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Unbundling as a regulation instrument in European energy sector

Summary

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Summary

The subject of this dissertation is to discuss the unbundling institutions leading to changes in functioning of vertically integrated energy companies, in the light of European Union law. The direction of these changes is dictated by the need to remove entry barriers to the recently monopolized markets in order to provide a level playing field for all markets participants, in particular those who are about to enter it.

The electricity market significantly differs from other commodity markets. This difference stems from the specific characteristics of electricity, i.e. the good that is traded. One of the main features is the necessity to use specific technical infrastructure for "transporting" energy between the supplier and the consumer. However, it is not possible to operate in this market without effective access to this infrastructure considered an essential facility. It means that its duplication is impossible or extremely difficult mostly due to the fact of legal and economic constraints. Such situation exists in the energy market where network is a natural monopoly causing then that it is no viable for market participants to build their own one (i.e. competitive network). Thus, they depend on access to the existing infrastructure. This creates particular limitation not only in the movement of electricity but also in the occurrence of the competition. Such situation requires applying special tools from competition law as well as from sector regulation.

Because of natural monopoly nature of electricity network, this segment of energy industry, as it is stressed in the literature, is a non-competitive and needs to be separated from the competitive segments such as production and supply.

The dissertation focuses on unbundling as a regulation instrument and its influence on creating the internal competitive energy market.

The idea of unbundling is part of a wider problem regarding liberalization process of electricity market in European Union. From the very beginning the

European legislator was intent on creating some competitive tools which would lead to:

- a decline of the cost of the electricity;
- an increase of the investments in developing electricity infrastructure;
- meeting customers growing needs for electricity
- and finally assuring security of supply by integration and closer cooperation of national markets of all Member States.

Nevertheless, the main problem in creation of a properly functioning internal energy market was the reluctance of Member States to transfer their prerogatives regarding energy sector on EU level. It should be noted that in many Member States energy companies were, until recently, owned by the state. It was justified by sensitive and important nature of this sector which plays an essential role not only in economy but also in public area.

The second problem was attributed to the structure of electricity sector whose characteristic feature– before liberalization process – was the dominant position of vertically integrated utilities which posed a threat to the competition in internal energy market. Those companies controlled the entire electricity chain – from production to supply. All efforts in opening national markets met and still are meeting with "resistance" of these companies which want to maintain *status quo ante*. It drives from the fact that conducting a competitive activity in supplying energy always requires using already existing infrastructure which usually -in part or as a whole- belongs to vertically integrated energy companies. In other words, competitors should be granted an access to this infrastructure on transparent and non-discriminatory conditions. Otherwise, they won't be able to render services in supply area. Therefore, vertical structure results in network entities favoring the ones belonging to this structure . As a result, competition in the market is limited, not to say obstructed.

In order to resolve this problem it was decided to use the regulatory mechanism involving the separation of vertically integrated activities (ie. Unbundling), led by energy companies. Unbundling is then perceived as a crucial instrument in protecting competitors against anticompetitive practices used by

vertically integrated companies. Those practices aim at preventing entrance of new market players, which may endanger recent monopoly position of those entities. In other words it can be said that unbundling is necessary because there is internal conflict of interests within a vertically integrated company by allowing access to the network which creates competition and thereby has negative impact on such company.

The realization of the idea of a common energy market requires, above all, the protection and development of effective competition. This requires on the one hand, deregulation i.e. divest energy companies of exclusive rights for providing of certain services, on the other hand, the introduction of certain rules which change the recent structure (i.a. organizational, legal, ownership) of vertical integrated energy entities. Therefore liberalization of the electricity sector implies the use of deregulation and regulation mechanisms. This means that beside the abolition of legal monopolies there are also formed new administrative regulation instruments. However, as it was indicated in the dissertation "unreliability" of conventional mechanisms of competition law, as well as the structure of the electricity market, in which the network companies are in principle in a privileged position (which has its source in the natural monopoly), justifies the use of regulatory tools. Otherwise, the further development of a common energy market would be significantly impeded.

It the European Union it was decided to introduce the so-called regulated network access (within the principle of third party access) which has lead to a specific competition taking place in network, not by separate networks. But the fact that the network companies conduct very often other activities (production and sale of electricity) in energy sector, thereby creating a vertically integrated structures makes the same instrument of TPA not sufficient. Effective operation of this principle requires, as it has been mentioned above, implementing some structural, personal, capital, and ownership changes within vertically integrated energy companies. This is what the institution of unbundling is used for. It leads to different degree of interference in the structure of the vertically integrated undertaking, separating the network activities (i.e. the transmission and distribution) from other ones (i.e. the production and supply). Doing so it prevents the vertical integrated companies from

blocking competitors access to network. In other words, unbundling aims at guaranteeing that the network will operate truly independently from the commercial and/or supply business. It is one of essential condition for competition in EU energy markets.

Although unbundling as a regulatory instrument can take different forms, the purpose of each of them remains the same, and that is the regulation of the sector in order to ensure equal and effective competition to all market participants. Therefore, this instrument is not the aim itself but is merely a mean to achieve it. It can than be said that the appropriate legal, ownership, and organizational structure of energy companies is a prerequisite for the proper functioning of the electricity market.

The thesis consists of an introduction, five chapters and a conclusion. In the first one I make a general presentation of the organization of the electricity market, with particular emphasis on those elements of its functioning which indicate the specificity of this sector and at the same time provide a starting point for further considerations related to the subject of the thesis. I also discuss the notion of energy company.

In the second one I present the way the institution of unbundling has evolved within three energy directives. I make some approximations of this regulatory instrument in the context of the liberalization of the electricity market.

In the third chapter I discuss the legal basis of regulation of the electricity sector, i.e. art. 114 TFEU, the objectives of sector regulation and characteristics of legal norms regulating the energy sector, which I do in comparison with the norms of antitrust law. In this chapter, I also refer to the issue of competences in the regulation of the electricity sector in particular in the context of the changes introduced by the Treaty of Lisbon.

In the fourth chapter I define two basic problems associated with the occurrence of competition in the electricity market. Thus, I present the question of natural monopoly and vertical integration of energy companies and their impact on the creation of a competitive electricity market. In the context of second issue I discuss in detail the elements of the definition of a vertically integrated undertaking, in particular the concept of control.

In the fifth chapter I discuss the issue of unbundling. The analysis of this institution is based on:

a) Directive 2009/72 / EC of the European Parliament and of the Council of 13.07.2009 r. concerning common rules for the internal market in electricity and repealing Directive 2003/54 / EC and

b) Act of 10.4.1997 r. - Energy Law.

I divide the issue of unbundling into the rules for the distribution system operators and the rules relating to the transmission system operators. The aim of this chapter is to analyze different forms of unbundling as a regulatory instrument in the energy sector with particular emphasis on legal issues related to its most restrictive form, i.e. ownership unbundling as literature suggests that there may be a series of legal objections against this instrument. Issues raised in this context usually concern the following: article 345 TFUE; the ECs competences and the limits of article 114 TFUE in particular; the breach of free movement of capital and the freedom of establishment and the right to property under ECHR and the EU legal order.

Finally I list the conclusions of the analysis carried out in dissertation.

I mostly deal with unbundling of vertical integrated energy companies in the context of Third Energy Package. However, it should be born in mind that unbundling can also be considered from general competition law perspective. Introducing unbundling instrument through the use of competition law has, nevertheless, a limited scope as it concerns only an individual undertaking which has breached the competition rules and due to this fact is under the investigation of EC. Contrary to antitrust rules, sector regulations allow to implement unbundling requirements to all vertically integrated companies operating in the electricity market. In the study I present unbundling as a remedy under art. 7 of Regulation 1/2003 and as a commitment under art. 9 of the same Regulation. I also give an insight into unbundling based on Merger Regulation (Regulation 139/2004). However I do so in limited extent subordinating this issue to the main topic. I also refer to third party access principle. I do so in a way which is necessary do discuss unbundling institution only.

In the study I make an assumption that unbundling is an essential instrument for the protection and development of competition in the electricity sector. Hypothesis formulated in this way is a consequence of the occurrence of a natural monopoly within the network activity as well as the existence of legal, ownership, capital, personal and organizational connections within vertically integrated energy undertakings.