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Energy Regulation & Investment Conference

Keynote address

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Thank you for the opportunity to speak at the opening session of this conference.

Let me touch during these remarks on three topics:

- The essential role of open markets for investment

- The deficiencies in competition that we still find in the European energy market

- The new perspective, as we move up to 2007—the year of full liberalisation of the European energy market. A new phase of restructuring of the energy market in Europe has begun. both in the EU and in neighbouring countries.

First, the background

The European energy market is moving through three stages of liberalisation:

- The first EU electricity & gas liberalisation package was adopted in 1996 and 1998, respectively,

- The breakthrough towards a competitive energy market came with the second liberalisation package in 2003, as most here will know,

- That package set the deadline for full liberalisation on 1 July 2007, with minor derogations for some Member States for additional transition periods.

It is the competitive conditions in energy markets that determine investment opportunities and that, I believe, should therefore be at the centre of attention at this regulatory and investment conference.

Secondly, the state of the sector

The European Commission has carried forward, under its competition law powers, an in-depth investigation of competitive conditions in the EU energy market, as we run up to full liberalisation.

We sent 3000 questionnaires to the sector, both gas and electricity. A Preliminary Report on the findings was published in February 2006, available at http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/energy/

We have found five main competition problems that hinder the competitive development of the energy market:

- Market concentration
- Vertical foreclosure
- Lack of EU-wide market integration
- Lack of transparency

- Deficient price formation mechanisms

I will not go into any details of the deficiencies but refer you to the published report. In essence, these deficiencies have led to substantial under-investment in transborder energy links in the Union, and an endemic lack of diversification in our outside supply relationships particularly in gas, with a consequential enhanced risk in security of supply. Let me just illustrate some of the key findings.

Gas:

Gas infrastructure remains mostly owned by incumbents and is not sufficiently unbundled. Long term capacity reservations in transit pipelines and storage block new market entry and new investment—hardly any capacity is available in the short term.

A closer look at our main gas supply routes confirms this. On the East / West axis there is minimal unsold capacity available for at least ten years.

Electricity:

Many market participants complain about inadequate unbundling of network and supply activities. There is a substantial lack at TSO level of grid connection for new power plants; interconnector capacity; and transparency.

Competition from imports is insufficient to erode the market power of incumbents. More interconnector capacity is needed, as demonstrated at a number of main links in the Union. Many interconnectors are chronically congested. Long term capacity reservations reduce capacity available for new entrants.

Thirdly, the new perspective

Let me then move to my third point: the consequences and the new global perspective of EU energy policy, set forth by the European Commission in its March Green Paper and largely endorsed by the EU Heads of States at the European Council under Austrian Presidency the same month.

The Green Paper ("A European Strategy for Sustainable, Competitive and Secure Energy", of 8 March 2006) sets out as main energy policy goals:

- Open energy markets
- Security of supply
- Environmental goals, the Kyoto process.

Let me here only mention the focus of this new perspective:

- Accelerate work towards effective market opening,
- Make energy dialogues with our key suppliers more effective,
- Diversify energy sources and suppliers.

In concrete terms, this means, inter alia,

- Review of implementation of regulation, for making the 2007 market opening date fully effective,

- Intensified application of antitrust to combat anti-competitive market blocking,

- Intensified dialogue with major external suppliers,

And

- Clearly identified priorities for the upgrading and construction of new infrastructure.

Making regulation work is at the centre of the attention of our regulators, as they cooperate in the CEER, the Council of European Energy Regulators—and there are of course many regulators present at this conference. The new regional regulatory initiatives in both gas and electricity are an encouraging sign. The European Commission will take stock of progress by the end of the year.

As regards competition law application, we will combat anti-competitive practices particularly in areas which promise to have the most rapid effect on market opening:

- Anti-competitive practices concerning tying of downstream markets—which hinder new entrants to serve customers in the newly liberalized markets,

- Anti-competitive practices concerning access to capacity on pipelines, gas storage and interconnectors,

- Market partitioning / territorial restrictions in supply contracts, or provisions with equivalent effect,

- Other anti-competitive and exclusionary conduct, such as impeding customer switching.

And, of course, the intense scrutiny of mergers under the EU's merger control regime is at the centre of our attention, as we witness a massive restructuring of the gas and electricity markets in Europe.

We have seen a series of recent EU decisions in this area:

- the EDP/GDP Decision (December 2004, Portugal). Prohibition of the planned acquisition of the Portuguese gas incumbent by the country's electricity incumbent (jointly with ENI),

- The EON/MOL Decision (December 2005, Hungary). Clearance with remedies concerning the acquisition of the gas wholesale business of the country's gas incumbent by German EON,

- The DONG Decision (February 2006, Denmark). Clearance with remedies concerning the acquisition of major electricity companies by the country's gas incumbent.

- The EON / Endesa bid (April 2006, Spain). Clearance concerning the planned takeover by EON of one of the two major electricity companies in Spain.

I will pass over the details of these Decisions. Let me just mention EON / MOL in more detail.

The acquisition by EON, the major German gas and electricity company, of the wholesale gas business of MOL, the Hungarian gas incumbent, was approved, but subject to strict conditions. Two sets of remedies were required;

- structural: ownership unbundling of the control of the infrastructure network,

- behavioral: commitment to a very substantial gas and contract release programme, in order to generate liquidity in the market and to avoid market foreclosure in the Hungarian gas market.

Instead of going into further detail, let me turn to the more general lines set by these recent decisions. EU merger control is <u>positive</u> on restructuring <u>but</u> will not admit monopolisation of markets and customer exploitation.

We must look carefully in all cases at effective unbundling of infrastructure and supply, and at ensuring sufficient liquidity. The latter means that we have also to look at the upstream situation.

Or say it in other words: Open upstream access to both gas and electricity supply facilitates open downstream markets—and this means consumer benefits.

Let me now come back to the broader supply perspective. The Green Paper aims at widening the EU's energy market, in line with the EU

European Neighborhood policy and its Action Plans—progressively creating a common regulatory space around Europe. This “would create a predictable and transparent market to stimulate investment and growth, as well as security of supply, for the EU and its neighbours”. One example is the Energy Community Treaty with partners in South-East Europe, many of which are present at this conference.

This also applies to the EU’s largest partner in the energy field, Russia. The EU Presidency and the Commission have set out in a statement earlier this month that the EU and Russia “are, and must remain, in a position of mutually beneficial interdependence.” As the Commission has stated on various occasions, Third Country energy companies entering the EU will be screened under EU competition law no differently from EU enterprises, as regards their impact on the competitive market structure. But this also means that one will have to take into account both effects, upstream position in the energy supply market and downstream acquisitions—as we would do with any other enterprise screened under EU competition law. Clearly common open regulatory principles in upstream supply markets would facilitate such a competition analysis.

This leads me back to my starting statement. Open markets facilitate restructuring and investment, to mutual benefit of upstream supply and downstream demand. Let me end on this point.