

The Commission's repeated emphasis on the need to stimulate investment is "totally misconceived", Thomas says. "A high level of investment is not a good thing per se. What is needed is a sufficient level of investment in facilities that will make a cost-effective way of improving service quality. The Commission's figures on the high levels of investment by unbundled network companies could as easily be an indication of regulatory failure as the positive effect of unbundling if the network company has successfully persuaded the regulator to sanction investment in facilities that were not needed."

Poor evidence

The PSIRU report sees some logic in the assertion that unbundling leads to lower market concentration – "if access to the networks is seen to be fair, new entrants will be more likely to come into the market", but rejects the Commission's evidence that in the cases of Spain, Italy and Portugal, "market shares of the largest generator dropped significantly following the implementation of ownership unbundling."

This interpretation "is a travesty of what actually happened," Thomas says. "In Italy, the government took a policy decision to unbundle the transmission network. It took an independent decision to reduce the market share of ENEL, to 50 per cent or less. It did this by requiring ENEL to sell some of its generating capacity in three packages. One of these packages was sold to the largest Spanish company, Endesa and as part of the deal, some of Endesa's assets in Spain to ENEL. The reductions in market concentration in both Italy and Spain were therefore solely due to a specific decision by the Italian government. Market forces played no part. Similarly, in Portugal, the government took an explicit decision to require some of the new capacity to be built by IPPs rather than the incumbent."

"There must be strong suspicions that the Commission does not believe that 'atomistic' competition in wholesale and retail markets is either achievable or even desirable," Thomas concludes. Indeed the EC suggests the way forward is to have a handful of powerful players in an integrated market with the financial muscle "to

negotiate with external suppliers without needing to own the network, represent a very large portfolio of customers, have access to a wider range of alternative resources (LNG, North Sea gas etc.), be more efficient and commercially focused than state-owned national incumbents.”

Ownership paranoia

Thomas sees no merit in the Commission's proposal that energy networks should be majority-owned by persons established in a Member State of the EU. “This is symptomatic of what appears to be paranoia, unsupported by any evidence, that Russian companies are waiting in the wings, ready to pick off the large European energy companies one-by-one,” the author says. “The concern with ownership of TSOs by third countries contrasts strangely with the lack of any measures to ensure that EU-based companies have the appropriate expertise and motivation to own the networks.”

The Commission acknowledges the strategic importance of energy networks, Thomas says, “but its priority should surely be to place strong requirement on regulators to ensure that owners of networks are fit and proper organisations to carry out such a task. Network owners must have strong technical, commercial and financial skills and must be required to prove a long-term commitment to the sector. Arbitrarily excluding companies from outside the EU will be seen by the victims of such a policy as provocative evoking a ‘Fortress Europe’ mentality and will invite retaliation.”

The EC notes that a key competitive problem is the existence of vertically integrated companies with dominance in both wholesale and retail market segments

– but it has no strategy to deal with this, Thomas says.

If the integration of wholesale and retail is allowed without restriction, competitive markets will not be created and the main point of the directives will be lost, Thomas says, “yet the Commission's new proposed legislation has nothing to say on this issue.”

Why? One possible explanation is that the EC expects unbundling of networks to be so effective that new entrant generators and retailers will be motivated to enter the market. “As argued above, this is implausible,” Thomas says. Another is that the EC believes there no realistic possibility of enforcing retail and generation unbundling. A third is that the Commission's priority is not to create efficient energy markets and it is happy, for other reasons, to allow European energy markets to slide into oligopoly.

A final possibility is that the EC has realised that efficient energy markets will mean that security of supply cannot be guaranteed, Thomas says. “In a competitive wholesale market, there would be free entry and exit, and governments and regulatory bodies would thus not be able to predict in advance supply . . . At least in an integrated company, gas wholesalers and electricity generators would have an incentive to ensure that their final consumers would enjoy a reliable, affordable supply of energy. However, this would mean that the impact of the Commission's reforms would have been to transform energy supply from a regulated public service to an unregulated oligopoly.”

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