

# Liberalising Energy in Europe: Public Service Obligations in the Energy Sector

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*Abstract:* The article deals with the issue of opening up the energy market in the European Union with the focus on public services, which need to be ensured in order for certain public interest objectives to be met. We presented public services and corresponding legislation from an EU perspective, with the emphasis on the energy sector. Public services are at the core of political debate in a market economy where public authorities need to ensure the smooth functioning of the market and, at the same time, safeguard the citizens' essential needs where the market fails.

*Key words:* energy market, liberalisation, energy policy, European Union, public services

## 1 Introduction

The dynamic process of liberalisation of the EU energy market started at the beginning of the 1990s. Liberalisation can be understood as the process of opening up the national markets to competition and improving security of supply and national competitiveness. Launching a single European energy market by integrating national markets is expected to lower the energy prices and generate several advantages, such as increased security of supply, the latter being a great concern of all the EU countries, because the European economy is steadily demanding more and more energy. Secure and affordable supplies can no longer be taken for granted, as the global energy demand is increasing and the oil and gas reserves are declining. An integrated and competitive internal energy market will deliver secure supply, via a larger and more flexible market, and competition-inspired efficiency gains, innovation and development. To deliver the common objectives of the EU – secure, sustainable and competitive energy – an approach based solely on 27 individual energy policies is not sufficient. After all, experiences from gas and electricity liberalisation, wherever it has taken place around the world, have always been positive, and are expected to be such in the EU as well [1].

Integrating 27 national energy markets into one single market and opening up the national markets to competition consequently empowers the consumers through being able to freely choose their suppliers as soon as non-discriminatory access to

the gas and electricity networks throughout Europe are provided. The markets opened up to non-domestic consumers in July 2004 and will open up to all consumers in July 2007. Customer choice is key to competition. But will the new operators, the drivers of competition, be able to enter the market and serve the very many new eligible customers? All in all, liberalisation should serve the general interests of society and, most importantly, must be achieved without endangering the provision of public services, because in the end, liberalisation and public policy should pursue the same goal – to serve and benefit EU citizens [2]. Therefore, the focus of this article is on public service obligations (“PSOs”), being understood as obligations imposed on the provision of services of general economic interest (“SGEI”), which play an increasing role as an essential element of European model of society, placing them among shared values of the Union. Despite the introduction of competition in the internal energy market, the achievement of PSOs cannot be left to the operation of the market.

The role of SGEI is essential for increasing quality of life of all citizens, providing the citizens universal service, continuity, quality, affordability and user and consumer protection. Because the EU is not a federal State, the obligation to define and provide SGEI is on the Member States themselves; SGEI touch on the central question of the role public authorities play in a market economy, in ensuring, on the one hand, the smooth functioning of the market and compliance with the rules of the

game by all actors and, on the other hand, safeguarding the general interest, in particular the satisfaction of citizens' essential needs and preservation of public goods where the market fails [3].

## 2 A European Strategy for Sustainable, Competitive and Secure Energy [4] – Developing a European Energy Policy

In March 2006 the European Commission adopted a Green Paper which has set out a new EU energy policy, and outlined possible actions that should be taken at an EU as well as a Member State level, because of the fact that the whole world, including Europe is entering into a new energy era: increasing global energy demand, Europe's import dependency is rising, reserves are concentrated in a few countries, oil and gas prices are rising, and the climate is getting warmer. Furthermore, Europe has not yet developed fully competitive energy markets. Only with an integrated internal energy market will consumers enjoy the benefits of security of supply and lower prices. Despite the fact that the EU energy *acquis* does not foresee any formal national energy policy, strategy or programme, energy policy is, in most Member States, reflected in their national legislation, followed by their energy industries and authorities.

EU energy policy pursues three objectives: the creation of a competitive, integrated internal market, maintaining an adequate level of security of supply and increasing the effectiveness of environmental protection. Developing a European energy policy is a long-term challenge, and action needs to be taken in six priority areas:

- completing the internal gas and electricity markets;
- guaranteeing security of supply;
- achieving a more sustainable, efficient and diverse energy mix;
- tackling the problem of climate change;
- accelerating the development of innovating energy technologies; and
- ensuring a coherent external energy policy.

One of the important areas which the Commission has stressed in the strategy is the completion of an internal energy market, where five core areas need particular attention:

- establishing a European grid;
- improving the interconnection capacities;

- investment in electricity generation capacities;
- ensuring that the provisions on unbundling are fully implemented; and
- boosting the competitiveness of European industry.

The importance of the Green Paper issued is in the proposals the Commission as the representative body of the EU has made, in order to warn the EU that action needs to be taken and a political and legislative framework provided for future development of EU energy policy at Union as well as Member State level.

## 3 Services of General Economic Interest and Public Service Obligations

Public services were traditionally seen in Europe as fundamental part of the States' national sovereignty. During the last decade, this has completely changed within the EU. Since the Treaty of Amsterdam (amending the Treaty on EU, the Treaties establishing the European Communities and certain related acts), there has been a fuller recognition of the independent value of public services as exemplifying a Community commitment to citizenship, partly as a result of their partial constitutionalisation in Article 16 of the Treaty [5].

*Services of general economic interest:* the term refers to services of an economic nature which the Member States or the Community subject to specific public service obligations by virtue of a general interest criterion. The concept of SGEI thus covers in particular certain services provided by the big network industries such as transport, postal services, energy and communications [6].

*Public service obligations:* refer to specific requirements that are imposed by public authorities on the provider of the service in order to ensure that certain public interest objectives are met, for instance, in the matter of air, rail and road transport and energy. These obligations can be applied at Community, national or regional level [6]. PSOs are diverse and they can be:

- "Obligations imposed upon the Member States, such as the obligation to guarantee universal service in electricity, to protect consumers in various ways, to publish PSOs and to ensure that eligible customers can easily switch supplier; to protect final customers, especially vulnerable customers.

- Objectives to be pursued by the Member States: environmental protection, security of supply, protection of final customers and social and economic cohesion.
- Options available to Member States: establishment of a supplier of last resort, the protection of remote customers, and the extension of universal service to small enterprises.” [7]

There is no general legal framework for SGEI at Community level, because the legislation has up to now been adopted on a sectoral basis. The fear is that liberalising sectors in the Community and introducing the competition can undermine the protection of public service values – how can it then be achieved that competitive markets are developed and at the same time public service obligations are fulfilled? And is there a definition of the content of SGEI?

Existing Community legislation on SGEI contains a number of common elements:

- universal service;
- continuity;
- quality of service;
- affordability; and
- user and consumer protection. [3]

EU sets minimum standards and has common provisions regarding public services, while respecting the diversity of traditions of the Member States. The degree of discretion left to the Member States varies accordingly with the importance of the public service that needs to be provided. In the light of liberalisation process of the energy market, through removing unnecessary restrictions on competition, public services cannot be ignored, and account has to be taken for public services to be seen as valuable expressions of citizenship rights, as through the introduction of a competitive market they are not necessarily provided.

“Undertakings entrusted with the operation of SGEI or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of Community.” [8] The concept of SGEI within the meaning of Article 86 of the Treaty means that the undertakings in question have been entrusted with a special task by the State. However, many SGEI cannot be viably provided on the basis of market mechanisms alone; therefore it is for the Member

States to ensure the financing of the SGEI. For instance, the market itself may not offer universal access or full geographical coverage. Currently, it is for the Member States to ensure the financing of the SGEI and to calculate the extra cost of the provision of such services; thus, financing is a way of intervening in the market operation, and leaves a wide margin of discretion regarding the nature of the services that could be classified as SGEI within Article 86 of the EC Treaty. Therefore, it is the Commission’s task to ensure that the provisions regarding the definition of SGEI are applied without manifest error [9].

#### 4 Public Service Obligations in the Energy Sector

In the energy sector local authorities are best placed to define the general public’s needs as they understand the cultural traditions and geographical conditions in the State and consumers’ choice of preferences, which significantly influence the organisation of SGEI. All Member States have discretionary powers in defining SGEI within the framework of Community rules; however, where conditions governing the imposition of PSOs are laid down in a Community instrument, the Member States may not derogate from them [10].

The public service plays an important role in a liberalised market. Member States define PSOs in the general economic interest, within the electricity sector, under five categories:

- environmental considerations;
- security;
- regularity;
- quality of supply constraints; and
- pricing policy considerations.

Member States can take the measures necessary to achieve them. And those measures should not restrict trade more than necessary.

In the Community secondary legislation, the Electricity [11] and Gas Directives [12] strengthen the provisions regarding PSOs and consumer protection in the energy sector:

“Having full regard to the relevant provisions of the Treaty, in particular Art. 86 thereof, Member States may impose on undertakings operating in the gas (electricity) sector, in the general economic interest, public service obligations which may relate to security, including security of supply, regularity, quality and price of supplies, and environmental protection, including energy efficiency and climate protection. Such obligations

shall be clearly defined, transparent, non-discriminatory, verifiable and shall guarantee equality of access for EU gas (electricity) companies to national consumers. In relation to security of supply, energy efficiency/demand-side management and for the fulfilment of environmental goals, as referred to in this paragraph, Member States may introduce the implementation of long-term planning, taking into account the possibility of third parties seeking access to the system.” (Article 3) To sum up, the Directives define more clearly the security of supply, the universal service requirement in the electricity sector, and emphasize the importance of environmental protection. The implementation of the Directives has aimed at reducing the obstacles to creating the single market by harmonisation of national standards. In this respect, the measures taken by Member States should be such as to avoid PSOs distorting the competition and slowing down the genuine opening-up of the market (from 1 July 2004, at the latest, all non-household customers; from 1 July 2007, all customers).

Community and Member States’ primary and secondary legislation contain the basic rules applicable to markets of services of general interest. However, in order to ensure that the objectives of regulation are achieved it would be insufficient to rely exclusively on the application and usual mechanism of the enforcement of legislation [13]. For this reason, the Community legislation obliged the Member States for the designation of National Regulatory Authorities (“NRAs”) to be responsible for carrying out the regulatory tasks. The basic task of the NRA is to contribute to the development of the internal market and a level playing field by cooperating with other NRAs and with the Commission in a transparent manner. At least, the regulatory authorities should be responsible for ensuring non-discrimination, effective competition and the efficient functioning of the market.

## 5 Conclusion

Through the introduction of free movement of goods and services in the energy field, the EU has decisively influenced the energy markets worldwide. The process of economic integration in a globalised environment has also strongly influenced and irreversibly encompassed the energy supply chain and its sector – the energy market. Secure supplies at stable affordable prices and reliability as well as availability of energy, gains

public interest and political impetus. Developments over the past years were characterised by continuously growing demand for energy, and unpredictable consequences of market liberalisation, competition and their impact on security of supply. Overall, liberalisation of the electricity and gas market is a very important tool which contributes to the development of the European economy and towards its goals of improving efficiency and competitiveness in an ever-increasing global market place.

Furthermore, the EU is developing its policy in the field of energy, combining action at the European and the Member States’ level, to put in place an integrated energy policy. The European Council has, as a milestone in the creation of an Energy Policy for Europe, adopted a comprehensive energy Action Plan for the period 2007-2009. It comprises the most important areas, internal market for gas and electricity, security of supply, international energy policy, energy efficiency and renewable energies and energy technology.

The focus of this article is on public service obligations in the energy sector, and the understanding of their importance in the process of creating a Single Market in the EU is conditional upon understanding the process of liberalising energy market in Europe. Services of general economic interest are an essential component of the European model, and assuring those services are of high quality, accessible and affordable, is an important element contributing to reach the strategic goal of the Union:

“to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.”[14]

The principle of subsidiarity - “In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effect of the proposed action, be better achieved by the Community.”[15] - will most likely remain of central importance when defining SGEI as the EU respects the diversity of different Member States and the roles of national, regional and local authorities in ensuring the well-being of their citizens and in guaranteeing the democratic choices regarding, among other things, the level of service quality. Consequently, the EU definition of public

services is likely to become whatever Member States decide should be a public service.

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