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Abstract

Liberalisation in economic sectors in countries with a small free-market tradition as Spain, is a result of the transposition of European law. This argument is difficult to be held when explaining the liberalisation of the Spanish electricity market. First, Directives concerning internal electricity market maintain the *status quo* in member states and do not offer any substantial regulatory challenge to Spain. Second, the Spanish electricity sector has traditionally opted for forms of self-regulation whereby electricity companies agreed with the Spanish Government on the way in which the electricity market would work and on the bases in the regulatory field of this sector.

In section 1, this paper analyses the challenges (if any) that internal electricity market directives pose to member states, and in particular to Spain. In section 2, it sketches the development of the Spanish regulatory framework concerning the electricity sector which is guided by the notion of public service and the cooperation and collaboration of regulated undertakings. In section 3, the paper analyses the current regulatory framework — a regulated competition market — and, finally, it evaluates compliance with internal market directives (section 4).¹

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1 Liberalisation of the electricity market from Europe to the internal energy market

The European Commission has been assigned a monopoly on drafting and proposing legislation in the European Union and, therefore, this institution defines the legislative agenda of the European Council and Parliament. In some economic sectors, such as the energy, it has opted for a liberalisation policy, prevailing in the Western societies and in the programme of the common market². For instance, though the Council established some general objectives about the energy policy regarding access to energy sources to transport networks in 1986, the Council presented the energy situation as a problem of market liberalisation and it based its proposals on the dismantling of public monopolies and the removal of obstacles against access to transport networks and energy distribution.

The Commission's legislative impetus encountered opposition from some member states, which were unwilling to lose control of a strategic sector such as electricity market. For this reason, member states do not consider it necessary to include in the Treaties a chapter on energy to provide the European Union a common policy different from internal market. Indeed, in so doing, it will be required unanimity among member states and a division of competences between the European Union and its member states, which will obstruct progressively more the ability to reach agreements on this issue³. Therefore, European intervention is based on the (general) functioning and establishment of the internal market (Article 95 EC) and on the explicit mention, in Article 3.1.u EC, of energy within the general framework of the European Union objectives.

1.1 First Step to the Internal Market: Directive 96/92

The process of adopting Directive 96/92 concerning the common rules to establish an internal electricity market was slowed down by two facts: the lack of a common energy policy; and the fact that the electricity sector is a strategic sector for all economies. This directive was less ambitious than the proposal made by the Commission, but it got a broad consensus, thanks to the discretion of member states in adopting specific actions to transpose the directive⁴.

Directive 96/92 liberalises the generation and retailing of electricity, but it maintains transport (through the high-tension networks) and distribution as regulated activities.

In relation to generation, Directive 96/92 gives member states the opportunity to choose between authorisation or bidding procedures, trying to liberalise the generation market, but accepting peculiarities from some member states which have chosen the bidding procedure. This is not the case in Spain, where the Act 54/1997 of the electricity sector has chosen administrative authorisation of generation facilities.

² See HÉRITIER, A., and MORAL SORIANO, L.: "Differentiating and linking politics and adjudication: The example of European electricity policy": *European Law Journal*, 2002, no. 8, pages 363-383.

³ See CRUZ FERRER, J. De La, *La liberalización de los servicios públicos y el sector eléctrico*: Marcial Pons, Madrid, 1998, p. 249. Since discussions to adopt the Maastricht Treaty, the decision on the suitability of giving the EU a common energy policy has been delayed to establish specific authorities in this sector.

⁴ LÓPEZ DE CASTRO and ARIÑO consider the Directive 96/92, as well as the 2003/54 one, gives many options to member states, because they would never have been adopted otherwise. Besides, they represent mainly the maintenance of the *status quo*, not just the impetus to the sector's liberalisation process. LÓPEZ DE CASTRO GARCÍA MORATO, L., and ARIÑO ORTÍZ, G., "Liberalización y competencia en el sector eléctrico: Balance 1998-2003": *Privatizaciones y Liberalizaciones en España: Balance y resultados 1996-2003*. Volume I, G. Ariño Ortiz (dir.), Comares, Granada, Spain, 2004.

Also, electricity consumption has been liberalised, with a schedule to help every consumer, from the biggest consumers to the smallest and domestic ones, to exercise their right to choose their electricity energy provider. Specifically, in 1999, member states had to open 26.48% of their own market to competition, which included a quantity of consumers who demanded more than 40 GWh per year. After three years, this expansion had to be increased to 28.3%, grouping consumers who demanded more than 20 GWh. Finally, liberalisation of up to 33% was predicted, affecting consumers who demanded 9 GWh. In this case, the directive also maintained the *status quo* of the retailing market, demonstrating that some countries such as Spain, where liberalisation started late, had fulfilled their consumption-liberalisation objectives before the deadline established by Directive 96/92 .

The regulation of access to the electricity transport network is fundamental to avoid discrimination and exclusion which can abort the liberalisation of the electricity sector. For this, Directive 96/92 established two different ways to guarantee access to the network, protecting plurality in the European Union. Specifically, member states could choose the Third Party Access (TPA), or the single-buyer model (preferred mainly by France). Spain adopted the model TPA, as did the most other member states, except Greece, Germany, and Denmark.

A transport-system operator was created as a measure closely linked to network-access regulation, although Directive 96/92 did not required the same for the distribution network; thus, same distribution companies are in charge of managing the networks. Furthermore, the obligation of separate accounting is imposed on the operator of the transport network, but the best way to ensure independence is the legal separation of the transport-system operator in relation to vertically organised companies. This was the option chosen by the most of member states, including Spain.

The electricity market could not be liberalised by sacrificing service quality; thus, Directive 96/92 implemented the public service in a liberalised environment, allowing member states to impose public service obligations in relation to general economic interests: these refer to security, in distribution, regularity, quality and price of supplies, plus the protection of the environment.

1.2 New impetus for the internal electricity market: Directive 2003/54

Four years after the approval of the first directive concerning the electricity sector during the European Council convoked in Lisbon, Portugal, on March 23rd and 24th 2000, European institutions were asked to offer new impetus to the liberalisation of electricity and gas for the full establishment of an internal energy market. In the Energy Council, convoked in May 2000, the Commission was asked to provide the Council a performance report on the internal electricity and gas markets⁵ in order to formulate legislative proposals. Also, the European Parliament, carrying out the recommendations of the Council convoked in Lisbon, supported the acceleration of the internal energy market⁶. The Commission committed itself to formulating new legislative proposals, taking into account the progress made during the Florence Forum in 2001. Its proposals were to modify the gas directive (98/30) and the electricity directive (96/92) and to adopt a regulation involving access conditions to the network to the cross-border electricity exchanges (COM (2001) 125 final). Regulation on access conditions to the network was approved⁷, but, regarding the directives, the option chosen was to replace the

⁵ “Recent progress with building the internal electricity market” COM (2000) 297.

⁶ Resolution A5-0180/2000, at July 6th 2000.

⁷ Regulation no. 1228/2003 of the European Parliament and Commission, on access conditions to the network to the cross-border exchanges in electricity.

prior electricity and gas directives with those finally adopted: Directive 2003/54 of the European Parliament and Council, on common rules for the internal electricity market; and Directive 2003/55 of the European Parliament and Council, on common rules for the internal gas market.

The Commission's document presenting the legislative proposal positively considers the real application of the first directive to the electricity sector, since, among the options predicted by the directive to liberalise the market, most of the member states opted for the regulated TPA, the authorisation procedure in energy generation, the juridical separation of the network's managers (the directive required only the accounting separation) and the creation of independent regulatory authorities.

This new *status quo* was to be legally upheld and, at the same time, the European Commission wanted to remove some obstacles to the internal electricity market, perceived by the Commission. According to the access to the network, there were some discriminatory practices: the level of separation of activities, especially in relation to distribution, was very low, since no major amount of supplies was coming from other member states and there was not a great number of customers that had changed their suppliers, despite the opening of the market. Also, obligations of public service could be improved.

From the standpoint of justifying this new liberalisation wave in the electricity market, the Commission lost one of its main arguments: price reduction. Firstly, reduction was inappreciable to domestic consumers, who lacked any economic incentive to change their supplier, especially in member states where the change was very difficult or liberalisation had recently started. Secondly, the Commission had not foreseen that prices would decline as the internal electricity market advanced, due to rising prices of petroleum used to produce energy (COM (2001) 125 final, page 9). Faced with this situation, the Commission shifted its arguments, stating that, under the new impetus of the internal market, prices had to reflect supply and demand, as well as improve market efficiency, which would be impossible if the national monopolies persisted.

While Regulation 1228/2003 spurs the internal market by eliminating obstacles to the cross-border supply of electrical energy, Directive 2003/54 has two different objectives: to improve the level and timetable of the market opening and to guarantee non-discriminatory access to the network. The first is a quantitative objective established by the Directive in the Article 21: on July 1st 2007, by which every consumer can choose a supplier (the proposed date was on January 1st 2005). The second objective is qualitative, and for its implementation requires a group of different measures which do not radically change in relation to the present ones but rather preserve the *status quo* in most of the member states.

For instance, according to the access to the networks, Directive 2003/54 opts for the regulated TPA, eliminating the negotiated TPA and the single-buyer model, in both transport and supply networks. The access system has to be based on public rates, which can be applied objectively to every qualified customer and without any discrimination among network's users (art. 20). Exemptions to this general principle are considered only in the Regulation no. 1228/2003 (art. 7) to new interconnectors and to a major improvement in the capacity of existing interconnectors, which has to be individually assessed in all cases, but member states (or their regulatory authorities) cannot provide any group exemption.

In relation to the separation of regulated and liberalised activities in vertically organized companies, although Directive 96/92 required only accounting separation, the new directive also requires juridical and functional separation of the transmission network's manager and distribution network's manager from generating and retailing companies. Legal separation does not

require the creation of a new company, except in cases where the vertically organized company is a natural monopoly. All transmission, distribution, generation and retailing activities can be carried out by the same company.

Regarding the generation market, the new directive opts for the administrative authorisation procedure of new generation plants and it foresees only bidding in exceptional cases: to guarantee supply security or promote new technologies. This rule, again, maintains the *status quo* in the most of the member states.

There are two exceptions in this tendency to maintain the *status quo* in member states: first, Germany did not wish to accept the imposition of a specific regulatory authority in the electricity sector; and, second, France did not accept it because it considered this liberalisation process an abandonment of its doctrine of public service⁸.

In fact, in relation to the institutional framework of the electricity market, the Commission opted for a strong national regulatory authority, which could fix or approve transport and distribution rates, to establish the access conditions to the transmission network and distribution networks. It also had to be in constant contact with the managers of the transmission and distribution networks and to collaborate with Governmental institutions and competition authorities. Its objective was not reached, because Germany raised strong opposition to the obligation of having a specific regulatory body for its electricity sector, where self-regulation is still its preferred way to govern. Therefore, the only way of externally regulating this sector was a *ex post* regulatory authority, the *Bundeskartellamt*. To make the institutional design created by the Commission compatible with the internal electricity market with *ex ante* authorities and a self-regulation model of the German electricity market, the obligation imposed by Directive 2003/54 was formulated to make a regulatory authority necessary, but not a specific regulatory authority of the electricity sector. Germany answered this demand by creating the Federal Network Agency for Electricity, Gas, Telecommunications, Posts and Railway.

In relation to the opposition of France, which defended the public service against the sector's liberalisation as well as in the adoption of the previous directive of the electricity sector, the Commission had to convince this country and others having an ingrained concept of the public sector (such as Spain), because it defended that the liberalisation of such strategic sectors, as the electricity one, can be an instrument to reach effectively the expectations of final consumers. For this reason, the Commission, through its legislative proposal, holds the idea that the introduction of competition in the electricity sector is not to the detriment of public service policy in member states, but rather Directive 2003/54 increases the obligations of public service; it incorporates the notion of universal service which increases protection standards to consumers; and it intensifies environmental protection measures. In addition, it contains a derogation system of competition rules, namely, in relation to the authorisation and bidding procedures, to TPA to the network, and to the authorisation of direct lines of electrical transmission.

Firstly, in accordance with public service obligations (Article 3.2 of Directive 2003/54), they can be applied to provide security, regularity, quality, prices of services offered, and environmental protection. It is a broad enough definition that the Commission deemed it necessary to prepare a non-binding note (16th January 2004) so that member states would not use public service obligations as a way to derogate the European competition law when applying the directive. Specifically, it has limited the imposition of public service obligations to general eco-

⁸ See CAMERON, P.: *Competition in Energy Markets: Law and Regulation in the European Union*. OUP, Oxford, 2002, page 360.

conomic interest and, in accordance with the European Court of Justice (ECJ) in relation to the *Almelo* case⁹, it requires that these obligations (i) be linked to the supply of the general economic interest service, specifically in security, regularity, quality, prices, and environmental protection; (ii) contribute directly to satisfying this interest thanks to requiring the supply obligation to every consumer throughout territory, guaranteeing its continuity, the non-discrimination, and the lowest possible management cost; and (iii) cannot be against the European interests. Under supervision of the European Court of Justice, the Commission has the duty of determining case by case whether the EU interests are being violated by the requirement of public service obligations, which occurs when an activity with public service obligations does not present any specific characteristic in relation to the rest of the activities or when an activity is already undertaken satisfactorily by companies working in accordance with market rules.

Secondly, Directive 2003/54 introduces the concept of universal service (Article 3.3), although it is limited to domestic consumers and to small- and medium-sized companies. It establishes the right to electricity supply with a set quality at reasonable prices which are easily and clearly comparables. To warrant this right, member states will require the supplier companies to connect their consumers to their network in accordance with conditions and rates approved by the regulatory authority.

Both public service and universal service obligations are linked to the assignment of exclusive rights and provision of financial compensations. In the former case, the compliance with the European law concerning exclusive rights will be determined in accordance with the ECJ doctrine in relation to Article 86 EC (the *Almelo* case). In relation to the provision of financial compensations, member states should comply with the ECJ doctrine on state aid (Article 87 EC). In particular, in the *Altmark* case (C-280/00, *Altmark Trans and Regierungspräsidium Magdeburg*, [2003] ECR I-7747), the ECJ lists four cumulative requirements which the economic compensations would have to fulfil in order to be considered in abidance with the European Law: (i) the company which receives the aid will be responsible to comply with the public service obligations; (ii) the costs of those obligations have to be previously established; (iii) compensation cannot exceed the necessary amount; and (iv) the compensation level shall be determined in comparison to the costs of a correctly manage company.

Finally, among the protection measures for the environment and the consumer, Directive 2003/54 introduces (Article 3.5) a new protection for vulnerable consumers through measures which prevent the supply stoppage. It is a social and territorial measure which should not be carried out by companies which provide the general interest service, but by financial entities or organizations having public possibilities and dedicating themselves to social or vulnerable communities' needs.

2 Regulation of the Electricity sector in Spain

2.1 Liberalisation of the electricity sector in Spain

Liberalisation, in economic sectors in countries with a small free-market tradition as Spain, is a result of the transposition of European law. This argument is difficult to introduce in the Spanish electricity sector for two reasons. The first has been explained above: Directives concerning internal electricity market maintain the *status quo* in member states; as we will explain below, it does not offer any substantial regulatory challenge to Spain. In fact, although

⁹ Case C-393/92, *Municipality of Almelo et al.* [1994] ERC I-1477.

Act 54/1997 of the Spanish Electricity Sector was approved after the adoption of Directive 96/92, the introduction of competition in the Spanish electricity sector is due to an agreement between the electricity companies and the Ministry of Industry and Energy in 1996. Therefore, Directive 96/92 did not require any measures different from those agreed upon by the Governmental regulator and the regulated companies. In fact, aspects such as public service obligations or the accounting separation of the energy transport and generation activities, are behind the regulation contained in Act 54/1997. It also happens in the case of Directive 2003/54, which did not require any fundamental modification of the requirements of the Act 54/1997. Some aspects, such as the universal service of the electric energy or the legal separation of activities, were established by Spanish legislation before the first Directive of the internal electricity market came into effect.

The second reason why it is difficult to explain the liberalisation in the Spanish electricity sector as a result of the transposition of European directives is related to an essential characteristic of the Spanish electricity sector: since its creation, it has opted for forms of self-regulation whereby electricity companies agreed with the Spanish Government on the way in which the electricity market would work and on the bases in the regulatory field of this sector. As we have stated above, the liberalisation impetus of the Spanish Electricity Act 54/1997 is the result of the agreement made by the Spanish Government and companies from this sector signed in 1996: Protocol to establish a new regulation of the National Electricity Market (*Protocolo para el establecimiento de una nueva regulación del Sistema Eléctrico Nacional*)¹⁰.

For these reasons, the directives governing the internal electricity market cannot be considered to be a change in the regulation of the sector in Spain. In reality, we need to analyse the current regulatory framework while taking into account two factors. The first one concerns the qualification of the electric energy supply as a public service and the evolution of this title of public intervention in a liberalised market; the second factor refers to a constant in the Spanish electricity sector: coordination and cooperation between companies and the Government to establish a regulatory framework in this sector.

2.2 Electricity market regulation in Spain: from a public service to a model of regulated competition

Electricity market regulation in Spain has been directly connected to the declaration of electricity supply as a public service. State property and the direct or indirect¹¹ management that the aforementioned declaration implies were justified by different aspects: the electricity market is a strategic market, rather complex from a technical standpoint¹²; it requires a network

¹⁰ The Protocol to establish a new regulation of the National Electricity Market was signed at Madrid, on 11th December 1996 by the Ministry of Industry and Energy and electricity companies. Its main aim was to establish operative bases of the New Electricity System; to define the dates, measures and safeguards which will be applied during a transitory period until we reach the liberalisation and competition objectives of the electricity market; to establish criteria used as a base to apply the system's structure and working, guaranteeing the competition of companies which comprise it and its competition; to establish the bases to pay for activities to be carried out in a natural monopoly regime; and to promote a new regulation which will adequately take into account the interests of consumers, workers, and shareholders.

¹¹ Electricity supply is an essential service. Companies that offer this service must satisfy certain demands: quality, continuity, universality and, also, non-discrimination of users.

¹² Electricity supply is an activity that necessarily involves different successive stages: generation, transport, distribution and retailing. It requires a high level of coordination between those stages, with the aim of meeting supply (generation) and demand (consumption), since electricity is subject to two physical restrictions, described in Kirchoff's Laws: electric energy cannot accumulate —except in small quantities, with a low voltage and duration and at a very high cost—; and it cannot be individualized within the entire network. *See,*

technology that excludes the existence of different networks, since this would be considered economically inefficient. For these reasons, traditional regulation granted exclusive rights to a network of state or private corporations, establishing the conditions for production and service provision¹³. The legal implications of the declaration of electricity supply on the basis of a public service underwent different changes before the publication of Act 54/1997, where such expression is excluded.

2.2.1 Electricity market regulation in a free market context

A first stage developed within the framework of a free market during the 19th century and the beginning of the 20th century is characterized by a business initiative that, in accordance with market laws, succeeded in spreading electrical service. Government intervention (especially by town councils and also by the national Government) consisted of the external regulation of the electricity market activity, with the sole aim of guaranteeing safety and allowing the use of land to install networks of transmission and distribution. The regulation of the activities and the authorisation procedures to use public-own land justifies the intervention of public administration. Nonetheless, new regulations would gradually impose requirements related to the provision of public services. This justifies a higher level of intervention and a centralized regulation of the service leading, therefore, to shrinking competences of town councils in favour of central administration¹⁴.

At the beginning of the 20th century, still within the framework of a liberal state, the process of the concentration of companies begun¹⁵. The electricity market suffered the impact of the First World War, which began in 1914; this event would greatly influence the configuration of the market that has persisted until today.

The instability of energy prices after the Great War gave rise to debate in favour of state intervention in the economy, also supported by the ideological crisis of the liberal state. State intervention is not any longer based on the ownership of the land where networks are installed, but on the public characteristics of energy supply activities. As a consequence of this reinforcement of public intervention in the electricity sector, the state authority over price establishment would be gradually strengthened¹⁶.

HERNÁNDEZ, J.C., “Regulación y competencia en el sector eléctrico”, Thomson-Aranzadi, 2005, p. 23 and following; and GONZÁLEZ-VARAS IBÁÑEZ, Santiago, “Los mercados de interés general: Telecomunicaciones y postales, energéticos y de transportes. (Privatización, liberalización, regulación pública y Derecho de la competencia)”, Comares, Granada, 2001.

¹³ See LAS HERAS, Miguel Ángel, “La regulación económica de los servicios públicos...”, p. 32. CRUZ FERRER, Juan, “La liberalización de los servicios públicos y el sector eléctrico. Modelos y análisis de la Ley 54/1997”, Marcial Pons, Madrid, 1999, p. 100.

¹⁴ See CRUZ FERRER, Juan de la, “La liberalización de los servicios públicos y el sector eléctrico”, Marcial Pons, 1999, p. 22; See also HERNÁNDEZ, J.C., 30 and following.

¹⁵ This process takes place thanks to the involvement of some banking groups in the boards of most of the leading electricity companies, thus starting an absorption process over small companies in order to create larger companies, so that they can face big investments, necessary to develop hydraulic facilities. The Spanish electricity-company scheme begins to take form.

¹⁶ In accordance with the statement by TRILLO-FIGUEROA y LÓPEZ JURADO, among others, the state’s authority of price establishment is independent from its intervention in the market using the concept of “public service”, since the former is based on public-property titles—even in those cases where they do not exist—and leads to the consideration of electricity as a raw material (TRILLO-FIGUEROA y LÓPEZ-JURADO, “La regulación del sector eléctrico...”, p. 147).

In Spain, electricity supply was first declared a public service in 1924, by the Royal Decree-Law of the 12th of April. The aforementioned Law also declared the gas and water supply as public services. Such declaration implied a new legal framework for the market and for the authorities of the state and of private firms.¹⁷

With the declaration of electricity supply as a public service, the Government began to consider the necessity of building an interconnected national network. To perform this task, the state encouraged, by the Royal Decree-Law of the 5th of April, 1929, the creation of a private body that would represent electricity suppliers. Thus the Association of Producers and Distributors of Electricity was created. This body represents the first step for coordination and collaboration between electricity companies and the national Government¹⁸.

2.2.2 Regulation after the Second World War

The definition of electricity supply as a public service entailed significant state intervention that would grow stronger during the first great crisis of the Spanish electricity market. Also climate, i.e. important droughts, impelled the national administration to take exceptional measures, such as the creation of the state electricity company (Endesa) at a time when electricity suppliers were highly concentrated. As a consequence, the electricity company Unidad Eléctrica S.A. (UNESA) was created. The company's shareholders came from the seventeen leading electricity companies in the country, representing the 80 percent of national production¹⁹. At that time, the measures that were adopted were the result of cooperation between private business and the state.

The energy crisis of 1973 also played a key role in electricity market regulation. More specifically, the need to make major changes in electricity market regulation was taken into consideration, in order to attain two main objectives: first, to achieve energy independence and the diversification of technology; and second, to encourage energy saving and implement a new pricing system that would include production costs²⁰.

In 1983 the socialist Government negotiated with the leading electricity companies in the country a new regulatory system for the energy market. This would set the basis for the Act 49/1984, published on the 26th of December. Such measure meant a radical change regarding state intervention on electricity market, since it defined the transmission network and the central electricity dispatch as public services. In the eyes of many people, this measure meant covert nationalization. The significant intervention of the state in the electricity market through the declaration of the transmission network as a public service gave way to the creation of the state-run company Red Eléctrica de España, S.A. (REE, Spanish Electricity Network)²¹, a company constituted under commercial law that managed the public service of unified operation through transmission networks. State control over REE became indirect when the state company Endesa became the major shareholder of REE.

One of the consequences of nationalization of the transmission network was the division of activities within the companies that were vertically organized. These could undertake transmission activities only outside the mainland network. The creation of REE was one of the first examples in the world of the separation of transport and management activities and those of

¹⁷ See SALAS HERNÁNDEZ, Javier, "Régimen Jurídico-Administrativo...", p. 62.

¹⁸ See SALAS HERNÁNDEZ, J.A., p. 44.

¹⁹ See SALAS HERNÁNDEZ, J.A., p. 49 a 53.

²⁰ See CRUZ FERRER, J. DE LA, "La liberalización de los servicios públicos...", p. 27.

²¹ Royal Decree 91/1985, published on the 23rd of January.

generation and distribution²². Such diversification would embody one of the main goals of liberalization in the energy market during the decade of the 90's in Europe.

Negotiations between the state and the companies continued in order to establish a price policy that would ensure economic viability for firms and investment productiveness. The agreement was reflected in the Royal Decree 1538/1987, published on the 11th of December, entitled Marco Legal Estable, (MLE, Stable Legal Framework). The result was overcoming the economic crisis that electricity companies suffered after the investment process that took place during the 80's. Nonetheless, some authors consider that this was achieved at the expense of free enterprise and all possible price competition²³.

In this period, Endesa began to absorb several companies, in order to create a group that would represent public interests more than private interests in the event of a potential change in regulation²⁴. This created an oligopoly structure in the Spanish electricity market that remains today. Further, the privatisation process of Endesa began in 1988 and was completed in 2000. The Spanish state got almost 6 thousands millions Euro revenue with the privatisation of Endesa.

In 1994 the Act of Regulation of the Spanish National Electricity System was adopted. It was conceived as a transitory regulation because foreseen both a liberalized market and a strong intervention of the Government in the sector. The main goal of this act was to improve the regulation system, making it more transparent and developing mechanisms to encourage free competition, on the basis of the internal electricity market sketched within the European Union²⁵. However, the necessary measures to attain these goals were never adopted by the Government, and the regulated model was kept, characterized by a strong intervention, although such intervention is made in agreement with the regulated companies²⁶.

2.2.3 Regulation changes: towards liberalized market

The failure of implementing the regulated competition model established in the Act adopted in 1994, along with the development of the internal electricity market made it necessary to make radical changes in the traditional regulation model. The deregulation environment in the European Union affected every market of general interest and developed into a system that made nationalized services incoherent, promoting free competition. Nonetheless, taking into

²² In LASHERAS, M.A., “La regulación económica de los servicios públicos”, Ariel, Barcelona, 1999, p. 289 footnote no. 53, this division may be a late response to nationalization policies in electricity systems during the post-war period in Europe, as a way of efficiently solving coordination problems within a national network, and not an anticipation to the re-scheming processes that took place during the decade of the 90's. In any case, it was also useful in this aspect.

²³ See ARIÑO ORTIZ, Gaspar, “Principios de Derecho Público Económico. Modelo de Estado, gestión pública, regulación económica”, Comares, Granada, 1999, p. 611.

²⁴ See FABRA UTRAY, Jorge, “¿Liberalización o Regulación? Un mercado para la electricidad”, Marcial Pons, Madrid, 2004, p. 90.

²⁵ See HERNÁNDEZ, J.C., p.70 and 71.

²⁶ See ARIÑO ORTIZ, G., “Privatizaciones y liberalizaciones en España: Balance y resultados (1996-2003)”, Comares, Granada, 2004, p. 161 and 162. See also CRUZ FERRER, who states that the integration of the energy market that the Act intended to achieve caused the creation of a wholesale commercial monopoly governed by the state, who became the only authorized party to commercialize electricity, through REDESA and the National Electricity System Commission (CSNE) which was created by this Act and is the predecessor of the independent regulatory authority Comisión Nacional de la Energía. See “La liberalización de los servicios públicos...”, p. 316.

account the characteristics and technical and physical complexity of this market, the liberalization process and the opening of competition are possible only to a certain extent.

Radical changes in traditional regulation models were implemented after the publication of Act 54/1997. This act was drafted on the basis of two documents: first, the “Protocol for the establishment of a new regulation for the Spanish National Electricity System”, signed by the state and the leading Spanish electricity companies; second, Directive 96/92, on common rules for the internal electricity market. The Protocol’s contents prove the fact that negotiation between the state and the companies reflected the liberalizing spirit and European common policy, although electricity companies are the ones that prompt market competition. Act 54/1997 confirms the difficulties implied in the creation of a new regulatory framework in such a strategic market without agreement between Government and companies ²⁷.

3 A model for regulated competition

Act 54/1997 embodies the current regulatory framework for the Spanish electricity market and shows a clear change of the Spanish regulatory model for the market, which evolves from the traditional public service into a regulated competition system. Thus, it is a more advanced competition model than the one described in Directive 96/94, attained thanks to a legal framework agreed upon by the economical agents involved ²⁸.

The preamble of Act 54/1997 clearly presents the objectives. Thus, although it aims to achieve the traditional goal of guaranteeing quality electricity supply at the lowest possible cost and protecting the environment, the Electricity Act does not consider it necessary to use intervention schemes, based on public centralized planning and operation. Moreover, in order to reach the aforementioned goal, the Electricity Act states that there is no need for the state to reserve the right to perform any of the activities involved in the electricity market. Free enterprise and new mechanisms make it possible to “re-create” the electricity market in those aspects where such renewal is possible.

Thus the model of agreed and compulsory planning is discarded and replaced by a new model in which companies are the only ones to manage and assign investment risks. That is why company autonomy is preserved and excessive interventionism is avoided, trusting the market’s efficiency in resource assignment.

The regulation framework does not show intentions to intervene in the market but, on the contrary, to complete it. For this, it creates market introducing qualitative and quantitative measures. Notable amongst these measures is the opening of the commodity to completing suppliers, with a calendar that gives the status of qualified consumers to those with an annual consumption of more than 15 GWh, at the time when Act 54/1997 came into force. Later on, such

²⁷ In this sense, MUÑOZ MACHADO, S. states that the Protocol is a current manifestation by which economic parties involved in regulated markets clearly intervene in the drafting of applicable regulation, thus excluding state control over traditional public services. These services were arranged on the basis of a specific regulation created unilaterally by the state. See “Servicio público y mercado. El sistema eléctrico”, Cívitas, 1998, p. 124.

²⁸ This is one example of what German doctrine calls *cooperative state* or *cooperative* action, in which hierarchical law ceases to be the keystone in favour of an agreed law, which includes an informative action beforehand aiming to create an agreement on regulation. See HERNÁNDEZ, J.C., “Regulación y competencia en el sector eléctrico. Evolución, regulación actual y perspectivas de futuro”, Thomson Aranzadi, 2005, p. 76. This author echoes the work by SCHMIDT-ASSAMANN, E., “La teoría general del Derecho Administrativo como sistema”, BARNÉS VÁZQUEZ, J., et al, (Spanish translation) Co-edition Inap-Marcial Pons, 2003, p. 38.

consumption was reduced to 9 GWh after the 1st of January, 2000, to 5 GWh after the 1st of January, 2002 and to 1 GWh after the 1st of January, 2004. After the year 2007 every consumer would be considered a qualified consumer. This calendar was modified twice, the last time by Royal Decree-Act 6/2000, which established that from the 1st of January of 2003 every consumer would be considered as a qualified consumer, completely freeing the supply to households in retail market.

Amongst the qualitative measures implemented to broaden the market, it has to be highlighted, firstly, the diversification between the different activities involved in electricity supply, in order to liberalize those that due to their technical and economic characteristic could be performed under competition rules, namely generation and sale to consumers; other services such as facilities operation and non-singularized services that are regulated (building and maintenance of networks, transport and distribution); and, finally, activities common to the entire system which cannot be duplicated and are also regulated (technical and economic operation of the system).

The aforementioned division of activities implies a new company structure within Spanish electricity market since Act 54/1997 imposes three different formal distinctions:

- Legal separation of regulated and competitive activities, though such activities may be performed by the same group of companies, provided that they are performed by different companies within the group.
- Shareholding separation regarding the bodies that are involved in the market and in the system, forbidding companies' direct or indirect stake in other companies' share capital and limiting companies' and state's direct or indirect stake.
- Separate accounting procedures for different activities within the market.

Company structure within Spanish electricity market is determined by the aforementioned formal divisions and by the principle of free enterprise. Thus, the operator of every activity, even of regulated activities, is a private company.

Company structure within Spanish electricity market is also determined by the different stages in the electricity market. Regarding this matter, private companies' performance in accordance with the principle of free competition is possible during some stages, whereas during others, the natural monopoly of the activity cannot be changed or remains without changes due to the lack of viability of opening it to competition.

Consequently, energy generation (liberalized activity) corresponds mainly to four companies that represent a 65% of Spanish energy production. These companies are: Endesa, Iberdrola, Unión Fenosa, and Hidroeléctrica del Cantábrico. In accordance with Act 54/1997, building, use, substantial modification and closure of each generation facility are subjected to a regime of administrative authorization. Moreover, such authorization has a regulated character, thus reducing the state's discretionary power in determining which companies can enter and compete in electricity generation. As a consequence, the new regulatory framework chose authorization over bidding as the appropriate mechanism for the opening of competition in electricity generation.

Electricity retailing also follows a free competition scheme. The leading companies are vertically organized within generation companies. The four leading generation companies (Iberdrola, Endesa, Unión Fenosa and Gas Natural Electricidad) represent more than 80% of electricity retailing. Despite the retailing competition opening and the new calendar to cover all consumers—including households in the group of qualified consumers—very few changes have been introduced in the suppliers, due to the existing duopoly in Spain—in this duopoly

system, two operators, namely Iberdrola and Endesa, control more than an 60 % of the market—and due to the fact that consumers are highly satisfied with the service provided by suppliers²⁹.

Transport of electricity through transmission networks is a regulated activity, although this activity is not performed by the state but by a private company: REE. Since it is a limited company, any natural or legal person has the right to purchase shares. Nonetheless, the independent regulatory authority Comisión Nacional de la Energía (CNE) has tried to minimize purchases by electricity companies, limiting that purchase to a range of 1% to 3%. The state had 25 % of its capital; this figure would later be reduced to 19 %; it continued selling shares and now controls 10 %. REE has the obligation of guaranteeing the electricity system's continuity and security. It also coordinates energy generation and energy transport, so that electrical current satisfies technical requirements and the principle of free competition. The REE also has the right to authorize TPA and such access cannot be denied unless the applicant is unable to meet the standards to satisfy security, regularity or quality of supplies. In short, REE is actually a private company in charge of performing public tasks³⁰.

Transport through distribution networks is not a liberalized activity and the company structure involved in it is constituted by the existing natural monopolies in each region of Spain. Basically, Endesa, Iberdrola, Unión FENOSA and Hidrocarbónico are the four main companies involved in electricity distribution, since they represent almost an 80% of that distribution. Distribution companies in Spain also retail electricity to consumers, however, they purchase electricity at market prices from the pool, and sell to consumer at the price settled by the tariff, which is approved by the Government.

In this brief description of company structure within the Spanish electricity market, we should include the market operator: OMEL S.A. This firm is a private capital company granted by Royal Decree 2.019/1997 with the functions of operator of the electricity market. More specifically, OMEL must match the generation of energy and the demand of consumers who buy from the pool of generation for each period and time of the day. Since supply and demand have to be matched by OMEL, this company sets the final price of electricity and settles payments to companies. Consequently, even though this is a regulated activity, the market operator must follow exclusively competition rules. Thus, if OMEL discovers that any undertaking behaves in a way that ignores such rules, it has the obligation of informing the CNE so that the latter may make the necessary inquiries. Although the price of energy which is purchased in the pool is a market price, consumers have the possibility of buying energy either from the retailer or from the distribution company at market prices and at the price settled by the Government in the regulated tariff. This is annually approved and revised.

The regulation framework for Spanish electricity market meets the minimum requirements established by the interior market of electricity energy in terms of separating activities; regulated administrative authorization to perform generation activities; TPA to the network, only limited for technical reasons; and formal legal division of the transport-system operators and market operators with respect to energy-supply companies, and public service obligations.

²⁹ See HERNÁNDEZ, J.C., “Regulación y competencia en el sector eléctrico. Evolución, regulación actual y perspectivas de futuro”, p. 191.

³⁰ This is just one more example of a control different from that performed by the state. This makes it necessary to take into consideration many questions about public responsibilities involved in the tasks performed by REE, or about challenge mechanisms over its performance. In other words, if the state has the duty to guarantee supply, and such duty is delegated to the REE, we may wonder whether the state has the obligation to assume that duty of supervision, in terms of liability, in the event that the REE does not perform its obligation.

In this sense, the most significant aspect is that Act 54/1997 excludes one of the most characteristic elements: the qualification of energy supply as a public service. This exclusion affects only the subjective concept of public service, by which the state renounces its managerial rights, whether direct or indirect, over any activity of generation, transport, distribution, or retailing, and gives up its majority representation in companies constituted under commercial law, such as Endesa or REE. State management over private activities is no longer valid, although the qualification of these activities as “essential activities” is accepted. Such a title justifies public intervention (not in managerial aspects) in those activities that provide goods or services to citizens and that should be accessible to every citizen, given its vital or basic characteristics for exercising fundamental rights and the consequent development of a dignified standard of living, in accordance with space-time development activities or social progress”³¹.

The qualification of electricity services as essential services, as opposed to the qualification of services of general interest that appeared in Act 54/1997, was suggested by the advisory body Consejo de Estado. Such a suggestion was probably motivated by the fact that the Spanish Constitution itself refers to essential services, whereas the qualification of “services of general interest” does not appear in Spanish law. Nonetheless, there is a close resemblance between these two categories when examining their objective and operational features: both derive from the imposition of obligations on the entities involved in public service or universal service.

The first consequence of the declaration of electricity supply activities as an essential service is to guarantee supply to every consumer within the national territory (Article 2.2 Act 54/1997). Thus electricity supply is a universal service, which requires certain obligations to be imposed on every company involved in electricity distribution and retailing (Article 45.1). Such companies must fulfil their task in complying with the principle of equality. Regarding generators (Article 26.2), they must produce electricity within the terms set forth by administrative authorization. Obligations for operation (Article 34) and transport (Article 37.1) are also well defined. In the event of real risk concerning supply, state intervention is also allowed.

Service continuity and quality are also obligations of a public service. Such obligations are imposed on every operator involved in the market (generation, system operation, transport, and retailing). Regarding supply security, Article 25.1 allows Government’s intervention through an array of procedures that are compatible with the free-market competition in generation so as to ensure the operation of the units generating electrical power using domestically produced primary energy fuel up to a limit of 15% of the total primary energy needed to generate the electricity required by the domestic market.

Finally, environmental protection justifies the obligation of incorporating into the system any surplus energy produced in special regimes (non-consumable renewable energies) or by self-generators. However, the obligation to inform the consumer whether or not the energy she is consuming is renewable has not been yet transposed into Spanish Law.

³¹ See MARTÍNEZ LÓPEZ-MUNIZ, J.L., *En torno a la nueva regulación de los servicios esenciales económicos en red (A propósito de la nueva Ley General de Telecomunicaciones y su sistema conceptual)*, included in “Derecho Administrativo en el Umbral del Siglo XXI. Homenaje al Profesor Dr. D. Ramón Martín Mateo”, Volume III, Tirant Lo Blanch, Valencia 2000, p. 2799.

4 Incipient evaluation of Directive 2003/54 transposition

If we compare the contents of internal electricity market Directives and Spanish regulation in electricity issues, we find harmony between the organization model for European electricity interior market and the Spanish electricity market. Such harmony does not seem to be a consequence of transposing directives, but rather of adapting the Commission's regulatory activity to the existing situation in member states. In this sense, we underline that the existing situation in Spain is not determined solely by the state but also by the electricity market. In fact, in Spain, decisions regarding the electricity market were traditionally made by agreement between the state and the regulated companies, i.e. electricity companies grouped in the association UNESA³². Such collaboration contrasts with the influence of the Florence Forum on the presentation of proposals for the Commission: in Regulation 1228/2003, regarding conditions governing access to the network in cross-border electricity exchange, the Commission seeks to prevent the implementation of the Florence Forum agreements, considering them an obstacle for the internal electricity market.

Even though it is still too soon to evaluate the implementation of Directive 2003/54 by member states, the Commission has already published a "Report on progress in creating the internal gas and electricity market" (Communication to the Council and the European Parliament, SEC (2005) 1448), where it encourages member states to pursue the directive's spirit and not simply follow its text³³. The Commission considers that, generally, member states have adopted a minimalist approach to implementing the directive. Nonetheless, some states have gone further than the directive. For example, Denmark, Finland, Italy, Holland, Spain, Sweden, the United Kingdom, Norway, Lithuania, the Czech Republic, Hungary, and Slovenia have adopted the division of transmission-network ownership, and some states have opted for the creation of a wholesale market in the region, such as Nordpool. However, in Spain, further works have to be done in relation to the legal and function separation between distribution networks and retailing activities, since companies in charge of the distribution also sell electricity to final consumers. In its report, the Commission insists on the need to integrate electricity markets. To attain this, it is necessary to improve interconnection capacity, encourage price convergence, and exclude discriminatory practices such as the one reported by the European Court of Justice in its case C-17/03 (*Vereniging voor Energie, Milieu en Water e.a.*)³⁴.

However, if cross-border competition is scarce, domestic competition also is, due to industry concentration, to the vertical organization of production and supply activities, and cross-border mergers of energy companies. This is the case in Spain, where the Government's policy is to create leading national companies that may be able to compete with front-running European companies, with the subsequent loss of domestic competition. In this sense, Spanish Government has removed the obstacles presented by the Spanish electricity market regulator CNE and by the competition regulatory authority (CNMV) regarding the merger of Gas Natu-

³² UNESA's collaboration includes a market operator, system operator and the independent authority on regulation.

³³ Asking Member States to go further than the Directive's letter can be understood only if we take into account that Directive 2003/54 includes the existing situation in member states and represents a challenge for only some of them.

³⁴ Regarding this matter, the ECJ considered that a system that gives priority to existing contracts over other requests for interconnection capacity is not compatible with the principle of non-discrimination. For this reason, national regulators and transmission-system operators should re-examine the practice of capacity reservation for electricity.

ral (the gas company that holds a monopoly on gas distribution in Spain) and Endesa (one of the companies that holds the electricity duopoly in Spain) in September 2005, since the result would be a “leading national company” that would limit competition both in electricity-energy and in gas-energy markets. This intense intervention in a (supposedly) free market clearly contradicts the position defended by the Commission’s president, the competitiveness Commissary, and the internal market Commissary, who have stated their preference for “leading European companies”, provided that the performance of these companies complies with the rules of competition.

This clash of positions clearly manifested itself when a German company, E-on, made a better offer than the one made by Gas Natural to purchase Endesa (February 2006). The result of the merger between the Spanish company and the German company would be the first European energy group (and the fifth in the world) and it would improve competition within the internal energy market and cross-border exchanges. The regulatory obstacles set by the Spanish Government to prevent the German company from entering Spanish energy market are against EU law, as the Commission has already stated³⁵. Such behaviour also seems to overlook that within a free market, intervention is not supposed to be aimed at protecting a national market over a foreign market, but rather is meant to encourage the market’s correct performance. In short, the spirit of Directive 2003/54 is not easily executed when member states refuse to relinquish their control over strategic markets, such as the electricity market.

There is at least one objective that, according to the Commission is being achieved in every member state: the obligations of public service. Customer satisfaction is, in general terms, quite good and claims that opening to competition would end the universal feature of the service have been proved wrong. Derogation of internal electricity market rules and competition based on the guarantee of electricity supply present more problems. Thus, member states such as Spain are using this intervention title with protectionist aims, far from the “European leading companies” policy that the European Commission defended, and which motivated the European Union Council on the 23rd and 24th of March in 2006. In this sense, the presidency’s conclusions on European energy policy stated the goal of improving supply security through: dialogue between the EU and its member states; diversification of energy sources; and a common position in the event of an energy crisis. To achieve this goal, the Commission’s role is reinforced. It must, among other things, develop an Interconnection Plan, promote building facilities that may contribute to supply diversification, and integrate regional markets within the EU internal market, while respecting the crucial role of companies involved in electricity-supply activities. The process of strengthening the Commission’s position and bolstering the role of the internal electricity market underscores the need of a European Energy Policy and not simply of an energy policy for Europe.

³⁵ The Commissary for Interior Market, Charlie McCreewy, would direct two proceedings against Spain due to its obstructionist attitude against the entrance of a German company (E-on) in the national energy market; also the Competitiveness Commissary, Neelie Kroes, approved the takeover bid from the German company, so that Spain will not be able to create new obstacles to block that merger.