

# Ownership Unbundling: the Views of European Regulators

The issue of unbundling is certain to be one of the most hotly contested elements of the “third package” of liberalisation legislation which the European Commission are expected to bring forward this summer. The European Regulators’ Group for Gas and Electricity (ERGEG) have consistently stated their preference, in principle, for ownership unbundling. Here they explain why.

ERGEG’s 2006 assessment of European energy markets, based on the reports of the national regulators, found that insufficient unbundling remains the most persistent barrier to competition in the internal market. The economic incentives on the networks are simply not right, undermining the principle of non-discrimination and distorting trade. The existing regime of “legal unbundling” leaves too much discretion to vertically-integrated companies, and has been implemented to differing degrees by Member States, meaning companies often act without fear of enforcement

Effective unbundling is crucial to the development of competitive single EU energy markets and to the security of our energy supply. A TSO must act – and be perceived to act – independently of commercial interests for markets to function, as the market participants or network users are the customers of the TSO. Areas where discrimination can occur include network access, real time operation of the system and the provision of information. Equally, and crucially, a TSO should be incentivised to maintain, plan and invest in the networks to extend capacity where there is a market need, rather than in the commercial interests of the

vertically-integrated parent company. Network operators sometimes have to spend money on projects which have a negative impact on the economic performance of their affiliated companies, which clearly without proper unbundling they will not be incentivised to do.

There are numerous attempts globally to unbundle transmission activities from affiliate interests in the competitive areas of the market. However, it is widely acknowledged that full “ownership unbundling” is the most effective and “clean” approach. The defining element of ownership unbundling is that the network is operated and owned by one independent company, which clarifies responsibilities and liabilities, and is the only approach where we can rely on “true” economic incentives on the network operators. Hence ERGEG believe that “ownership unbundling” of transmission should, in principle, be the model required at EU level. All alternatives require an intrusive and burdensome regulation of individual activities within the companies.

Analysis recently undertaken by ERGEG in those countries that have adopted ownership unbundling clearly supports the model. In Portugal, for example, investment in the networks more

than tripled in real terms in between 2000-2006, following the introduction of ownership unbundling; and over the same period quality of service improved whilst prices fell, with interruption times and transmission tariffs coming down significantly. In the UK, similarly, £10 billion of investments in the network are planned in the coming 5 year price control period, and grid reliability is 99.9997%, among the highest in Europe. In Italy, there was a 30% increase in the investment plan in the 4 years following the merger of system operation into a fully unbundled TSO.

Recognising the ongoing political debate, ERGEG have also undertaken internal analysis recently into the commonly referred to alternative of an "independent system operator" model. "ISO" models are, at first glance, less drastic to implement, since they preserve the ownership of the assets by the vertically-integrated company. In reality, however, they are also much more complicated. This interface between the asset owner and the ISO requires complex, heavy and intrusive regulation – and appropriately empowered national regulators to enforce it. There is no one ISO model, and a sliding scale can be envisaged between a "shallow" ISO, where most

transmission functions remain with the vertically-integrated asset owner; and a "deep" ISO, which takes control of all of the transmission functions, including live operation, connection, network planning and investment decisions. From the perspective of minimising discrimination, the optimum ISO model will be the deepest one.

Finally, however, it is important to recognise that no unbundling regime can work without effective regulation. The extent of regulatory oversight required and therefore the resulting regulatory burden is in inverse proportion to the degree of unbundling, which points again to the benefits of ownership unbundling. Unbundling therefore, whilst vital, is one element of a package of measures that are required to create genuine, competitive, single European energy markets. ERGEG believe that strong, independent regulation at national and EU level, and clear roles and responsibilities for TSOs and regulators in a comprehensive EU-level regulatory framework are, together with ownership unbundling, essential to achieving the EU's energy objectives of "security, sustainability and competitiveness." These elements should all be included in the eagerly awaited "third package" of EU legislation. ■

