



MEDREG

**TOWARDS A CONSISTENT AND HARMONISED REGULATORY FRAMEWORK FOR
ELECTRICITY AND GAS REGULATION IN THE MEDITERRANEAN BASIN**

Concept and Strategy Paper

1. INTRODUCTION

1.1 The Mediterranean Basin

1. An historical tradition of relationships and strong complementarities exist between EU and non EU countries within the area of the Mediterranean Basin.
2. The Mediterranean Basin includes 23 countries, with a population of more than 470 million slightly larger than the EU. The average annual GDP growth rates for the period 1997-2007 are around 5.1% for non-EU Mediterranean countries and 3.3% for EU countries in the Mediterranean basin.¹ Over the same period the average annual population growth rates are around 1.53% for non-EU Med countries and 0.16% for EU Med countries.
3. Financial, managerial, and technological resources are necessary, together with enhanced co-operation among countries in the area, to cope with the development's trend expected in the Basin.
4. As far as energy is concerned, while the European Union is a net energy importer, countries of the Mediterranean Basin as a whole are endowed with more energy resources than they need for their current and near future requirements.
5. The electricity and gas trade potential across the Mediterranean is increasing, and far from being fully developed. Therefore a great development of energy infrastructures, trade relationships, technological transfers and know how exchange is expected.

1.2 Energy in the Euro-Mediterranean Partnership

1. Institutions have been very active in the promotion of Mediterranean energy trade. The Euro-Mediterranean Partnership, the *Euromed* or Barcelona Process, was launched in 1995. Since the dawn of the Euromed, energy has been a primary focus.
2. Efforts by the EU and Mediterranean Partners achieved significant results at the Euro-Mediterranean Ministerial Conference on Energy, held in Athens on 21 May 2003, which approved the following goals:
 - reform in the countries on the southern shore of the Mediterranean with a view to gradual integration of the Euro-Mediterranean electricity and gas markets;
 - development of South-South-East-North and North-South energy interconnections;
 - promotion of the potential of renewable energy sources and support of the Kyoto process;
 - promotion of more efficient energy demand management;
 - harmonization of rules and standards, as well as information systems and statistics used in the energy sector.
3. Participants renewed their decision to contribute to the implementation of the important commitments agreed at the following Ministerial meeting held in Rome on 1-2 December 2003, where some important agreements were signed, notably:
 - the «Protocole d'accord pour l'integration progressive des marchés d'électricité de l'Algérie, du Maroc et de la Tunisie dans le marché intérieur de l'électricité de l'Union Européenne»;
 - the Declaration of Intent on the Euro Mashrek cooperation in the field of natural gas;

¹ Sources: Analysis on IMF database, World Economic Outlook, April 2006

- the “Agreement on General principles for Israeli-Palestinian cooperation in the sphere of energy demand management and renewable energy”;
 - the “Declaration of Intent on the establishment of the Rome Euro-Mediterranean Energy Platform (REMEP)”. REMEP’s aim is to set up a common ground to intensify the euromediterranean partnership on energy issues among the countries within the Mediterranean Basin.
4. On the other hand another important development gained momentum in part of the Mediterranean region. The “Athens process”: South East European countries, and the European Community have signed in Athens on 25 October 2005, the Treaty establishing the Energy Community, aiming at full integration of these countries into the EU Internal Energy Market (IEM) after implementation of the “Acquis communautaire”. Moldavia, Turkey Ukraine and Norway have Observers status in this process.
 5. Lately, the Green Paper of the European Commission “*A European Strategy for Sustainable, Competitive and Secure Energy*” acknowledges the need to promote a “common regulatory space”, which is one of the main goals of the European Neighbourhood Policy, whereby “the EU has been engaged in widening its energy market to include its neighbours and to bring them progressively closer to the EU’s internal market”.

2. THE BENEFITS OF MODERN REGULATION AND DEVELOPMENT OF INFRASTRUCTURE AND TRADE

1. All Mediterranean countries are aware of the benefits of increasing market integration in the Mediterranean Basin. It is clear that, while some integration projects have been already significantly developed it is necessary further exploitation of these and other abundant natural gas reserves as well as of primary electricity resources and of interconnection benefits, in terms of strengthened security of supply, continuity and economic efficiency of energy supplies on both shores of the Mediterranean. The completion of electricity and gas Mediterranean rings, as foreseen by the European Commission’s Guidelines on Trans-European Energy Networks, is commonly recognized as a shared objective.
2. So far, market integration and infrastructure development has been led and financed by business interests, including national companies of both EU and other Member States, supported by their Governments.
3. Spreading and sharing advanced regulatory culture may lead to remarkable improvements on this situation, and pave the way to increasing private and public sector involvement and accelerated deployment of infrastructure, in particular of electric and gas transmission lines, forming the Mediterranean ring and networks.
4. It is widely agreed that a stable, fair, cost reflective and performance based regulation leads to much lower investment risks, and hence to larger investments, improved choice of contractors and lower costs of financing. On the other hand energy regulation guarantees consumers protection in terms of sustainability of investments, more transparency and better quality of service with reasonable electricity and gas prices. This is the best contribution that an advanced regulatory culture, as could spread within the framework of collaboration between Mediterranean regulators, can provide to industrial investment, notably in the electricity and gas industries.
5. In the longer term, regulators of neighbouring countries or of countries hosting a common infrastructure could agree or recommend harmonized rules, including the

opening of access to infrastructure on a non discriminatory basis, fostering further investment in the exploitation of upstream resources.

6. More generally, closer links would help to bring Mediterranean Partners an increasing awareness of energy trade benefits and to facilitate energy markets integration.

3. MARKET REFORM

1. A worldwide interest exists with respect to the regulatory experience of the EU and other countries that have undertaken market reform in electricity and gas. Principles of such reform are: the unbundling (mainly transmission and distribution of electricity and gas, large gas storage) activities from production and supply; stable and independent regulation; free customer choice between competing suppliers.
2. Advanced regulation is always related with some gradual market reform, broadly inspired by the same principles followed for the establishment of the IEM.
3. The main pillars of such reform would be:
 - Market participants should be companies of any kind (); it is essential that, once their mission has been clearly set, they operate independently from political influence and their managers are responsible of the economic results.
 - State aid should be linked to well defined objectives of general interest and gradually awarded to participants on a non-discriminatory basis; any other state aid should be gradually phased out while plans to ensure the generalised payment of bills should be devised and gradually enforced.
 - Competition should be introduced where possible, notably in power generation, gas exploration and production, trade, ancillary services and gas storage, electricity and gas supply, provided that a level playing field is established and that national markets are sufficiently large or interconnections exist giving room to larger regional markets.
 - Countries may devise their integration process both with neighbours and EU (including the promotion of cross border trade) and possibly by envisage a suitable path through necessary technical, institutional and regulatory steps including the development of interconnections.
 - Even if competition is practically non-existing yet , free entry is not yet allowed and customers are not eligible, a limited but significant reform may consist of improved, incentive-oriented monopoly regulation, such as price-cap on tariffs, quality control, unbundling of accounts and benchmarking.
4. Market reform should be gradually introduced and should be decided by each country or (for international issues) by groups of countries after careful assessment of actual institutional technical and economic conditions.

4. THE ROLE OF REGULATORS

1. Market reform is often related to the establishment of energy sector specific regulators, commissions or agencies and this has been the case, to some extent, of the Mediterranean Basin. Independent regulators have been established in all EU Member States following the Directives 2003/54/EC and 2003/55/EC. Moreover, due to the Treaty establishing the Energy Community for the integration of the Balkan energy Market into the EU one, new

regulators have been also established in South East Europe. In the remaining countries of the Mediterranean Basin some regulatory authority have also been already set up.

2. The actual role and independence of such institutions varies and the benefits of stable and performance-based regulation are generally accepted. Regulators (Authorities, Ministers, Agencies) already in place in the Mediterranean basin have different powers and competences, nevertheless a very important step should be to have harmonised rules in place so to have a unique platform in terms of rules in order to promote and facilitate energy integration and exchanges.
3. A better understanding of modern regulation' benefits will spread into the countries leading to other developments such as bilateral agreements to participation in the Energy Charter Treaty and potentially to integration with the IEM.
4. All regulatory authorities and agencies as well as the Ministries who are actually responsible for energy regulation in the countries of the Southern and Eastern Mediterranean Basin have shown a remarkable interest in European energy regulation experiences through their frequent requests for collaboration on a bilateral basis (twinning, technical support, study visits and training of staff) or through other regional cooperation exercises such as the Regional Initiatives (EREG), ERA (Energy Regulator Regional Association) and others. Last but not least, thanks to the support of the EU Commission there was a wide and highly qualified participation at the Workshop "The energy regulators community in the Mediterranean Basin" held in Rome on May 29th2006 that demonstrated the interest of Mediterranean Partners on this respect. The Conclusions are attached to the present Paper.
5. International co-operation of regulators has proven useful in the European Union, where it is officially recognised by Directives 2003/54/EC and 2003/55/EC, and institutionalised in the EREG. In the developing world, such international regulation has been useful also in the case of Latin America, where it has helped to achieve mutual reinforcement and greater independence. The European regulators through the CEER have strong cooperation exercises already in place with correspondent organization such as: FERC (*Federal Energy Regulatory Commission*) and NARUC (*National Association of regulatory Utility Commissioners*) of USA, ERA (*Energy Regulators Regional Association*) of East Europe, ARIAE (*Asociación Iberoamericana de Entidades Reguladoras de la Energia*) of South America and ECRB the new regulators' body in the South East Europe; other forms of co-operation are in place with some African and Middle Eastern associations.
6. Regulators are respected institutions, widely seen as above private interests as well as not involved in current political conflicts; therefore, their positions – and also internationally agreed common positions - are quite influential with respect to national governments, market operators and the private sector including financial institutions even when they are not legally binding. On the other hand regulators should always bear in mind the technical nature of their role and pursue their national interest.
7. This co-operation could also be facilitated by already existing initiatives such as the the Florence School of Regulation (FSR), REMEP and the International Energy Regulation Network (IERN), that represents an effective platform to exchange profitable information and experiences.

5. CONCLUSIONS

Considering the above situation, the following conclusions can be drawn:

1. Infrastructure reinforcement is necessary to increase trade in both natural gas and electricity and attract more efficient and secure energy supplies from and across the Mediterranean Basin, involving the whole European Union and other Middle Eastern, Central Asian and West African countries, which are geographically connected with Europe across the territories of Mediterranean Partners and Mediterranean sea. The diffusion of modern regulatory culture may lead to reduced uncertainty, more efficient and faster involvement of private capital, accelerate the deployment of huge infrastructure (as necessary for the completion of the Mediterranean ring for electricity and natural gas transmission), guarantee consumers protection in terms of sustainability of investments, more transparency and better quality of service with reasonable electricity and gas prices.
2. In order to achieve such goals, permanent collaboration between the regulatory authorities of the EU and Energy Community Member States and those of all other Mediterranean countries, would be most useful. A preliminary step for such collaboration and co-operation has been the foundation of a permanent **Mediterranean Working Group on Electricity and Natural Gas Regulation (MEDREG)**, as decided in Rome on May 29th, 2006.
3. The main objectives of the MEDREG will be:
 - a. information exchange, common analysis and comparison of existing energy legislation and regulation;
 - b. development of common positions on regulatory issues, including criteria for those issues related to cross border electricity and gas trade;
 - c. promotion of Euro-Mediterranean regional electricity and natural gas markets towards their respective integration, taking into consideration and building upon the projects already under development;
 - d. promotion of harmonized, transparent and non discriminatory market rules;
 - e. the promotion and exchange of know-how, expertise , specialised training and studies in the field of energy regulation, notably in collaboration with the Florence School of Regulation (FSR), created by CEER and the European University Institute, and with the support of the European Commission.
 - f. the establishment of a stable relationship with CEER, through its International, Training and Benchmarking Working Group (ITB WG), and with the Energy Regulators Group on Electricity and Gas of the European Union (ERGEG);

The MEDREG will be composed by the main representatives of Regulatory Authorities or Ministries of countries where an independent Regulatory Authority has not yet been established. The MEDREG will function according the internal rules defined in a separate document.