COMMUNICATION BY MS. NEELIE KROES IN AGREEMENT WITH MR PIEBALGS

Subject: Sector inquiry pursuant to Article 17 of Regulation 1/2003 EC in the European electricity and gas markets

COMP/B-1/39172 (electricity sector inquiry) and COMP/B-1/39173 (gas sector inquiry)

1. Background

1. In its Communication of 2 February 2005 to the Spring European Council “Working together for growth and jobs, a new start for the Lisbon strategy”, the Commission endorsed a more pro-active application of competition policy, in particular, by means of sectoral screenings for barriers to competition in inter alia the energy sector. The decision proposed to the Commission by this Communication seeks to render this objective operational. The sector inquiry is undertaken in agreement with Mr Piebalgs and in parallel with the preparation of the report to evaluate progress in creating the internal market under the Electricity and Gas Directives 2003 /54-55/EC.

2. Legal basis

2. Pursuant to Article 17 of Council Regulation (EC) 1/2003¹, the Commission may conduct general inquiries into a particular sector of the economy or a particular type of agreements across various sectors where a trend of trade between Member states, price rigidity or other circumstances suggest that competition may be restricted or distorted within the Common Market. Indications that specific undertakings have infringed the relevant Treaty provisions are not required. Under Article 17, the Commission may publish a report on the results of its inquiry, and invite comments from interested parties.

3. Once the Commission has adopted a decision under Article 17 of Regulation 1/2003, it will have investigative powers to obtain all necessary information from undertaking and associations of undertakings.

4. The investigative powers available under this inquiry will be those pursuant to Articles 18, 19, 20 and 22 of Regulation 1/2003. Article 18(1) allows the Commission to request, or require by decision, all necessary information from undertakings and associations of undertakings, with scope for fines under Article 23

¹ Council Regulation (EC) of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81and 82 of the Treaty, OJ L 1, 04.01.2003
and 24 where information is misleading or incorrect, or where (following a decision that requires the provision of information) responses are incomplete or absent. Article 18(6) also allows the Commission to request all necessary information from governments and national competition authorities. Under Article 19, the Commission can take oral statements from natural or legal persons that consent to do so. The Commission will also have the power under Article 20 to undertake inspections in the framework of the inquiry or, in accordance with Article 22, ask a national competition authority to conduct such an inspection on its behalf.

5. Information can only be collected for the purposes of Article 17, namely giving effect to Articles 81 and 82 of the EC Treaty, either on their own or in conjunction with Article 86 of the EC Treaty. Conducting the inquiry under Article 17 will provide the necessary guarantees to undertakings that confidential information and business secrets will be protected.

6. To the extent that the inquiry confirms the existence of anticompetitive agreements or practices or abuses of a dominant position, the Commission or, where appropriate, the national competition authorities could envisage using the information collected in order to take the appropriate measures to restore competition in the relevant markets, including addressing individual decisions to the entities concerned based on Article 81 and Article 82, on their own or, for the Commission, in conjunction with Article 86 of the EC Treaty.

3. **Indications that competition in the energy sector may be restricted or distorted**

7. Both gas and electricity prices have risen during 2005. Current forward prices point to further price rises in the future, especially for gas. Electricity customers and particularly energy intensive industrial consumers in many Member States also complain about difficulties securing competitive offers from different suppliers, they receive almost always very similar price offers, and they have difficulty negotiating non-price terms in their contracts. Price rises are of particular concern since complainants express little trust in existing mechanisms of price formation. Liquidity is low on most electricity exchanges or gas trading hubs. This leads to price volatility and may give scope for manipulation.

8. The incumbent suppliers attribute the price increases to increased costs and technical arguments. The Commission is at this stage not convinced that these arguments can fully explain the price increases. The following circumstances suggest that there may be impediments to competition.

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In the ‘west central region (BE, NL, FR, DE, AT, SI), pre-tax prices for electricity for large customers increased from about €40 to €50/ MWh from January 2003 to January 2004 and have since stabilised at this higher level. Meanwhile forward prices in wholesale markets in the UK rose sharply in early 2005 to around €50/MWh. At the same time, prices for large consumers in Nordic area (SE, FI, NW, DK) have however remained stable at around €40/MWh.

Border prices for gas have increased from around €8/MWh to €9/MWh and forward prices in wholesale markets point to higher gas prices during 2005.

3 Fourth benchmarking report, Annual Report on the Implementation of the Gas and Electricity Internal Market Communication from the Commission, COM (2004) 863, 05/01/2005. Annex 3 and 5. For instance, only 188.7 TWh were traded on the major electricity exchanges EEX, APX, Powernext and EXAA whereas EU consumption amounted to about 2700 TWh.
9. New entry has been limited and market concentration remains very high. In gas, new entrants complain of difficulty securing supplies of gas and network access, and customer switching rates between suppliers are typically low\(^4\). In electricity, the few new entrants in the sector have invested rather small amounts in new generation capacity and allegedly mainly bought from the incumbent. The incumbent is often the only player\(^5\) which has a large and varied portfolio of generation, which because of the technical characteristics of generation and market conditions is of particular importance in setting prices.

10. Cross-border flows seem to have limited effects on constraining prices between most Member States, and integration between historically separate national markets has been slow in many regions. There appear to be significant barriers to entrants accessing existing interconnection capacity. In addition, transparency as to the available capacity of networks, across borders or in-country, seems to be limited, especially for gas.

11. Directives 2003/54/EC\(^6\) and 2003/55/EC\(^7\) oblige Member States to establish a legal and functional unbundling between monopoly activities (network) and competitive ones (generation and supply). However, complainants have raised concerns that network operators nonetheless favour their affiliates. The sector inquiry will look into this and analyse whether this alleged behaviour of network operators respects the relevant dispositions of European competition law. In addition, it seems that the design of network rules appears not always to take into account in a sufficient manner the needs of a competitive market at a European level: Access costs to gas networks allegedly show a surprising degree of variation, given that it is regulated and should be based on cost and operational requirements that might be expected to be largely similar between similar facilities. Also access costs to gas storage, which is not regulated, seem to show a high degree of variation.

4. **Approach**

12. The gas and electricity sectors may present different obstacles to competition not only because the markets are at different stages of development but also because the two sectors have quite different production structures and because gas is obtained from a limited number of sources. However, it is also important to bear in mind that, since a large part of the electricity generation capacity uses gas as a fuel, competition problems in the wholesale gas markets can have an impact on electricity markets and that suppliers increasingly make dual fuel offers.

13. The proposed Decision provides investigative powers for a sector inquiry covering the entire EU. Data collection will give priority to those Member States and issues where markets appear to function less optimally relative to others and where enforcement measures are likely to have the largest immediate impact on stimulating the emergence of more competition on the European market.

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\(^4\) Ibid pages 5 and 6 of Annex 1
\(^5\) Ibid pages 5 and 7, annex 3 table 3.3 and annex 5 table 5.1
4.1 Data to be collected

14. Data to be collected will cover information to place companies’ unilateral conduct and cooperation in their proper legal and economic context. Account will be taken of the need to ensure security of supply and of public service obligations. In addition to the guidance that will be provided to competition law enforcement the results of the inquiry will also contribute to the Commission’s assessment of progress on the implementation of Directives 2003/54/EC and 2003/55/EC, on which it is required to present a first report by the end of 2005.

15. For the electricity sector, the analysis of key problems set out above would lead the Commission to collect information inter alia on the following issues:

- how company conduct, the organisation of the trading system and transparency of wholesale markets influences the price formation mechanisms in the wholesale market and, consequently, prices paid by final consumers;
- electricity generation and supply, notably: information on merit curves, prices, market transparency and other factors determining generators’ dispatching and bidding strategies. Information gathered on costs will also be analysed with a view to any possible implications on EU state aid policy in the sector;
- barriers to entry, notably into wholesale or retail markets, in particular long-term agreements, and their impact on electricity supply and customer acquisition, barriers to building and exploiting optimally new generation capacity as well as barriers resulting from balancing arrangements;
- legal and operational regimes for inter-connectors, including in particular their impact on access, risks and costs for electricity importers, and on actual capacity reservations;
- relations between network operators and their affiliates and the effects of their interactions on the markets;

16. For the gas sector, the analysis of key problems set out above would lead the Commission to collect information inter alia on the following issues:

- the terms of long-term import contracts and swap agreements, in particular, their interactions with network operations and hub liquidity, operational practices in these relationships, transparency of wholesale markets, and the market impact of these factors;
- legal and operational regimes for networks, with particular focus on cross-border transit, including in particular the extent of available capacity, transparency, and the market impact of these factors;
- legal and operational regimes for balancing and storage and their market impact, including justification for the delineation of balancing zones, transparency, and market requirements for flexibility products;
- the existence of long-term downstream contracts, and other contractual mechanisms or incumbent conduct that may increase switching costs or deter market entry;
- relations between network operators and their affiliates and the effects of their interactions on the markets.

4.2 Agents to be contacted
17. The scope of the inquiry primarily covers aspects of the business activities of the following undertakings:

- In electricity: generators, traders of electricity or access rights (or financial derivatives from these), owners and operators of transmission and distribution networks, electricity exchanges, operators of “merchant” inter-connectors, wholesalers and demand aggregators, industry associations, consultants, intermediaries, end-users and retail supply companies;

- In gas: gas producers (including some producers outside the EU), gas importers, traders of gas or access rights (or financial derivatives from these, operators of gas hubs, owners and operators of high-pressure transmission and low-pressure distribution systems, operators of “merchant” inter-connectors, wholesalers and demand aggregators, storage operators, industry associations, consultants, intermediaries, end-users and retail supply companies;.

18. In conducting research, information might also be sought from authorities such as National Regulatory Authorities and their European representatives, National Competition Authorities, financial regulators or Member State governments.

5. Procedure

19. Article 17 of Regulation 1/2003 requires that the Advisory Committee on Restrictive Practices and Dominant Positions be consulted prior to proposing this decision to the Commission. The Advisory Committee agreed with the envisaged Commission decision to open a sector inquiry in the electricity and gas sectors and recommended publication of its opinion. In accordance with standard practice, the report on the outcome of this consultative procedure is annexed to this Communication. The Commission will inform the National Competition Authorities, the National Regulatory Authorities and their European representatives regularly on the progress of the inquiry, within the limits provided by Council Regulation (EC) 1/2003.

6. Proposal

Therefore, it is proposed to the Commission that it

- Takes note of the opinion of the Advisory Committee
- Adopts the attached decision to open a sector inquiry under Article 17 of Regulation 1/2003.