

**Participation of Commissioner Piebalgs in the
“12th Meeting of the European Electricity
Regulatory Forum”**

Florence, 1 September 2005

Introduction

Good morning Ladies and Gentlemen

I would like to welcome all of you to this meeting of the European Electricity Regulatory Forum. I am very pleased to participate in this meeting for the first time and I am glad to see that this coincides with the return of the Forum to its town of origin: Florence.

I would first like to emphasise the importance the Commission places on this unique opportunity for regulators, network operators and market participants to meet in a semi-formal atmosphere and to discuss the major issues in this ongoing task that Europe has decided to set itself: the introduction of a competitive electricity sector. We should never fall into the trap of under-estimating the magnitude of what we are trying to achieve in this field.

At a time when concepts such as auto-regulation, co-regulation become very popular in all the economic sectors, it is important to recall that the Florence Forum opened the way of this new type of regulation in 1997.

I. Achievements in the opening of the electricity market

Of course we have already achieved a great deal as well and the previous meetings of this Forum paved the way to the results to date including the separation of TSOs and the creation of ETSO, the introduction of industry specific regulation with a high level of co-operation at European level with the Council of European Energy Regulators and now ERGEG; and finally the gradual emergence of a high degree of consensus on the strategic direction for the European electricity market. The creation of ERGEG as a consultative body for the Commission has to be understood in this context. ERGEG has its own consultative process. The Florence Forum, of course, made a huge contribution to the successful adoption of the 2003 electricity Directive and cross border regulation.

We have already solved a number of specific issues in this group, including the removal of cross border charges and the acceptance of the principle of non-discriminatory market based congestion management. These changes have clearly improved the prospects for cross border competition and the integration of

markets. Further improvements are likely once new guidelines are adopted and implemented.

However the European Union - both the Commission and the other institutions - regulators and industry must continue to examine whether everything is all as it should be in the internal electricity market and whether the reality matches up to the expectations. We will be held to account for the results of the restructuring of the industry, not on how elegantly the procedures were followed or the quality of our arguments.

So far the results have been somewhat patchy. There are some rather positive developments. The industry has considerably improved its efficiency, electricity prices have fallen in real terms for most consumers groups and in most Member States. Indeed electricity prices are roughly the same in nominal terms as they were in 1995.

By contrast, the oil price in 1995 was 15 dollars per barrel. Similarly gas import prices have increased from less than 10 Euros per MWh to some Euro 15/MWh during this period. These price reductions in real terms have been achieved at the same time as the industry has been experiencing a high degree of change for other reasons, not least the rapid increase in the penetration of renewable energy and the reduction of the levels of harmful SO_x and NO_x emissions.

II. Challenges ahead

However, even larger challenges arguably lie ahead. The European Union has set itself even tougher targets to reduce emissions of CO₂. At the same time the Union is increasingly reliant on imported primary fuels for which prices are at all-time highs. Finally a large proportion of generation plant will need to be renewed in the next 15 year period. All of these things have to be now dealt with in the context of a competitive market.

This suggests to me that the Union must make it itself totally clear on its expectations for the market opening process and expected results. Mixed messages and half measures simply will not deliver the required outputs. If Member States and regulators try to deliver the necessary restructuring without total commitment there is a clear risk that the result will be failure and lead to an unravelling of all the efforts that have been made so far.

Electricity prices

Current attention is focused on the developments of wholesale electricity prices. These have increased sharply across the board in the last two years. For example prices are now around 40/45

Euro/MWh. This contrasts with levels of Euro 20-25/MWh which were seen immediately after market opening.

Of course, these fluctuations often represent relatively small amounts of electricity being exchanged and for most customers the effect of these movements is smoothed out by supply companies: either voluntarily, or as a result of regulatory intervention.

However, it would appear that the very largest users are now unwillingly exposed to these types of price fluctuations. Both electricity companies and large industrial users have an interest in hedging against price fluctuations of this type since they both have to make long term investment commitments. It would be expected, by the Commission, for such large customers and electricity producers to negotiate on this basis.

Certainly the working of wholesale power markets merits careful consideration, particularly in terms of their level of transparency and the powers of market surveillance. In close contact with me, Commissioner Kroes has therefore decided to launch an investigation of the electricity market which focuses on some of these unanswered questions. Many of you will have received a questionnaire in this respect.

It is also important not to overreact to current price developments. The reasons behind current wholesale price trends are rather complex. Higher prices for raw materials, the upcoming need for investment in new generation, climatic conditions and new obligations on the electricity industry are all external explanations for the current trends in electricity prices. Furthermore we need to give the market a chance to respond to price signals by bringing forward new investments in generation capacity, or through energy efficiency measures. We need to remember that electricity generation is no longer a monopoly activity and any company is now entitled to enter this market to take advantage of current price levels if there is some profit to be made.

Competition

However companies entering the market need to know that competition will be fair. Any perception of discrimination or obstacles to the free movement of their product will be a severe disincentive in this respect. Here is where the work of this Forum can continue to make a significant contribution.

As you know, in addition to the sectoral inquiry, the Commission will, by the end of this year, also produce a report examining the implementation and effects of the 2003 Directives for electricity and gas. You have already had a

chance to discuss some of the themes to be examined in this report yesterday and we have already received submissions from both market participants and formal reports from Regulators.

It is probably safe to say that we know already that some arrangements are still less than perfect for the development of competition, particularly as we wish to see electricity markets going further than national borders. This is partly due to incomplete implementation of the existing legislation. Some Member States still have not implemented key aspects of the Directive and others have only just done so. The Regulation on cross border electricity exchanges is also not yet implemented in a satisfactory way across the board.

It is also possible to envisage, if necessary, possible improvements to the regulatory framework. These range from technical issues, which it may be possible to introduce within existing frameworks, to more far reaching measures which some might argue are necessary to ensure a really level playing field where conflicts of interest, both real and perceived, are all removed. Of course this applies to both the gas and electricity sector.

The Commission has still to develop its position in this regard and much will depend on the result of the existing measures; not just by the end of this year, but also in future years. Therefore,

for the time being, the Commission remains in listening mode. I hope that our report at the end of this year will allow for debate to continue while some Member States catch up with implementing the current Directives.

Be assured that we will continue to work closely with regulators and stakeholders during this time. However, it must be made clear that the Commission will not hesitate to come forward with new proposals if the time is right and if the evidence is such that new proposals are the best way of dealing with the outstanding issues.

Conclusion

The introduction of competition is, of course not the only objective of European Union energy policy. Sustainable development of energy policy which delivers environmental objective and security of supply is also a key feature of this work.

One of the priorities of the Commission with respect to both these objectives is the need to continue the improvement of energy efficiency. I would like to finish by explaining the main points of our recent Green Paper on this subject.

Of the large industrialised nations, Europe leads the world in terms of its energy efficiency performance. For example, the EU25 uses less than half the energy per capita than the USA which translates into a far superior level of efficiency. This has the potential to become a significant economic advantage to the European Union given the current position of global energy prices. I want our leadership in this area to be continued and expanded as far as possible.

In this context, I have made it one of my priorities to further promote energy efficiency in general. Despite the good record of the EU in this regard, it is estimated that one fifth of our energy is simply wasted. Simple changes in behaviour (such as switching off lights, computers and machines on stand-by) or small investments (such as in energy saving light bulbs, insulation or thermostats) can make a big difference to Europe's total energy demand bill.

I am therefore convinced that there still remain easily achievable gains to be made in the demand management field and that reducing energy demand and improving energy efficiency must be central objectives. We need to ensure that the industry and consumers all have the correct incentives to achieve such reductions.

The Community already has a large range of legislation in this field which sets a good background to guide national efforts. The Directive on Energy Efficiency and Energy Services, currently being discussed, should ensure a further concentration of effort in this area. These initiatives are already expected to reduce the rate of growth of energy consumption in the economy.

The Green Paper examines the further potential which exists for energy efficiency and I anticipate a constructive dialogue with various stakeholders, including the electricity industry, to work together towards exploiting this potential.

I would like to sum up by reiterating the commitment of the Commission to the process of embedding competition into the electricity and gas markets. Already further developments are being progressed including the adoption of guidelines under the cross border regulation. which should be approved in the coming months. We should continue our discussions on what other improvements might subsequently be envisaged.

Continued progress that is being made both here at the Florence Forum and in other discussions. I would like to recall that

through this work, over the last seven years, the European Union has built the most advanced system of electricity regulation in the world. It is a common work of all participants, principally the Regulators as well as ETSO, who have shared with the Commission their responsibilities and expertise.

I would therefore like to thank all of you for your good cooperation which has provided these results. I very much hope and expect these results to continue in the future thanks to the excellent work of the Florence Forum.