



E-CONTROL

**Report to the European Commission pursuant to Directives
2003/54/EC and 2003/55/EC**

Summary

Editorial deadline: 18 July 2005]

Summary / major developments in 2004

Composition of the regulatory agencies

There are **two** regulatory authorities for electricity and gas in Austria.

E-Control GmbH is an independent company, though it is wholly owned by the federal government. The Minister of Economics and Labour is responsible for supervising the activities of Energie-Control GmbH and administering the government's shareholding in the company. Walter Boltz is the chief executive of E-Control GmbH which has a staff of about 60.

The **E-Control Commission** is a "collegiate body with a judicial element" in the meaning of Art. 20 (2) Austrian Federal Constitution. Its members are not bound by any directions in the exercise of their office. The Commission consists of three members, one of whom must be a judge while the others must possess relevant technical, legal and business expertise, respectively. The judge chairs the Commission's proceedings.

Statutory objectives and interaction of E-Control GmbH and the E-Control Commission

The core duties of **E-Control GmbH** include:

- Supervising competition;
- Monitoring unbundling;
- Developing market rules;
- Arbitrating between consumers and market participants;
- Collecting statistical data;
- Preparing the Commission's decisions.

The principal duties of the **E-Control Commission** are:

- Approving the general terms and conditions of system operators for access to electricity and gas transmission and distribution networks;
- Determining the system charges and other electricity and gas tariffs;
- Forbidding the use of contractual terms and conditions for final consumers that constitute breaches of legal prohibitions or good practice;
- Arbitrating in disputes between market participants in the electricity sector;
- Arbitrating in disputes relating to the settlement of balancing charges;
- Hearing appeals against decisions by Energie-Control GmbH.

Enforcement powers

In performance of their regulatory duties E-Control GmbH and the E-Control Commission are empowered to issue:

- Regulatory decisions;
- Orders; and
- Approval notices.

Decisions and orders take immediate effect. Appeals to the Administrative Court of Appeal and the Constitutional Court are permitted, and may be granted suspensive effect.

Independence of the regulatory agencies

E-Control GmbH is to a large extent independent. Reasons must be given for any ministerial directives, and they must be made in writing and be published. No directions have been issued since E-Control GmbH came into being. E-Control GmbH must report to Parliament on an annual basis, and is subject to supervision by the Austrian Court of Audit and the Austrian Ombudsman Board.

The E-Control Commission is not bound by directions and thus enjoys full independence.

New legal framework

2003 brought far-reaching changes in Community electricity and gas law, with the passage of Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity, and of Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas, repealing the Electricity (96/92/EC) and Gas (98/30/EC) Directives, respectively.

The new legal framework became directly applicable in all member states when Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity entered into effect on 1 July 2004.

Austria implemented the mandatory unbundling provisions of the new Electricity Directive by amending the EIWOG (Electricity Industry and Organisation Act). The amended Act, Federal Law Gazette I No. 63/2004, entered into effect on 22 June 2004. Unbundling was also a key issue for the Austrian gas industry in 2004, as the relevant statutory provisions came into force on 1 October 2003 (the so-called "gas year" starts on 1 October of each year) and 1 January 2004. In autumn 2004 E-Control GmbH posted a compliance report on its website. This deals with legal, organisational and accounting unbundling in the gas sector, and includes sample compliance programmes for use by integrated and unbundled companies.

System charges

A verdict of the Austrian Constitutional Court on the System Charges Order 2003 clarified the position for system operators and the E-Control Commission. The System Charges Order 2003 determining the tariffs for network access was the subject of a number of cases brought before the Constitutional Court in 2004. The court upheld the E-Control Commission's practice of setting the tariffs by order.

Following several years' discussions, in mid-2005 the regulator and the industry reached an agreement under which a multiyear, incentive based regulatory regime for **electricity system charges**, derived from a benchmarking analysis, is to be introduced on 1 January 2006.

Prevention of market abuse

E-Control GmbH's market monitoring and supervision duties also include the prevention of discriminatory treatment of market participants by monopolists (system operators). If E-Control identifies abusive behaviour it must take all the steps necessary to achieve non-discriminatory behaviour without delay.

In 2004 E-Control about 30 abuse proceedings were heard. Most were brought by consumers or their suppliers. These cases concerned a wide range of issues including assignment to grid levels, system access provision and admission charges, use of system charges (for interval and non-interval metered consumers), application of the market rules and improper billing of administrative fees.

General investigation of the Austrian electricity and gas sectors under section 2 Competition Act

In Austria as elsewhere, the electricity price increases for the mass market and large consumers announced by some suppliers and in part implemented in the autumn of 2004, and the possibility of further price rises led to a debate on competition in the electricity market.

In September the Minister of Economics and Labour suggested to the Federal Competition Authority that it undertake a general investigation of the electricity sector under section 2 Competition Act in cooperation with Energie-Control GmbH. The Federal Competition Authority and E-Control GmbH accepted this proposal and launched a joint investigation, also involving the Federal Cartel Prosecutor. As of the editorial deadline of this report the authorities concerned had published two interim reports on the electricity sector. These define the relevant geographical and product markets, and identify a number of companies with dominant positions in retail markets. The second interim report reaches the conclusion that dominant undertakings have special responsibilities with regard to transparency, and non-discriminatory and competition friendly behaviour, among other matters. The main finding of the investigation to date is that the narrow market boundaries in Austria reflect manifold barriers to entry, and that in the case of the retail market the underlying causes of these are often closely related to insufficient unbundling of system operators. The incumbents are in a position to exercise a direct influence on the handicaps faced by alternative suppliers. A similar investigation, into conditions in the gas sector, is currently under way.

In the interests of competition and providing Energie-Control GmbH with a full range of supervisory and petition rights, the regulator should be accorded the right — analogous to the petition rights under the Cartel Act — to apply for cease-and-desist orders prohibiting anticompetitive behaviour under the Unfair Competition Act 1984. These considerations should be reflected in future legislation.

Summary

The Austrian electricity market was fully opened on 1 October 2001, and the gas market one year later. Since then all electricity and gas consumers have been free to choose their suppliers, network access has been regulated, and the system charges have been fixed by order. There are few instances of difficulties in switching suppliers. All groups of consumers profited from a reduced system charges and energy prices in the immediate aftermath of liberalisation. However all the main new suppliers are subsidiaries of the former monopolists. Independents have so far failed to establish a lasting foothold on the Austrian market.

Instead, a number of mergers so strengthened the market positions of many incumbents that they were able to impose considerable price increases in 2004. The Federal Competition Authority responded by launching a probe into the competitive situation in cooperation with E-Control GmbH.

Austrian legislation anticipated most of the provisions of Directives 2003/54/EC and 2003/55/EC **long before they entered into effect**. It only remained for an amendment to the EIWOG, enacted in 2004, to add provisions governing legal and organisational **unbundling** in the electricity sector to the federal enabling act. However by the time of the completion of this report there was still no provincial implementing legislation on the statute book. Since the federal act is only aimed at provincial legislators, at present the electricity companies are under no legal obligation to comply with the unbundling provisions, though some have done so on a voluntary basis. Rapid and complete implementation is required if the competitive environment is to improve.

In the gas sector the unbundling requirements of Directive 2003/55/EC were implemented in October 2002, i.e. **before the directive came into force**. Five supraregional transmission companies and one distribution system operator were legally unbundled, while the other system operators were only obliged to undertake organisational unbundling. Accounting unbundling is mandatory for all transmission and distribution system operators. However an analysis of Austrian gas companies' unbundling practices based on their compliance programmes under Art. 9.2(d) and Art. 13.2(d) Directive 2003/55/EC reveals considerable room for improvement, particularly as regards organisational unbundling. In the case of the transit pipelines, which are not regulated in Austria at present, there is still considerable international cross-ownership of marketing and system operation activities which is probably incompatible with the unbundling rules established by the EU directive.

Concerns are also raised by cases in which suppliers with dominant positions in their home markets own substantial interests in the transit pipelines upstream from those markets (e.g. ENI, GdF and Ruhrgas). Here, there are good reasons for suspecting that there is a conflict between the interest of the dominant company in the downstream market in excluding competitors and its obligation to provide non-discriminatory access to the upstream transit pipelines that it co-owns.

Since liberalisation alternative suppliers have entered both the electricity and the gas market. However there has been further increase in concentration in the small consumer and business-to-business markets in the electricity and — to some extent — the gas sector as a result of the Energieallianz marketing joint venture. Likewise, the part-merger of five gas suppliers (including Energieallianz

shareholders) with the OMV Group's gas wholesale business significantly increased concentration in the business-to-business gas market. The Verbund/Energieallianz merger — which was cleared by the European Commission in June 2003 but had not yet been implemented as of July 2005 — would further strengthen the vertical integration of Energieallianz, and thus its dominance of the electricity market.

In 2004 there were four electricity suppliers independent of system operators serving the Austrian market from local or home country branches. At the time of completion of this report it was not yet possible to gauge the importance of Verbund's return to the electricity retail market at the start of July 2005. One new supplier has gone into the ring against the incumbents in the gas market.

A **standardised administrative procedure for supplier transfers** has been introduced under the Austrian market rules. Efforts have been made to minimise the administrative burden for consumers. The switching procedure is simple and there are **no charges** for final consumers. Large, interval metered electricity consumers are the group most likely to switch; the cumulative churn rate has been 25% since 2001. Separate analysis of the estimated cumulative switching rates for large electricity consumers with an annual demand of more and less than 5 GWh reveals no differences in 2004. "Other small consumers" (small businesses and farms) have recorded a cumulative switching rate of 6.4% and domestic consumers one of 2.8% since liberalisation.

The reasons for the relatively low switching rates in the small consumer segment have been found to be opaque price information on electricity bills (all-inclusive prices), unreasonable minimum agreement terms or agreement terms linked to differential pricing (sliding scale clauses), certain rebate systems (loyalty rebates), and bundling and tying (multi-utility rebates). The competitive situation in the electricity market is the subject of an ongoing sector investigation by the Austrian Federal Competition Authority and E-Control, launched in autumn 2004.

Full electricity market opening in 2001 led to marked retail price reductions, especially for large consumers. Overall, consumers' annual electricity costs fell by some €1 billion or 20%, due to lower energy prices as well as cuts in system charges.

However, despite a number of reductions in system charges, overall electricity prices have risen steadily since January 2003 as a result of the introduction of a single nationwide support payment system for green power, small hydro and combined heat and power (CHP) generating stations, an increase in the energy levy and several energy price increases by suppliers. The total prices paid by industrial consumers have in many cases returned to 1999 levels. The overall prices charged to domestic consumers are above pre-liberalisation levels in nominal terms, but below them in real terms. Medium-sized enterprises are still paying less than they did before market opening.

Suppliers' announcements of energy price increases to coincide with reductions in system charges ordered by the regulatory authority (sometimes completely cancelling them out) point to continued cross-subsidisation by the regulated system operation area of activities in which companies compete on the market. This suggests in turn that unbundling, i.e. autonomous decision-making by the system operation and marketing activities of integrated electricity companies, has not truly taken hold.

Viewing the Austrian **wholesale electricity market** in purely domestic terms, concentration in the generation segment is relatively high. Only five companies have shares of over 5% of total generating capacity, and the top three control 54% of all capacity. It should also be noted that capacity accounting for about one-quarter of overall production is already at least partly shielded from competition, since at least part of the revenue derived from it comes from support mechanisms (e.g. green power and CHP subsidies). However, there is no congestion at present on the interconnectors with Germany and Switzerland. This means that the Austrian control areas form a **common wholesale market** with Germany, and wholesale price formation thus takes place not in Austria alone but in this wider market.

Most electricity transactions are carried out on a bilateral (OTC) basis. Transparency could be improved by making details of prices, volumes and power station use available so as to give all market participants access to the same information.

The Austrian balancing power system is based on balancing groups. Steps are currently being taken to **merge the German and Austrian balancing power systems**, which would enable foreign generators to offer electricity on the Austrian market.

There is power network congestion at the borders of the Austrian control areas with the Czech Republic, Hungary, Italy and Slovenia. Allocation at the most congestion-prone borders is by means of explicit auctions. Efforts are being made to enhance coordination and efficiency by introducing implicit auctions. There is potential for increasing the amount of marketable capacity by achieving closer cooperation on determining available capacity, and scaling down or terminating legacy contracts.

The internal network situation — marked by massive north-south congestion on the ultra high voltage grid — necessitates labour and cost-intensive congestion management in order to maintain operational reliability. Since the n-1 security rule is regularly violated Verbund APG is currently exempt (up to 2007) from compliance with the UCTE Operation Handbook/Multilateral Agreement. Following long delays due to difficulties in obtaining official approvals, the control area manager has now launched a drive to build the missing 380 kV line section from southern Burgenland to Kainachtal (“Styrian line”).

Austrian **electricity supplies are highly reliable**, and the average duration of scheduled and unscheduled supply interruptions is only 30.33 minutes per year.

In the **gas** sector, too, there are wide variations in the willingness of consumer groups to switch. While 1.6% of domestic consumers have switched since liberalisation the cumulative churn rate (over three years) for “other small consumers” is 3.4% and that for large consumers 4.2%. These trends show similar switching behaviour to that of electricity consumers after three years of deregulation. The causes of the relatively low switching rates in the small consumer segment are presumably the same as with electricity.

In the Austrian retail gas markets as in their electricity counterparts, the factors working against switching are lack of alternative suppliers and opaque quotations (all-inclusive pricing and various sliding scale price clauses). These obstacles are favoured by insufficient separation of companies’ marketing and system operation activities.

Price trends on the retail gas market are largely driven by import prices (and thus by oil price movements), as procurement costs account for most of the price paid by final consumers. In contrast to the electricity market no significant price falls were witnessed after liberalisation, as gas import prices climbed sharply between October 2002 and April 2003. These price increases outweighed the cuts in system charges. Import prices declined in the second quarter of 2003, but have risen steadily since October 2004, pushing up overall retail prices despite further reductions in system charges.

Gas wholesaling takes place at two levels: on the wholesale market, on which OMV Gas GmbH which is the only Austrian importer with long-term supply agreements with foreign producers (Gazprom and Norwegian producers); and on the regional long and short-term markets where the large retailers procure their gas.

Unlike Belgium and the Netherlands, Britain or northern Germany, Austria and its Baumgarten hub do not have a short-term gas trading platform. However the balancing market is employed for trading purposes, and not merely as a means for control area managers to compensate for market participants’ forecasting errors.

In 2004 use of the balancing market as a “spot market” represented 2–3% of total demand in the Eastern control area. In addition, EconGas annually auctions 250 million cubic metres under the gas release programme; however most of this goes to foreign buyers. These observations show that there is a demand for a short-term trading platform in Austria, and that there is a sufficient supply of gas. The conditions for establishing such a market should be rapidly created, and the obstacles to it removed.

There are barriers to entry to the national and regional wholesale markets. In particular, there is a shortage of transport capacity on Austrian transit routes. As in other EU countries, these are blocked by long-term agreements, although considerable amounts of physical capacity would otherwise be available.

The Austrian gas storage market is highly concentrated. There are only two storage operators — OMV and RAG — and the capacity is located in eastern Austria. Access to Austrian storage facilities is on a negotiated basis. The extent to which the Austrian storage system operators comply with the Guidelines for Good TPA Practice (GGP) differs. While the larger of the two, OMV, had already met the main requirements of the GGP by the time that they entered into effect, RAG's compliance still leaves a lot to be desired.

Much of the gas carried on the Austrian network is in transit. The ratio of transit volumes to locally consumed gas is about 4:1. A key objective for cross-border gas shipments, which are not regulated at present, should be non-discriminatory network access. There are still gaps in GGP compliance, particularly with regard to efficient utilisation of existing capacity through “use it or lose it” clauses and secondary market services, as well as some of the transparency requirements relating to publication of capacity. At the present there does not appear to be sufficient cooperation between the transit companies.

Major network expansion programmes will be necessary to maintain security of supply in the face of forecast demand growth. There is a particular danger of future network congestion in southern Austria and on the transit route to Italy. The planned expansion of the TAG pipeline system could make a significant contribution towards relieving congestion. Planned investments in infrastructure also include the WAG transit system expansion, the international Nabucco pipeline and the new Haidach storage facility. There are no forecasts of production capacity. The problem of the lack of a link between the pipeline systems in eastern and western Austria remains unsolved. The Tyrol control area currently imports all its gas from Germany, and there is therefore no gas-gas competition in Tyrol or Vorarlberg. The main reason for this is the fact that transit to Tyrol via the German network has hitherto been frustrated by lack of capacity — despite the very low volumes nominated — and excessive system charges.

To sum up, not only could competition in the gas and electricity markets be intensified by better implementation of the unbundling rules, but it would also be possible to create regional markets extending beyond Austria's frontiers.