

SPEECH OF MR BARBASO

DEPUTY DIRECTOR GENERAL

DG TREN

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Ladies and gentlemen:

First, let me say that I am delighted to be here in Florence for my first experience of the Florence Forum. I think it is important to note that the Commission attaches considerable importance to these types of “semi-formal” meetings and you may be aware that we now have additional Fora to discuss renewables issues and questions related to fossil fuels at Amsterdam and Berlin respectively.

As you know, the Commission, in March 2006, published a Green Paper on Energy Policy. This document sought to address some of the major challenges ahead for the European Union to ensure a competitive, secure and sustainable energy supplies. A considerable part of the document was devoted to the question of the functioning of the internal market and the important role of competition in delivering these energy policy objectives.

In this context, it is worth recalling the key benefits of the internal market for the three objectives of competitiveness, sustainability and security of supply.

Firstly, in relation to competitiveness: we remain convinced that the internal market will lead to more efficient companies in terms of their operations and investment decisions. This, over the long term, will be the best situation for customers too. Of course it is always possible to hold prices artificially low by a government decree without introducing competition. But in the end someone will have to pay the real costs of energy provision and these costs are likely to be higher in the absence of a competitive, transparent process.

Of course, I know that energy prices have increased rather quickly in the last two years and that this has had a negative impact on some energy consuming businesses. I also agree that part of the cause might be the result of a dis-functional market. At the same time it is important to remember that prices will fluctuate and react to external forces just as they do for other commodities such as metals, chemicals

and so on. Prices have to be free to give the right price signals for investment.

At the same time, it is also worth underlining that, ultimately, individual companies are responsible for their own energy procurement. A competitive market at European level, with companies free to negotiate according to their own requirements, will deliver the most efficient results and the best outcome for consumers over the long term.

Therefore I firmly believe that the answer to current state of disillusionment is to improve the new framework rather than contemplating backward steps. The Commission is working hard to deliver improvements, both through the sectoral enquiry and the work of our Directorate-General which I will explain later.

Regarding the objective of security of supply, it is my view that we now have powerful evidence to suggest that an integrated market will, in fact, provide a strong incentive to investment in generation plant

and gas infrastructure. Clearly it is a much safer proposition to devote, for example 500m Euro to a new plant, pipeline or LNG terminal if the potential market is 400 million customers rather than small national market of 25 million. A larger market also better allows for greater diversification into a range of different primary energy sources from different locations.

The results so far are encouraging and a large amount of investment is already in progress – for example, something like 100GW of new and replacement generation plant is being planned and constructed. There are similar investments on the gas side.

Finally, in relation to the question of sustainability, an important feature of a competitive market is that it leaves space for a variety of different energy solutions. With fair network access and the introduction of customer choice, new ideas and approaches are more likely to be initiated and succeed.

Incentives such as the renewable Directive, and schemes such as Emission Trading, which allows for a price to be put on carbon emissions will accelerate this process.

Suggestions that the Community, in the face of higher energy cost, should also abandon these key sustainability objectives would seem to me to be misplaced. And I can tell you frankly that this is not a step we will be taking. Certainly there are certain improvements that could be made, for example, to the Emission Trading framework and Member States and the Commission will be working towards this in the 2008-12 and subsequent allocation rounds. The European Union has decided to take a leadership role in this question and we have to face up to these responsibilities.

These are some of the main reflections of the Commission on progress to date with market opening. However the picture is not all positive.

At the meeting last year was discussed the input to the Commission's 2005 report on the implementation of the Directives. This document set out a range of shortcomings and a work programme for the Commission. One of the key messages from stakeholders was that the implementation of the existing Directives should have a high priority. As you know, we have taken this message seriously and in April we launched a number of infringement cases against Member States. I can assure you that the Commission will continue to diligently apply the existing rules regardless of any future developments.

The Commission also undertook to produce an updated report at the end of 2006 based on further examination into the real functioning of the electricity and gas markets in individual Member States, including interviews with key market participants. These so-called country reviews are now being completed.

Our objective with this work has been to get a clearer view of the dynamics of the market opening process in Member States and to

really focus on the main barriers for future development – not just to assess what has happened to date.

A final task which the Commission set itself was to maximise the use of existing possibilities to adopt guidelines – both through the ERGEG process and under the Regulations. I remind you all that the gas Regulation entered into force in July 2006. The new congestion management guidelines, which are a mandatory requirement, will be in place before the end of this year. ERGEG has also come forward with numerous important initiatives that have already been discussed today.

Talking to the companies which are trying to operate in the new framework, in the context of the country reviews, has given us a good idea of the various problems that still exist. It is now two years since the Directives were required to be implemented and I consider we have now arrived at the point where it is possible to draw together some basic conclusions about how well the electricity and gas market

will function. It is no longer “too early to judge”. In my view there are three main areas that merit further attention:

The first is the important question of the role of energy regulators. It is already clear that there are substantial inconsistencies between the various powers and duties of regulators in Member States and the level of day to day independence. There are also several instances of regulatory gaps at European level in which, it is alleged, the most powerful companies can exploit to gain an advantage.

This situation must be improved.

A second question, which is not so clear cut, are the various issues relating to the organisation structure of transmission system operators. TSOs have already made a very significant contribution to the market opening process. At the same time I believe it is also undisputed that there are some additional improvements that could be realised in this area.

Transmission system operators themselves rightly identify the need for additional investment and the necessity for a correct incentive structure. There are also views that a higher level of co-ordination, for example relating to real time information exchange and dispatch would considerably increase the amount of cross border capacity without the need for investment.

There are several models for transmission system operation that could be envisaged. The current framework of legally separate TSOs, closely regulated by existing and future guidelines is one option. Another possibility, which has already been used with some success, is common system operation across more than one transmission network. Finally, there are more fundamental structural solutions relating to unbundling which some argue is the only way to resolve the outstanding issues.

A third area, which has I know, already been the subject of significant discussion here, is the question of transparency and information disclosure. This has emerged as a high priority issue in the context of

the regulatory framework and as a part of the sectoral inquiry and it is clear that legislative options need to be examined by the Commission.

Finally, our country reviews have brought together considerable evidence of a lack of effectiveness of competition for smaller commercial customers and a lack of preparation for market opening for households. The root cause for this appears to be the unsatisfactory state of unbundling of distribution system operators. I want to make the point very clearly that the Commission will not tolerate further delays in implementing the unbundling requirements and that any discriminatory practices, cross subsidies or distortions coming from vertically integrated distribution and supply companies must be stopped.

As you will be able to discern from these comments, the Commission will, in its report at the end of 2006 begin the process of considering further legislation in the area of the internal market. This report will set out in more detail the possibilities along the lines I have just

mentioned. It will invite comments from stakeholders and it will conduct a full impact assessment on the various possibilities.

I want to be in a position by the middle of 2007 where the Commission is able to put to the Council and Parliament a well researched, proportionate set of measures which will tackle the remaining issues in the development of the internal electricity and gas markets.

The Commission has already received some useful suggestions from stakeholder in the context of the consultation on the Green Paper and I am looking forward to discussing these in more detail with you today.