

PRESS STATEMENT

17th November 2005

EFET reaction to the initial report of DG COMP inquiry into the energy sector

EFET welcomes the recent publication of an initial report by DG Competition, explaining the first results of its inquiry into the electricity and gas sectors in the European Union.

EFET appreciates the transparency of the consultation process and of the report itself as issued by the Commission. The inquiry could mark an important step towards the establishing of open and liquid European energy markets.

EFET supports most of the conclusions reached so far, on the basis of the analysis of answers to questionnaires sent out as part of the DG COMP inquiry. In particular the significant criticism of market concentration, vertical foreclosure, lack of market integration and price formation in the gas sector are well founded. We also agree that non-transparency of information for new market participants about utilization of infrastructure is a barrier to entry in both the power and the gas sectors.

However, of "the five areas of market malfunctioning"¹, identified at this stage, EFET will be raising questions on the electricity side about three of them:

- **Market integration:** We do agree that "inadequate allocation rules are barriers to market integration". However, it is an oversimplification to conclude that: "Incentives to increase capacity need to be strengthened. Congestion fees should be used more for reinforcing cross border capacities"²;

¹ See <http://europa.eu.int/comm/competition/whatsnew.html>, press release MEMO/05/425.

² Enforcement by regulators of the transmission operators' legal obligations under EU Regulation 2003/1228, to *maximize* the capacity being made available to suppliers at cross border interconnections, is a far more important and efficient means in the medium term of overcoming barriers to market integration. Physical reinforcement of lines will only be needed in exceptional cases. Operators are routinely underestimating the capacity that they could make available to market participants *using existing infrastructure*, and routinely overestimating how much capacity must be withheld in case of outages or unusual loop flows. Regulators are acquiescing in outdated and inflexible calculations of NTC (so-called "net transfer capacities".) With proper incentives, operators will be capable of guaranteeing much higher transfer capacities for use in trans-national wholesale markets than they do at present. They could often use their auction revenues operationally to back such guarantees, for example by coordinating the re-dispatch of generating plant or counter-trading, without needing to incur capital expenditure (*Peter Styles*, Chairman of EFET Electricity Committee).

- **Transparency:** The phraseology adopted in the DG COMP press release, "...poor transparency of wholesale markets prevents a level playing field for electricity trading [...] useful, important or indispensable information is lacking" (DG COMP, par.4) was badly chosen. On the other hand, the initial report itself seems to make it clear that the issue is not transparency of information available to new market entrants concerning the use of electricity infrastructure³;

- **Price formation:** We have already heard often in the last year or so that "energy consumers do not believe that prices on wholesale markets result from fair competition" (DG COMP, par.5); the accuracy of their belief with respect to electricity remains to be tested.

EFET very much hopes the representatives of industrial consumers will join with us, as advocates of properly functioning markets in power and gas, to demand due implementation and enforcement in all countries of Europe of the internal market reforms already achieved, as indeed urged in the DG TREN preliminary report. Special treatment for "protected" sectors, a return to regulated prices, or distorting subsidies will be counter-productive⁴. Those interested in the future competitiveness of Europe must always work for rather than against the markets; because if our markets do not function none of us in Europe can win on the global stage in the long run.

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³ Transparency of information for new market entrants about the availability of physical infrastructure, which is normally controlled by the companies with whom they seek to compete, is indeed crucial. It is important, however, to distinguish allegations by some misinformed commentators, about lack of transparency in the functioning of wholesale power markets themselves, from the very real difficulty of some traders in obtaining information about transmission flows and generation output. It is quite normal for OTC bilateral and brokered wholesale transactions in electricity or any other commodity to be the subject of commercial confidentiality about the price and other terms. In liquid markets broker platforms and price reporters provide anonymous estimates of the actual market prices over time. On a power exchange the bid and offer prices are publicly known but the identity of sellers and buyers is protected, for similar reasons of commercial confidentiality.

⁴ We understand that major energy consumers are disappointed with the results of liberalization at this stage of the evolution of power markets. They face competition across the world from companies with access to cheaper labor and energy costs. However, most of them missed an opportunity to lock in their electricity costs, or hedge against future increases, when wholesale prices sank dramatically in the period 1999-2002. It is unfortunate that not many of even the largest industrial consuming companies run an active energy price risk management function and thus are not much evident in the wholesale electricity markets themselves. They could potentially add to liquidity and place their own power demand responsiveness more actively into the supply and demand equation.

EFET shares the concerns of those energy consumers that urge more rapid progress in the development of traded gas markets throughout Europe. Not only are gas consumers often denied competitively priced gas, but also many power generators who use gas for fuel are unable to source their gas supplies on robust traded markets).