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THE INTERNAL ENERGY MARKET:



FOUNDATION OF THE EU ENERGY POLICY

Why an internal energy market?

The EU has clearly recognised that a functioning and competitive internal energy market is essential for ensuring fair prices to citizens and industries. It also ensures that smaller companies have access to the energy grid. A well functioning market provides incentives for investments in power plants and transmissions networks to avoid interruptions in power or gas supply.

Evidence shows that the internal energy market is not functioning well. More needs to be done to create a European gas and electricity grid and to have a truly competitive market. In order to realise the full potential of the internal market, the European Commission has therefore identified a number of possible improvements as part of its Energy Policy for Europe.

The situation today

A competitive internal market for electricity and gas has been progressively implemented across the European Union since 1999-2000. Liberalisation has clearly led to some efficiency improvements in energy supply and delivered savings to customers, particularly in the initial phase. However, recent increases in wholesale electricity and gas prices have, to some extent, fed through into the bills of end-users and now offset some of the earlier reductions, particularly for the very largest industrial energy users.

Retail electricity prices have remained relatively constant in real terms over the period. As far as gas is concerned, the factors affecting prices, such as the need to move to higher cost sources of supply and the continued linkage of some gas imports to the price of oil, would have occurred whether or not competition had been introduced. It must be recalled that energy prices cannot be expected to always remain low regardless of external factors.

The Commission also believes that other factors come into play. One of them is the fact that energy markets in the EU remain fragmented, with limited competition. As a consequence of these shortcomings, the Commission has, throughout 2005-06, been conducting an inquiry for the gas and electricity sectors under competition law.

At present, the European Union is far from being able to guarantee to any EU company the right to sell electricity and gas in any Member State on equal terms with the existing national companies, without discrimination or disadvantage. In particular, non-discriminatory network access and an equally effective level of regulatory supervision in each Member State do not yet exist.

The Commission's objective is to have a complete internal energy market with open competition and effective regulation in place. A real European grid should work as one single grid. Therefore, a number of actions need to be taken in order to address these shortcomings.

Actions needed

The identified measures include:

- New rules to avoid discrimination, for instance so that a company owning both power generation and distribution network does not hinder the access of other companies to the market. Two unbundling options could redress the problem. The most radical is called "ownership unbundling", by which vertically integrated companies would be split between their different activities. Another possibility would be the creation of independent system operators, by which system operation would be separated from ownership of the assets. The unbundling solution chosen must apply to all operators and to all national markets in order to avoid inconsistencies between the national dimension of regulatory competences and the EU dimension of a single energy market.
- National regulators should be granted additional "ex-ante" powers. These powers would be used to prevent abuse of dominant positions by well-established market players. Certain individual national regulatory decisions, in

particular as regards cross border issues and the effective development of competition, should be notified to the Commission, possibly following a well-established model in the electronic communications sector.

- A functioning European wide regulation is also important for facilitating cross-border trade. The integration of national markets will increase competition and ensure a positive effect on gas and electricity prices. The Commission is currently analysing several different options.
- Gas and electricity needs to be able to flow freely across the European Union. This is essential not only to ensure a competitive market but also to guarantee security of supply. In order to achieve this, it is essential that transmission system operators make sufficient transmission capacity available to meet demand and integrate national markets. The network in the Member States was designed to fit the needs of many partitioned national markets not those of a single European one. Increased investment in the network with a pan European objective is therefore strongly needed.
- The electricity and gas networks are at the heart of a well functioning European market. Several actions could speed up investments in key bottlenecks, which typically occur at cross-border links. A number of most problematic missing links has been identified, such as power links between Germany, Poland and Lithuania, off-shore wind power connections in North Europe, electricity connections between Spain and France, gas pipelines from the Caspian to central Europe.
- The Commission will pay special attention to two key questions for the gas market: long-term contracts between external producers and companies supplying customers should not result in market foreclosure within the European Union. Concerning access to gas storage facilities, a balance has to be found between the need for effective access and maintaining incentives for new storage developments.
- Transparency is essential to market functioning. New legislation will be needed to establish minimum requirements. At present, Transmission System Operators provide varying levels of information, making some markets easier than others to compete in for new entrants. Furthermore, some regulators require generators to be more transparent regarding generation availability than others, which can help prevent price manipulation. Minimum requirements need to be established and to be respected by all EU companies, similar to that already adopted for telecommunications.
- Common minimum, binding network security standards are necessary as well.
- The Commission will pay special attention to the rights of consumers' and energy as a public service. An Energy Customers' Charter will be developed. This will include measures to address fuel poverty, information to customers to choose a supplier and supply options, actions to lower red tape when changing energy supplier, and, protect citizens from unfair selling practises. A specific information campaign will be launched to support this initiative.

The Commission intends to make proposals to the European Parliament and the Council in order to amend the existing legislation for electricity and gas.