European Commission Conference

Energy Sector Inquiry – Public Presentation of the Preliminary Findings

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"TOWARDS AN EFFICIENT AND INTEGRATED EUROPEAN ENERGY MARKET – FIRST FINDINGS AND NEXT STEPS"

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Check against delivery

Ladies and Gentlemen,

Good morning, and welcome on behalf of the European Commission. Today I will present the preliminary findings of the Commission's sector inquiry into the gas and electricity markets. This conference also marks the start of a period of discussion on our findings and possible ways forward.

Reliable energy supplies at reasonable prices for businesses and consumers are crucial to the economic performance of any economy. Only a few days ago, G8 Finance Ministers highlighted the need for open energy markets. They left us in no doubt about just how vital market mechanisms are for the effective functioning of the global energy system.

During the 1990s the EU decided to gradually open the energy sector to competition. Liberalisation of the European internal energy market sought to increase efficiency in the production, transmission and distribution of energy. It sought to reinforce security of supply and the competitiveness of the European economy whilst respecting environmental protection.

Two waves of liberalisation Directives have tackled the inefficient monopolised energy markets of the past. There is no doubt that some progress has been made. But when this Commission came into office, we heard no-one saying that a single, competitive European energy market was yet in place and working well.

Instead, we got the clear message – from business leaders, from parliamentarians, from consumer groups, from companies trying to enter the market – that there remained real concerns about the development of wholesale gas and electricity markets, not to mention high prices and limited choice for consumers. The message resounded with my own sense that something was not quite working out in these markets of such crucial importance for the Lisbon agenda of growth and jobs. It suggested the need for complementary action in addition to regulation. It suggested the need for a more proactive use of competition policy tools.

That is why this was one of my two top priority areas for assessment through a sector inquiry – a new tool for identifying barriers to free competition, introduced under the reformed competition rules.

We presented the first findings of the inquiry in an Issues Paper last November. The first signs were very worrying, and confirmed our suspicions. We found indicators of real market distortions. The Preliminary Report I want to share with you today confirms and expands on these findings in the light of our further work.

I use the word 'sharing' very deliberately. Sector inquiries can only work if they are a shared undertaking. These findings and the analysis we present today would simply not have been possible without the input and cooperation of people involved with the industry. I know the efforts which had been made to deliver quality input within stringent deadlines. Thank you for this, and thank you for being here today to contribute to the important debate on where we go next.

Sector Inquiry

I would like to use the first part of my speech to present our main findings. I will group the main issues according to the five themes identified in November's Issues Paper. I am afraid I have to paint a rather gloomy picture.

(1) Market Concentration

First, there is a high degree of market concentration.

Most gas and electricity markets remain highly concentrated. This reflects the old market structure of national or regional monopolies. Incumbents often retain a firm control of the liberalised markets, each of them within its own traditional territory. There is very little new entry.

Gas incumbents tend to control imports and/or domestic production. The inquiry shows that only a small proportion of their gas is traded on Continental gas hubs.

Electricity incumbents tend to control the generation assets and have considerable scope to exercise market power. The findings of the inquiry suggest that operators can influence prices on certain wholesale markets. This is one of the points which merit further study.

(2) Vertical foreclosure

Second, there is a related problem: vertical foreclosure.

New entrants are largely foreclosed from the markets, preventing them from offering their services to the consumer. Incumbents are often vertically integrated, acting at several levels of the supply chain. They demonstrate little or no interest in trading with new entrants. The preliminary report paints a picture of markets characterized by long-term contracts and a lack of liquidity: there is a lack of available gas and electricity that could be acquired by alternative providers. This creates a vicious circle with higher risks, fewer entrants and thus even more vertical integration.

One real problem is the strong link that often still exists between the incumbent wholesalers and the network companies. Respondents to the inquiry told us that inadequate unbundling is an important obstacle to entry. Some alleged discriminatory treatment. Joint ownership of supply and network businesses, as well as gas storage facilities, results in chronic problems. Incumbents remain dominant at all stages of the supply chain. Markets remain closed to competition.

(3) Market integration

The third problem is the lack of market integration in Europe.

Both gas and electricity markets are still largely national. Incumbents remain both largely national and largely dominant. They often seem to have limited interest in going out and competing on their neighbours' territory.

In the gas market, new entrants find it very difficult to secure transit capacity on key routes. Pre-liberalisation contracts give long-term control of these pipelines to the incumbents. This situation is made worse by congestion management mechanisms on most transit pipelines. Most of these simply do not work. And even when there is new capacity, most of it appears to end up in the hands of the same incumbents.

For electricity, the inquiry shows an overall lack of interconnector capacity. Moreover, the capacity that is there is not fully available to new entrants. Again the main reasons are long-term historic capacity reservations and inefficient congestion management mechanisms. In addition there are important differences in the market rules applicable to each area. Finally, a lack of adequate incentives to invest in additional capacity completes the worrying picture.

(4) Transparency

Our fourth area of concern relates to the endemic lack of transparency on the markets.

Market actors told us that better access to information is crucial for establishing a level playing field. There is a complete lack of timely and reliable information for both competitors and consumers. This is not just a barrier to entry. It also undermines confidence in trading, and stops consumers from making informed choices.

For gas, network users request more transparency on access to networks, on transit capacity and on storage. They want a degree of openness that goes beyond the current requirements set by EU legislation. Overly strict Confidentiality rules for pipelines with few capacity holders are another problem.

For electricity, more than 80% of market participants are dissatisfied with the current level of transparency. Rules on proper market conduct and supervision differ significantly from one Member State to the next. Users point to the need for more information on technical availability of inter-connectors and transmission networks. They want to know more about generation, about balancing and reserve power, and about load.

(5) Price formation

Finally, there is the key issue of how prices are set.

We have seen dramatic price increases over recent months for both gas and electricity. There are, no doubt, several causes of this. But one of them may be anti-competitive practice.

A well-functioning and transparent market mechanism for setting prices is essential. Without it energy markets will not function properly and will not deliver the advantages of efficiency and choice to the consumer.

Gas prices in most long-term supply contracts are linked to oil or oil derivatives. Contracts from the same field also generally have the same index and often even the same actual price. Contrary to hub prices, these contracts fail to react to changes in supply and demand in gas. And ensuring liquidity is crucial to confidence in price formation on gas hubs.

Many large energy consumers consider that electricity prices on spot and forward wholesale markets do not result from fair competition. I should also mention that in a number of cases co-existence of regulated and free market prices causes distortions and can be an obstacle to full market opening. The long term effects of this price regulation will need further examination.

Way forward

So these are the problems that the sector inquiry has identified. I would now like to come to the challenge of solving the problems – what comes next?

Persistent concentration is a core problem in the markets. So there can be no alternative to meticulous scrutiny of future merger operations. In order to avoid any possible inconsistency in the treatment of merger cases scrutinized at national level, the rules of the EU Merger Regulation may have to be reviewed and amended. And the Commission will continue to be very vigilant in the field of state aid control, as the sector moves into a period of major investments.

Controlling mergers and state aid can only ever be just part of the solution. In the coming weeks and months the Commission will launch individual antitrust investigations. We will tackle areas where we suspect violations of the competition rules, where action can have concrete and immediate effects, and where we can set valuable precedents. By way of example, these cases could cover vertical foreclosure caused by long-term downstream contracts, and the hoarding of capacity on pipelines, gas storage and interconnectors.

We will probably also take a closer look at the price-setting mechanisms on electricity wholesale markets, including power exchanges.

You can take this as a gentle word of warning if you like. We are just at the beginning of a period of more intensive antitrust enforcement. I can only encourage everyone to take a close look at their practices. Prevention is always better than cure.

As regards the regulatory environment, the inquiry suggests that the existing Community Directives – are not fully implemented. The Commission has already said that it will review the implementation of the gas and electricity liberalisation directives, and consider the need for further proposals by the end of the year. My colleague Andris Piebalgs will update you on this later today, and I don't want to pre-empt his intervention. I would just note that the findings I've presented today will obviously be fed into the Commission's reflections. And from a competition perspective a number of relevant issues seem to be emerging.

I have already explained that one of our keyfindings is that transparency is endemically insufficient in the sector. There seems to be broad consensus that this issue should be addressed by strengthening transparency obligations, be it through regulation or through competition law.

Another concern is that the remaining "grandfathering rights" of incumbents, concerning reservation of capacity on bottlenecks such as pipelines, are a significant barrier to entry. The elimination of these bottlenecks merits further analysis and discussion.

A third issue is that further progress is certainly needed as regards regulation of the international segments of the gas and electricity grids. Our findings suggest that purely voluntary cooperation schemes of regulators do not provide the investment certainty and regulatory coherence necessary to develop international pipelines and interconnectors.

Finally, market structure is a real concern. I'm talking about bundling of generation, supply, pipelines and grids, and distribution. Owners and operators of critical networks often compete with companies that need to have access to these same networks. Can we expect such integrated companies to treat competitors in a fully fair manner? Their own self-interest would suggest not.

In this respect, I very much welcome the move that is being made in the country I know best towards full structural unbundling. Personally I believe that this will allow a more efficient market to develop. Companies would be able to enter the markets and compete on their merits. Regulation would be made less complex and more effective. It would improve the incentive structure in the energy markets.

For all these issues, the problems appear clear, but the appropriate remedies less so. Which remedies are appropriate, and which tools should be used to implement them are issues that I would invite you to reflect on. I will reflect carefully on your comments, whether you agree or disagree.

Conclusion

Let me conclude.

An open and competitive, liquid and interconnected, single EU market is crucial to ensure effective provision of energy to our consumers. Because of the problems I have outlined here, the Europe of today does not have the energy market that European industry and European consumers need. We are missing a great opportunity.

European competition policy provides a series of powerful tools to enforce conditions of fair competition in liberalised markets. I am committed to use these tools to the full. But competition enforcement is just one partner, one half of a ‘pas de deux’. It dances not alone, but in step with regulation.

Regulation opens the market – and competition policy makes sure that the opened markets really work. Neither of the two can do the dance alone. And both have to adjust their movements in parallel, in line with the pace of the music. And when it comes to redefining the dancefloor – in this case fundamental restructuring of the energy marketplace – both dancers need to step into motion. Andris Piebalgs and I myself are fully committed to just that.

Thank you for your attention.
