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Reflexive Governance in the Public Interest

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Why should EU Agencies regulate deregulated network industries?

An economic perspective

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Working paper series : REFGOV-IFM -53

European FP6 – Integrated Project
Coordinated by the Centre for Philosophy of Law – Université Catholique de Louvain – http://refgov.cpdr.ucl.ac.be
WP –IFM-53

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(www.grjm.net // www.energyblog.eu)

(5 October 2008)

INTRODUCTION

Why should EU Agencies regulate deregulated network industries?

There are two questions there. The first one is: *Why regulate deregulated Network Industries?* While the second one is: *Why to regulate them at the EU level through an Agency?* Both are familiar questions in the economics of regulation & deregulation. While the second one related to the EU level is the more difficult to answer.

The answer comes within four steps. The steps one and two will show how regulation of "deregulation" is produced with both a demand and an offer. Step one will show that a demand for public intervention can be rationally derived from the economic properties of the industry process (namely: 'monopoly' and 'externality' which can generate market failures). Step two will show that the offer of public intervention comes more from the institutional design of the industry (namely: the actual capability to build credible tools dealing with monopoly & externality problems and being or not being market friendly). The third Step will apply that frame of analysis to comparing the "EU regulation potential" for three network industries being transportation, telecoms and energy. It will show that the needs fro EU regulation is not the same for all these industries and ranges from very weak to really substantial. The fourth and last step will emphasize that the energy case is the most convincing and that an EU energy agency could really add value to the liberalization process and help building a competitive internal market.

(I) STEP 1-
ECONOMIC RATIONALE FOR DEMAND FOR PUBLIC INTERVENTION IN DEREGULATED NETWORK INDUSTRY

Introduction

An economic rationale for demand for public intervention can come from two network economic characteristics: Monopoly & Externality. A "*Monopoly*" permits controlling the industry and market chain. When an essential facility controls an industry vertical chain (a typical "*bottleneck*") and cannot be bypassed there is an economic rationale for public intervention. An "*Externality*" is an economic effect bypassing the market. It can be typically a security effect or an interoperability effect both bypassing the standard market mechanism. The governance by the market being bypassed, there is some economic rationale for public intervention. However the exact nature of the needed public intervention still has to be defined as the next step 2 will underline.

I-1 MONOPOLY AS A RATIONALE FOR PUBLIC INTERVENTION

I-1-1°- Legally based monopolies are supposed to be suppressed yet. It therefore rests only the "natural monopoly" being a monopoly relying on economic foundations. They frequently are monopolies of essential facilities operating "bottlenecks" (notably the network facility).

I-1-2°- However all network facilities are not necessarily "natural monopoly", like show some airports (Baden airport in Germany *vs* Strasbourg airport in France to serve the European Parliament) or many telecoms' infrastructures.

I-1-3°- Many of the today natural monopolies could be contested latter *if demand grows enough to permit creating new facilities **when industry technology changes up to bypassing existing facilities.

I-1-4°- Even some "robust" natural monopolies can be encapsulated with competitive mechanisms allocating or defining the monopoly rights like: franchise bidding, licence auctioning, "open seasons", etc.

I-1-5°- Due to information asymmetry, especially in highly technological activities like modern networks are, licence contracts cannot describe all details of the fair behaviour expected from the operators. Then swiftly reacting regulatory mechanisms must be in place to

continuously monitor the possible network monopoly abuses and protect the correct functioning of the downstream competitive market. Usual ex post mechanisms activated by competition authorities are simply too slow to be efficient especially when the competition has been too recently introduced in downstream markets.

I-2 EXTERNALITY AS RATIONALE FOR PUBLIC INTERVENTION

Externality can be negative ('welfare reducing' like security failures) or positive ('welfare enhancing' like well functioning interoperability). Both kinds of externality bypass standard market rules and ask for specific provisions.

I-2-1°- Negative externality is typically a "*security effect*" affecting goods or people. Like in air traffic, in telecom privacy or electricity black out. Negative externalities are dealt with security rules and security officers. Both can be operated privately under public supervision (like Transmission System Operation –TSO- or Distribution System Operation –DSO- in the electricity or the gas industry).

I-2-2°- Positive externality is typically a "*connection effect*" which permits more people or more planes or more trains to be connected to each other; or a "*variety effect*" which brings more add-on on a given device or platform. However some positive externalities can be privately assessed (= valued by consumers) and privately managed (= designed and offered by companies). Therefore in many cases public supervision can stay punctual and concentrate either on helping to reach a "*critical mass*" starting point or organising a "*universal service*" ending point.

I-3– CONCLUSION OF STEP 1

I-3-1 Rational demand for public intervention can come from two economic network characteristics which are "Monopoly effect" and "Externality effect".

I-3-2 However none of these effects exclude a priori that appropriate market design and competition policy can fix the related problems when a competitive market has been properly established in the downstream industry.

I-3-3 Therefore there is not a general case there for a very deep permanent, direct and extensive public intervention. This contradicts what has been the credo all over the "Welfare State" decades when the State was supposed to be inherently superior to market because of existing market failures.

I-3-4 Public intervention can restrain to verify that initial market failures have been reasonably fixed by appropriate Market Design and to guarantee that the operation of the non standard arrangements being needed will be reasonably pro-competitive.

(II) STEP 2
ECONOMIC RATIONALE OF OFFER OF PUBLIC INTERVENTION IN DEREGULATED NETWORK INDUSTRY

Introduction

It exist two economic rationales for public intervention in deregulated network industries. They are the monopoly and the externality effects. However the nature of the offer of public intervention can vary dramatically because it exists many different ways of dealing with monopoly and externality effects.

Accordingly the actual offer of public intervention comes mainly from the institutional framing of the operation of the monopoly and externality effects. This framing is called in modern economics the "Credible contracting" and "Credible Commitment" operation framing.

The core economic question there is that an appropriate management of monopoly & externality effects requires that the industry operators and the public authorities can credibly commit on robust "service contracting" and on robust 'codes of conduct".

If both the industry and the public authority can build such a frame ex ante, much less regulation and much less regulation authority is needed as a governance of the industry operation. If such a frame cannot properly be built more regulation and more regulatory governance have to continuously follow the industry operation both ex ante and ex post.

II-1 EX ANTE CREDIBLE COMMITMENT AS AN ECONOMIC RATIONALE IN OFFERING AN "ARM's LENGTH" PUBLIC INTERVENTION

II-1-1°- A monopoly effect being duly framed ex ante (through an operation code or a service contract) can be submitted to an ex ante competition process like 'franchise bidding', 'licence auctioning', 'open season', 'commodity release', etc. Then such a frame can be monitored ex

post by the customers (being the buyers of the contracted or codified service) as well as by a Competition Authority using the "*Market Dominance Abuse*" approach.

II-1-2° – An externality effect being duly framed ex ante (through an operation code or a service contract) can be dealt with through private enforcement being: *§a-* specific private arrangements completing the standard market mechanisms *§b-* under the supervision and monitoring of a Competition Authority using the "*Restrictive Practices*" approach.

II-1-3°- A Competition Authority is best equipped to intervene ex post assuming a priori that market forces and market mechanisms work presumably well (« workable competition » doctrine).

II-1-4°- A Regulation Authority is more an "operation governance" which intervenes both ex ante (by defining rules and conditions) and ex post (by monitoring the actual conduct and the actual results obtained under the existing operation rules).

II-1-5°- Actually the credibility and robustness of a given monopoly and externality ex ante framing is not constant everywhere and in any industry. It varies from one industry to the other as well as from one country to the other. It mainly depends from two factors: §a- the economic nature of the industry service; §b- the public commitment to sticking to the rationale frame needed for the operation and to restraining from ex post political re-bargaining on that frame.

II-2 POLITICAL ECONOMY AS AN ALTERNATIVE RATIONALE FOR PUBLIC INTERVENTION

II-2-1°- Network industries delivering "widespread mass services" are obvious candidate for "political economy" pressures from many groups of interests. Each group of interest has many reasons to believe that the monopoly effects and the externality effects have to be corrected only to serve its own cause.

II-2-2°- Public Authority as Government and Ministries can hardly resist political pressures and bargaining (including with their national champions) on detailed regulation.

II-2-3°- It is why it is frequently assumed that an independent agency can perform better in the regulatory area. However that agency has to be strong enough to resist capture by "dominant groups of interest" in its area because a weak independent agency will typically buy peace with leniency.

II-2-4 – While being independent from the governments to keep away as much political pressures as possible these independent agencies have to be responsive to needs and accountable for their outcome. That asks for a kind of political and institutional equilibrium.

II-2-5°- Compared to a sector Regulatory Agency a Competition Authority is truly harder to capture because it deals with all existing markets and industries. A Competition Authority has no particular reason to find attractive entering into deals with this or that particular industry whiles it should prefer having a reputation strong enough do deter all players to badly behave.

II-2-6- However all existing Competition Authorities in all EU countries do not have the same skills, power and resources to really invest in the demanding task of effectively monitoring the network industries. The recent EU energy sector enquiry has shown how demanding an effective monitoring can be.

II-3 STEP 2 - CONCLUSION

The institutional framing of offer of public intervention in the monopoly or externality areas can expand or reduce the need for a regulation authority.

Some industries will inevitably call for more regulation governance while others can reasonably behave under the sole competition policy framing. Some countries are less credible than others in their ability to build a robust national framing to deal with monopoly or externality effects through the actual building of the EU internal market.

(III) STEP3

Comparisons of EU regulation potential for three types of network industries: Transportation, Telecoms and Energy

Introduction

The EU regulation potential will be revealed by crossing two axes of analysis.

On the one hand stands the axe of "*EU industry and market process*". It will consider if monopoly and externality effects are significant at the EU level and if these effects substantially alter the operation of the EU internal market.

On the other hand stands the axe of "*EU institutional framing of industry and market*". It will consider if the EU competition policy and DG COMP can fix the bulk of the problems instead

of calling for an EU Regulatory Agency. This is more likely * if negative externality effects (= security) can be treated in a way not disturbing too much the market operation of that industry and ** if exist alternative infrastructures or a credible access contracting to monopolized infrastructures. If it is not the case an EU regulation agency will make sense to supplement the work done by DG COMP.

It is assumed -and therefore not deeply discussed here- that a substantial regulatory function at the European level will be better managed by an EU sector regulatory agency than by any existing DG. It is obviously a strong assumption.
The core of this assumption is that the task of EU harmonization of national regulations and markets can be dealt with by an EU DG when it really consists into harmonizing "workable national schemes".
On the contrary, an EU regulatory agency should be preferred to an EU DG when the task mainly consists into managing an EU "common good" being a strong EU externality effect (like security) or a typical EU "public good" (like spectrum), or being the effective opening and monitoring of monopolized interconnection facilities (including both the access and the development of interconnections or priority corridors).

The five network industries being compared below are: 1-transportation, 2-railways, 3-telecoms, 4-gas and 5-electricity.

III-1 AIRWAYS
A CASE FOR A LIGHT EU REGULATORY AGENCY

The Airways industry shows a case for a ''light EU regulatory agency''.

III-1-1 The negative externality of air traffic security is strong enough to call for a regulatory authority. Of course such security authority can be national. However a set of independent national Air Traffic agencies will not maximise the volume of EU traffic one can get at a given level of traffic security or will not maximise the EU traffic security one can get at a given level of air traffic. It therefore makes sense to establish an EU traffic agency.
III-1-2 Regarding positive externality provision with connection and interoperability, we can guess that private companies will try to offer it to their customers through establishing "hubs"

where lines and flights complement. We can guess that airports will try to attract more customers and more traffic by promoting such “hubs” and service complementarities.

III-1-3 We can hope that enough open competition will impede companies and airports to extract too much from the customers willingness to pay for these positive externalities.

III-1-4 Obviously a vibrant competition policy and a vigilant competition authority are needed there to impede governments and airports do collude with national champions against foreign competitors or with established companies against low costs companies etc. Access to attractive airports and attractive slots has to be kept fair for all competing companies. We will assume that competition policy can guarantee this and therefore an EU agency can mainly focus on the security outcome.

III-2 RAILWAYS
A WEAK CASE FOR AN EU REGULATORY AGENCY

Railway industry shows a weak case for an EU regulation industry while it actually got an EU agency.

III-2-1 While air transportation is a still growing EU mass industry, particularly on its “low cost” segment having a strong effect on the welfare of the EU customers; the railways show quite the opposite picture. A priori the importance of the EU interstate railways service on the welfare of customers and on the growth of the EU internal market is more limited.

III-2-2 It is true that EU interstate trade is widely supported by road transport which is a source of more negative environmental externalities than an efficient EU interstate railways service could be. However to build an EU efficient interstate service still seems to be a daunting tasks 17 years after the 1991 directive (91/440).

III-2-3 Furthermore the negative security externality attached to a secure operation of trains can reasonably be managed at the national level while of course a harmonization of security rules is useful and welcomed in the EU.

III-2-4 In the same vein a harmonization of interoperability of equipments is useful and welcomed in the EU. However interoperability development has been very slow mainly because of the strength of national technical traditions that can almost only evolve by consensus. It is true that a supra national mechanism should have been more efficient if politically supported by member states which stays a very unlikely scheme.

III-2-5 Regarding the monopoly effects and the other positive externality effects (like the "hub" effects delivered on the new High Speed station in London) it can be sufficient to say that international trains and High Speed trains are generally submitted to such a competition from the airways and truck industry that a workable external competition really exists there even when train keeps a monopoly on its rails.

III-2-6 However such external transport competition does not exist for all train services and competition policy and competition authorities have still a play to play (for example one can wonder if High Speed trains between Paris and Brussels suffer any competition at all).

III-3 TELECOM
A CASE FOR A LIGHT EU REGULATORY AGENCY

Like Airways the telecom industry is important for the welfare of the EU citizens and is a substantial part of the EU internal market. Similar to the Airways the EU welfare in telecom can be expanded with a "light" EU regulatory agency.

The core of this industry is yet competitive enough to permit DG *Information Society* in November 2007 to ask eliminating ex ante regulation for 11 markets out of the existing 18. In the seven "staying regulated" markets, five belongs to fixed telephone network and local loop businesses being both related to typically local monopoly facilities.

III-3-1 A kind of EU agency is notably needed to harmonize the frequency band definition and allocation which relates to externality encapsulated into a "public good" being the spectrum (In economics a "*public good*" is a natural recipient for strong externality effects which hamper the use of individual property rights by its users). Harmonization at the EU level will bring a better use of the spectrum than a State by State regulation (mostly like in air traffic control).

III-3-2 An EU Agency yet exists to deal with security of telecoms operation, mainly privacy of the data and protection against piracy and spam. It can naturally join the spectrum concern into a common EU agency if efficiency gains can thus be obtained.

III-3-3 It is argued by DG *Information Society* (November 2007 package) that an EU agency can go further and harmonize all the other regulatory conditions which are mainly related to the local monopoly bottlenecks and their interoperability externality to create a unified EU market. It is obviously true that the member states' regulations need to be harmonized. It is

true too that harmonization cannot be obtained only by consensus between national regulators and that some EU ruling has to overcome some national preferences (particularly those protecting the national champions).

III-3-4 However it is unclear –at least into our mind- why it has to be obtained through an EU Agency and not through DG *Information Society* itself. We still guess that the European Commission can manage this harmonization process through its existing power framework or through a reinforcement coming from a proper EU directive or regulation. We are not familiar with the idea that local monopoly facilities regulation asks for an EU wide Regulation Agency while we do understand it asks for a reinforced harmonization power given to DG *Information Society*. However the fact that DG *Information Society* should prefer injecting some or all its new harmonization powers into a new EU Agency is not shocking as long as it permits having an effective harmonization of national regulations of access to local monopolies.

III-3-5 Today most of the telecom infrastructure can be duplicated except the local loop monopoly which has to be submitted to unbundled access (while waiting for new wire or wireless technologies which can possibly opening it up). Duplication of main of the infrastructures coupled with a real openness of wholesale and retail markets increase the scope for direct competition and the importance of competition policy and competition authority.

III-3-6 As a result an important part of the job done by regulatory authorities will be related to positive externality with interconnection, interoperability and the costs and conditions of connecting through networks and services at the local level.

III-3-7 However the growing internet services industry (from *Internet Explorer* to *Yahoo*, *Google*, *Ebay* and *Skype*) stays apart and is mainly unregulated while relying on private forces to define and to enforce connecting and interoperating terms and conditions. DG COMP showed with the Microsoft case how competition policy can deal with some core features of this new sector.

III-4 GAS
A CASE FOR A MEDIUM EU REGULATORY AGENCY

Like airways or most of the telecom the gas industry could be a quite ordinary competitive industry.

III-4-1 Like airways or most of the telecom the gas industry could be a quite ordinary competitive industry *IF*.

If there was enough alternative infrastructure facilities being enough connected to each other with enough "open gas" in it. It is roughly the case in the USA and in UK. However it is not in most of the EU where still dominate a strongly "radial" infrastructure of the network and a highly concentrated portfolio of transmission capacity contracts and of gas sources.

III-4-2 While Competition Policy plays an important role in opening the market whenever it is possible (like suppressing "destination" clauses in upstream gas contracts; or obtaining "gas release" or "customers release" or shorter long term contracting as merger remedies) it cannot impede competition to be blocked by the insufficiently pro-competitive nature of the existing infrastructures. The remarkable expansion of LNG terminals as well as peaking storage facilities shows that facility competition can enter here like in telecoms. However it is not yet restructuring the core of the infrastructure set or of the market dynamics.

III-4-3 It results in an important role still plaid by energy regulators to ex ante define and price the access to existing infrastructures (gas pipes and storage) and to expand the network towards more room given to competition forces.

III-4-4 Given that most of the EU gas supply comes from external sources the EU wide regulation of access to existing facilities as well as to their interconnection and interoperability is a key component of the welfare of the EU citizens and economy and of the creation of the EU internal market. We also may dream having an EU gas transmission and storage investment priority programme. Both sets of tasks call for an EU regulation agency much louder than in the telecom sector. With no EU regulatory agency only limited competitive pressures can be exerted on the existing monopolized infrastructure which is too little and too slow to build an open internal market for gas.

III-4-5 While negative and positive externalities in the gas sector are less intense than in telecoms or airways the "security" concern is not lower. Securing supply in the short run (with rules and procedures to deal with disruption and crisis) and in the long run (with some key infrastructure being prioritized) is a common interest of Member States and EU citizens. Such agenda deals with the same facility areas like the pro-competitive programme: gas pipes and storage. That agenda can also rely on competitive mechanisms to enlarge the size of the internal market which will help absorbing local shocks in a bigger frame of operation. Like insurance market a gas market being much larger will not suffer any more of second order hazards or third order troubles.

III-4-6 It is therefore the “EU demonopolization” policy and some harmonization of “EU security of supply” policy which are the key rationale for an EU gas regulatory agency. Of course such an agency should act within the frame of the EU competition policy and should look at constructing the internal market as a goal. Regulation and competition policy will be there two faces of the same “EU market and security” coin.

III-5 ELECTRICITY
THE STRONGEST CASE FOR A MEDIUM EU REGULATORY AGENCY

Electricity industry offers the strongest convincing case for a « regular » EU regulatory agency. Electricity sector is a rare case where most of the factors and determinants spontaneously go in the “wrong” direction either on the monopoly side or on the externality one. Except if a consistent EU regulatory policy voluntarily meets a strong EU competition policy as a thumb and an index to building together a common architecture for an EU internal market.

III-5-1 The electrical network infrastructure is a resistant set of monopoly facilities both because of the economics of transmission lines and because of the value of the positive externality bring by the interconnectedness of its lines.
III-5-2 Of course some direct lines (“merchant” lines) can be built and add some competitive forces here and there. However they stay on the fringe and deal only with niches within the market. Moreover “merchant” lines must be operated in a way consistent with the “non merchant” grid not to generate negative externalities on the latter such as “loop flows” reducing its transmission capacity.
III-5-3 The bulk of competition forces comes from generators having to run on the network of monopolized facilities and to exploit the positive externality it offers as a cobweb of generators injections and consumption withdrawals. The mere fact that electricity industry relies on different generation technologies and different plants to meet the demand and to follow its changing pattern in real time asks for interconnection and brings value to it.
III-5-4 On the top of the monopoly nature of lines and of the associated positive externality of interconnectedness comes the threat of the negative externality. If power is not continuously ready in real time to follow the pattern of the changing load the frequency cannot keep its standard value and the all system collapses. It has been seen within 18 seconds in November

2006 with 13 millions customers disconnected within three Europes, or with the Swiss-Italian blackout in September 2003. A similar threat comes with voltage stability which can derail a system if not properly dealt with like in the Midwest-New York-Toronto black out in August 2003 (50 millions people disconnected and more that 6 billions $ estimated damages).

III-5-5 While the transmission network has that economic properties it bears the only doors we have to open the EU internal market between the existing electrical zones managed by some 35 European Transmission System Operators. The actual allocation and use of transmission interconnection makes the internal market work or not. There is no real and no feasible alternative to this. It is why an EU regulatory agency is needed and should bring value added to the existing regime of juxtaposition of not enough open and not enough harmonized national facilities.

III-6 STEP 3 – CONCLUSION

We found two types of EU regulation potential: a light one and a medium one (= regular).

III-6-1 The light one is a case for a "*Security and Harmonization Agency*" doing an ex ante framing of market operation by defining EU "property rights" for the operation of the industry at a EU scale. It is the case for air traffic security and telecom security and spectrum. It can be enlarged to host the "market harmonization" tasks as claimed by DG *Information Society* while such tasks can also stay treated at the corresponding DG.

III-6-2 The regular (medium) one is a case for an "*EU Gate Keeper Agency*" doing an ex ante and ex post governance of the very core facilities which will keep the EU market and industry operation gates open to create an internal market. It is the case where interconnection facility cannot staid regulated at the national level if we want to create an EU level playing field. It is partly the case for gas and much more for electricity.

III-6-3 There is no case in the EU for a "*strong EU regulatory agency*" (like the FERC or the FCC in the USA). It is because most of the job of such a big federal agency (FERC: 270 millions $ annual budget 2008 and 1400 employees) is actually done in the EU by National Regulatory Agencies (NRAs) or Energy Ministries. That allocation of regulatory tasks in the EU is consistent with the nature of the European Union institutional frame where many tasks of implementation of the European policy are performed by national authorities.

(IV) STEP 4
IN DEPTH CASE OF EU ENERGY AGENCY

Introduction

An EU energy regulation agency could bring real "value added" to the liberalization process. Because the EU energy industry process asks for an effective regulation and because the EU institutional framing of the internal market needs to be completed.

IV-1 THE EU ENERGY INDUSTRY AS REVEALED BY THE SECTOR ENQUIRY AND THE NOVEMBER 2006 BLACKOUT

IV-1-1 Electricity has no "alternative" infrastructures like Air transportation or Telecoms. Furthermore it cannot be stored and has strong EU positive and negative externality. As a result it cannot escape entrenched transmission and distribution network monopolies being often vertically integrated and horizontally dominant firms and frequently protected by Member States politics as "National Champions".

IV-1-2 The November 2006 blackout revealed important EU grids' management deficiencies pointed out by the UCTE and ERGEG reports, notably: *detailed definition of security rules, *harmonization of rules' implementation principles, *monitoring of compliance with security rules, *actual cooperation between grid operators, etc. If several grid operators can really manage the EU grids security that deficient way, while they all acknowledge that security management is their core function, how do they actually manage the operation of the EU Market facilities?

IV-1-3 Gas has more alternative sources and facilities like LNG, gas storage, and some gas hubs. However the amount of free gas and of free transmission capacity is too small. It ends with a strong dominance of vertically integrated and horizontally dominant firms.

IV-2 THE CORRESPONDING REGULATORY AGENDA

It is why the EU needs an ex ante and ex post detailed framing of the industry operation of the EU market gates which are the transmission facilities and notably the interconnections. That regulatory agenda should cover:

1- Binding grid security rules and operation codes (including emergency and crisis procedures)

2- Interconnection capacity calculation and management

3- Interconnection allocation rules (extended to congestion management principles)

4 - Interconnection capacity investment plan and costs allocation

5- Planning priority for few EU energy "corridors"

6- Balancing Rules (for very short notice energy supply)

7- Harmonisation of natural monopoly competitive encapsulation (like "Franchise bidding", "Open Season", VPP, etc.).

IV-3 THAT AGENDA GOES BEYOND DG COMP OPERATION CAPABILITIES AND CALLS FOR AN EU ENERGY REGULATOR

The detailed ex ante and ex post framing of industry operation of the EU market gates is a typical regulatory job going beyond competition policy tools.

IV-3-1 It is true that DG Comp brings a powerful tool to the EU market building policy. DG Comp can effectively threaten and punish and therefore it actually frames actors' behaviour, decisions and ruling. However it cannot harmonize details, coordinate various parts of the operation, monitor implementation and behaviour to regularly adapt ruling to actual results.

DG Comp cannot do the ex ante detailed harmonization ruling and the ex post detailed monitoring of industry operation of "EU Market Gates" in Electricity and Gas. While devil there still is in the details because of the inextricable mix of monopoly and externality effects at the national and the EU level.

IV-3-2 National Regulatory Agencies are still reluctant to use their limited powers and resources to voluntarily give a real priority to the building of the EU Market. Probably none of existing NRAs really considers the EU Market building as its own real priority. Moreover, none of existing NRAs can have the necessary overarching view to take fully into account the complex issues related to the building of the EU Market. A simple example is given by the security of supply issues than can only be considered on a national basis by NRAs.

IV-3-3 We stay there with a real need for an EU institution mobilizing the NRAs skills and resources to do the job of keeping the EU market gates open. It is really a case for an EU "medium" Agency and not for a "light" one.

IV-4 THE ENERGY THIRD PACKAGE' S AGENCY SHOULD BE VERY WEAK

The Third Energy Package from September 2007 provides an "*Agency for cooperation of energy regulators*". However it does not seem really designed to be such a "medium agency". It is rather a very weak or a "very light agency" with too light powers and a too heavy structure.

IV-4-1 Only too light powers are given to the agency (Articles 5 to 8). The agency will have few regulatory and decision powers. Its many rights or duties are defined as giving reports or opinions (except in the "exemption" area if that power can really be exerted). The actual agency agenda will stay between "*Sunshine Regulation*" (as opening public debate on issues) and "*Smart EU Regulatory Advisor*" (as making recommendations to real EU decision making body being the Commission).

IV-4-2 A too heavy institutional structure is set for the agency (Articles 9 to 15). That institutional structure is similar to the typical US (or the French Monsieur de Montesquieu) "constitutional" paralysis of powers. Because the agency governance is split between two core Boards voting at 2/3 and one executive Director.

The *Administrative Board* (with 12 members; coming ½ from Commission and ½ from Member States as "Council") decide at 2/3 and appoints all others.

The *Regulatory Board* (with 28 members; 27 being NRAS) decides at 2/3.

The *Director* (short listed with two names by Commission) acts with the Regulatory Board.

A *Board of Appeal* treats appeals on decisions taken in the limited area where agency can take decision (like the "exemption" area).

(V)
GENERAL CONCLUSION

V-1 There is an obvious need for some EU regulation agencies. They should be of two types: a light or a medium.

V-2 A light Agency would mainly rule or manage the actual industry operation of security externality and some critical European "public goods". It is typically the Air Traffic or the Telecom security and spectrum agencies. That agency type can be enlarged to host harmonization of market rules like DG *Information Society* wants while that DG should have prefered keeping market harmonization as a proper Commission's task.

V-3 A medium Agency would act as an ex ante and ex post EU market gate keeper covering the operation of core EU monopolized facilities, and the corresponding positive and negative externality operation. It is typically the EU energy agency case. It should restrict its action area to the interconnection facilities and a few priority energy corridors. Of course it should also be empowered to defined and enforce a cross border trade market design in order to avoid the likely difficulty to make consistent the slowly emerging regional markets. This EU Agency should be helped by DG Tren and DG Comp to make national market designs to evolve toward more integration. A pending question is the EU market surveillance which is not done at the national level by NRAs while the energy sector enquiry at the EU level has been a "one shot" monitoring exercise.

V-4 Therefore no EU agency will never be a "strong" regulatory agency as seen in the USA. It is because the bulk of EU regulation work is done by existing National Regulatory Agencies or Member States ministries.

V-5 However the building of the needed "medium" agency is not provided by the Energy Third Package which sets a "very light" agency having few powers and a heavy institutional governance structure.

V-6 We do understand that both Member States and the Commission have veto powers on building an effective "EU medium regulatory agency". We unavoidably doubt a competitive internal energy market can be built with no medium EU energy agency.