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Public Hearing to the Sector Enquiry,
16 February 2006
Statement by Harry Roels
CEO of RWE AG

Chairman,
Ladies and Gentlemen,

It is a great pleasure for me to be here today and to participate in the panel discussion on the preliminary findings of the Energy Sector enquiry. Having considered the thoughtful presentations made this morning by the different teams, I would like to use some of my time to address the issue from a different perspective.
RWE is in favour of creating a level playing field for competition in the European energy sector, including further integration of national markets.

In that respect, I agree that stronger interconnection capacities are vital if we are to bring national markets together effectively.
RWE is playing an active and leading role in the development of interconnections. In the past few years, RWE's transmission system operator has already improved capacities for cross-border exchanges of electricity by extending interconnections towards the Netherlands and France. We are in discussions with international and national network operators to further optimise cross-border cooperation.

To be specific, I am pleased to inform you about our most recent project. Since the beginning of 2005, electricity trading capacity between Germany and France has been limited owing to the fact that the physical power flow from Germany to France has to pass through the German-Dutch border. As a consequence, RWE Transportnetz Strom is currently exploring with its Dutch counterpart TenneT various alternatives to build a new 380 kV tie line between Germany and the Netherlands. This project could increase transmission capacity at the German-Dutch border by some 1,500 MW or 30% and may thus help to both relieve the trade restriction between Germany and France and increase overall system reliability. We are discussing the project with the German Federal Grid Agency at this very moment.
Separately, RWE’s in-house experts have been contributing to the efforts of the Pentalateral

Forum. Commissioner Piebalgs supports this regional cooperation between France, Germany and the BeNeLux countries as an important intermediate step towards a fully harmonised EU electricity market.

Building new interconnection lines will take time – 10 years or more. If we want to seriously shorten this process , it will take a concerted effort from all European and national authorities. We would particularly appreciate support to apply the administrative procedures as quickly as possible.

In the meantime, in order to handle current impasses, market-based congestion management mechanisms should be implemented and long-term capacity reservations should be suspended at all borders as RWE has done already. By the way, the revenues resulting from the auctioning of cross-border capacities have been and will be used to lower grid fees in the meantime, consistent with the EC regulation.

Please allow me to now comment further on some recent developments that are not addressed in the sector enquiry, which is based on data collected just after the summer recess 2005. As a consequence, its findings look back to a time when the liberalisation process was gathering speed, particularly in Germany. In the meantime, Germany is already overcoming some of the obstacles that have been identified.

1. Change in the German Regulatory Framework

   In July 2005, Germany implemented the 2nd liberalisation package and designated a regulator for electricity and gas. The far reaching consequences of the new regulatory framework and the work taken up by the German Federal Grid Agency (Bundesnetzagentur) are obviously not yet reflected in the issues paper:

   § Access to the German electricity and gas grids are subject to transparent and non-discriminatory rules.
   § Electricity grid fees have to be approved “ex ante”, i.e. before they come into effect.
   § In the gas market, we expect more intense competition as a new, simplified grid access model will become effective in October 2006.
   § German energy companies are implementing the unbundling requirements. Sometimes much faster than legally required: already in 2003, RWE separated its network activities in Germany in accordance with EU requirements.

   No doubt, the new regulatory framework will considerably improve competition in the German retail market, which already has a very diversified market structure.

2. Market Concentration

   Additionally, let me give you some recent figures that illustrate the trend towards a more “fragmented” and competitive generation market: In Germany, almost 50% of the announced new generation capacities to be installed by 2011 — 24 power stations with some 18,000 MW in total — will be built by companies other than the four largest incumbents, including foreign companies. This will reduce the market share of the incumbents considerably.
   And Statkraft for example, involved in two projects, has had no difficulties in securing the necessary throughput capacity from the RWE TSO.
   As to the supply (marketing) side, the market share of RWE in Germany vis-à-vis industrial customers and regional distribution companies has been declining from around 30% to ca. 20% since the year 2000 due to customer switching and a growing activity level on the liquid and transparent wholesale market.

3. Market Transparency

   RWE has actively contributed to Eurelectric’s work on increasing publicly available information benefitting market transparency.

4. Energy-intensive customers: a common destiny

   RWE is aware that high electricity prices put pressure on energy-intensive industries. It is in our own interest that these large energy users do not relocate their production sites. Therefore, we have supported our customers' applications for lower grid fees and worked together with them to design innovative and tailor-made contracts to meet their individual requirements. Just to give you an example, it is even possible to index electricity prices to metals quoted on the LME. Thus, the RWE key account team in 2005 was able to contract some 56 TWh with various industrial customers from all types of industries and throughout Germany.

5. Price Formation

   Even in liberalised and competitive markets, prices can rise due to fundamental factors in supply and demand. Taking into account the Europe-wide increase in electricity prices since 2003, it is difficult to see how a single market player, even a strong one from a national point of view, would be able to influence or manipulate prices on the European wholesale markets. For example, 135 participants, more than half of them from abroad, are trading on Germany's EEX. A large number are non-utility related traders such as hedge funds, banks or oil companies. These players would not participate if free market forces did not prevail. Also, wholesale markets in general, and the EEX in particular are closely supervised by independent regulatory authorities. Liquidity also increases steadily.

6. Green paper on a European Energy Strategy

In the light of the most recent developments (e.g. Ukraine), we believe Commissioner Piebalgs makes a strong argument in favour of a more coherent European energy policy approach. What we need is regulatory stability that promotes investment and ensures security of supply in a competitive market environment. The challenge is enormous: The International Energy Agency estimates that more than 1,800 billion US Dollars will have to be invested in the electricity and gas sectors of the EU-25 within the next 25 years. To attract this capital, a reliable long-term political framework is indispensable. The rules regarding EU Emissions Trading post 2012 would be a good example. Another one would be a commitment to refrain from new legislation before existing directives have been fully implemented.