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EUROPEAN COMMISSION

Brussels, 9 June 2011

COMMISSION STAFF WORKING DOCUMENT

2009-2010 Report on progress in creating the internal gas and electricity market

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Report on progress in creating the internal gas and electricity market

1. CONTEXT

The general economic context has put pressure also on the energy sector with level of consumption still relatively low, although figures for the beginning of 2010 show some signs of recovery. On the regulatory front, some positive signs of market integration are registered such as the market coupling of the Northern and Central West electricity region. However a truly single energy market is far from complete.

As the EU single energy market has the potential to deliver great benefits in terms of growth and development, its achievement remains a priority for the Commission, as stated in the Communication "Energy 2020 A strategy for competitive, sustainable, and secure energy". The internal energy market is a crucial lever to provide Europe with secure, sustainable and affordable energy supplies. This report¹ discusses the developments in the EU electricity and gas markets over 2009 and first half of 2010 and their likely affects on future market developments.

¹ This report is based on the following sources mainly: reports submitted by national regulators and Eurostat data on end user prices. The national reports were submitted to the Commission in the second half of 2010 and they mainly cover 2009; Eurostat data were available for the first half of 2010 and were retrieved on 3/12/2010.

2. DEVELOPMENTS IN KEY AREAS, DEFICIENCIES STILL TO BE ADDRESSED

2.1. Implementation of legislation

Third Package

In 2010 Member States were actively engaged in preparing the transposition of the Directives of the Third energy package² into their national laws. The Third package was adopted in June 2009 and the deadline for its transposition was 3 March 2011. The Commission has consistently underlined the importance of a timely and correct transposition of the Third package Directives.

In particular the implementation of the rules on unbundling of networks, and of new rules on the functioning of retail markets are of great importance. Also the new rules on the independence and powers of national regulators are indispensable for a proper functioning of markets, and national regulators must be equipped with sufficient resources to fulfil their role notwithstanding budget austerity that may exist in certain Member States.

So far the results of the transposition of the Third package in the Member States have not been reassuring. By 1 June 2011, no Member State had yet notified transposition measures to the Commission, although 4 Member States had filed partial notification. Only in a few Member States had draft legislation been submitted to Parliament for adoption, while in other few Member States the government had been empowered by the Parliament to adopt the necessary transposition measures, but the measures themselves had not yet been adopted. Overall the state of implementation of internal market legislation at national level is disappointing, with still many open infringements under the second package.

Second Package

The Commission monitors the functioning of the Member States energy markets and controls the application of the relevant Community law. When a violation is detected the Commission takes action by opening infringement procedures. In the course of monitoring compliance with the second energy market liberalisation package, the Commission, in June 2009, initiated infringement procedures against 25 Member States and sent Letters of Formal Notice with respect to non compliance with the Electricity Regulation (1228/2003) and Gas Regulation (1775/2005).

The Commission after analysing the replies to the Letters of Formal Notice of the Member States concluded that Denmark, Estonia, Finland and Latvia had taken

² This package consist of five new legal acts: Directive 2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC; Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) No 713/2009 establishing an Agency for the Cooperation of Energy Regulators; Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005.

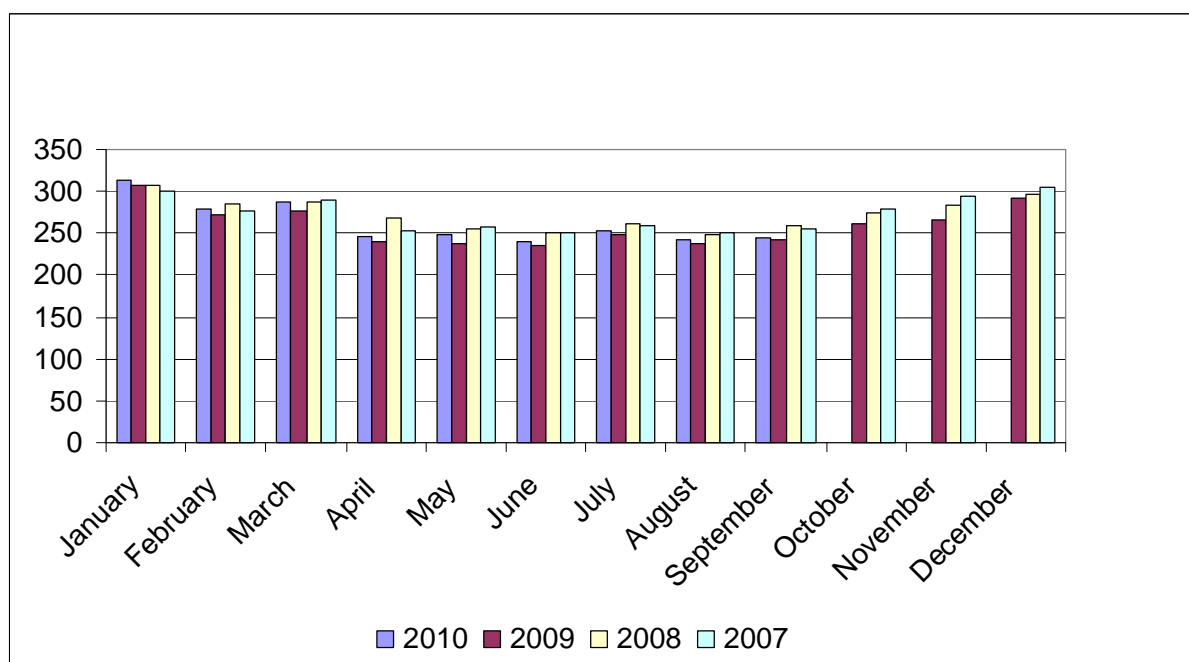
measures to align with the requirements of the Community law. For the rest of the Member States, the Commission's assessment pointed out only few violations had been properly addressed and decided in June 2010 to pursue the infringement procedures further and sent 35 Reasoned Opinions to the following Member States: Austria, Belgium, Bulgaria, Czech Republic, Germany, Spain, France, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, Romania, Slovenia, Slovakia, Sweden and United Kingdom.

The Commission is currently reviewing the replies to the Reasoned Opinions it will decide on possible referrals to the European Court of Justice.

2.2. Market integration

Description of the trends in gas and electricity market

Graph 1 –EU 27 monthly gross consumption of electricity (TWh)

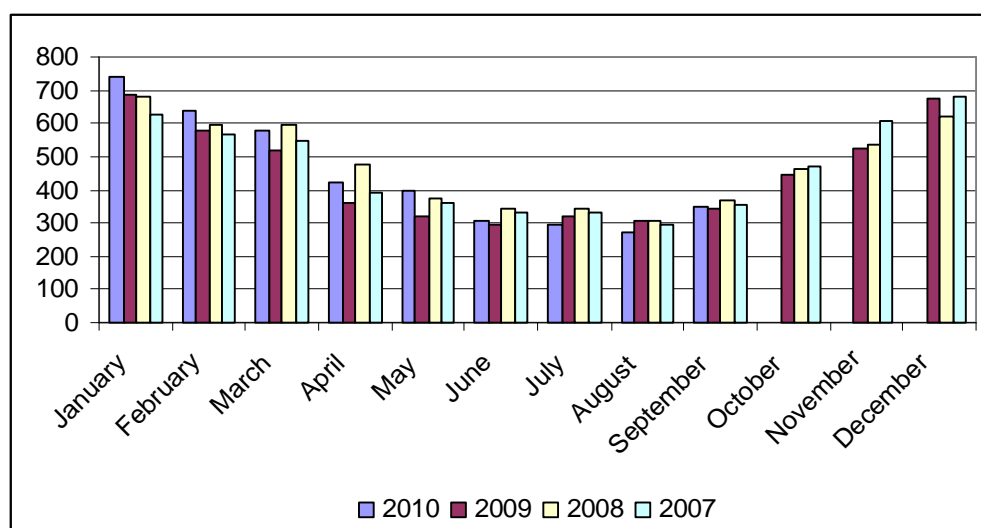


Source: Eurostat

In 2010, according to Eurostat preliminary figures, the monthly electricity consumption in the 27 Member States started to slightly increase again confirming that the Union was slowly coming out of recession. In the electricity markets generation capacity increased steadily in the EU 27 Member States. Generation and consumption of electricity were roughly in balance in 2009. In the aftermath of the economic slowdown, consumption decreased by more than 4% in 2009, much in line with EU real GDP growth. Also in 2009, for the majority of Member States, the

amount of energy exchanged³ with neighbouring countries in relation to the consumption was well above 10%

Graph 2: EU 27-monthly consumption of natural gas (TWh_GCV)



Source: Eurostat

On the natural gas market the most obvious impact of the economic crisis that affected the Union was the significant slump in consumption. This reduction was outpaced by the decline in EU domestic production of natural gas as more and more production fields were entering into post-peak phase. Nevertheless, gas consumption increased again in the first months of 2010 starting to recover from the downward trend experienced in 2009.

Volume and liquidity on wholesale market

Positive developments towards more market opening and integration have been registered. Market participants continued to trade actively on spot markets despite the reduction of industrial demand resulting from the recession and slow recovery. For example the volume of electricity traded at spot markets remained stable in 2009. In gas, the traded volume on the three most liquid spot markets rose by 4.45% to reach 1455 TWh in 2009.

Wholesale electricity markets showed increased integration through market coupling spread to several regions and a greater convergence of wholesale price has emerged. Examples of such positive developments are the significant decrease in price differences between Nord Pool Spot and EEX/EPEX Spot in 2008-2009 and increased price convergence in the Iberian wholesale market. On November 2010 market coupling was launched to the whole Central-West region and simultaneously the first harmonisation between two regional market coupling projects (Central-West region and the Northern market, involving 10 different countries). In the near future other projects of price coupling are expected to be implemented on the Italian-

³ Total electricity exports and imports as % of gross consumption- 2010 Annual Report of the Market Observatory for Energy

Slovenian border and with the introduction of the BritNed and NordNed cables in the market coupling of the Central West region. These are important steps towards the target of a pan-European price coupling, by 2014.

Wholesale gas and electricity markets play a key role in determining energy costs for households, businesses and in supporting investments in new generation. Therefore an adequate regulatory framework of these markets is necessary to deliver effective oversight and transparency. With this concern in mind the Commission on 8 December 2010 launched the proposal for a Regulation on energy market integrity and transparency⁴. The proposed Regulation develops rules which could prohibit market abuse on wholesale markets in electricity and natural gas and their related products. These rules include clear prohibitions on trading on insider information and market manipulation and are formulated in a consistent way with the Market Abuse Directive, and do not apply to financial instruments which are already covered by that Directive.

Regional initiatives: future and past

As stated in last year's benchmarking report, the future success of the Regional Initiatives will depend on their ability to adapt to a number of challenges which include the new top down approach of network codes, the risk of divergence between regions and the format of stakeholder involvement. For all these reasons and considering the entry into force of the Third Energy Package, the Commission published a Communication on the future role of the Regional Initiatives⁵ on 7 December 2010.

The integration of Europe's national energy markets continues to also progress through the concrete developments registered across all 7 electricity and 3 gas regions⁶. The regional electricity initiatives have focused on improving congestion management procedures, harmonising transparency and integrating market balancing. Some of the concrete developments that have occurred over the past few months particularly with regard to capacity calculation, capacity allocation and congestion management are the following: i) a Memorandum of Understanding on the capacity allocation mechanism was signed between the Baltic TSOs on 27 April 2010 and a congestion management procedure was implemented on the Latvian-Estonian interconnection aiming at the introduction of an implicit auction from January 2011; ii) in the Central West region, with the launch of the market coupling, TSOs have put in place coordinated capacity calculation verification and data exchange to build a common base-case and a new set of rules has entered into force for long term allocation of capacity; iii) in the Northern region the Danish TSO has proposed the use of the Use It Or Sell It (UIOSI) principle instead of the Use It Or Lose It (UIOLI) principle on the border of Germany to Western Denmark for 2011 long term auctions. This means that financial transmission rights will effectively be introduced. As far as transparency is concerned, 5 of the 7 electricity regions have adopted regionally-based transparency reports leading to a significant degree of coherence on the timing and type of data that must be published.

⁴ COM(2010) 726/3

⁵ See : http://ec.europa.eu/energy/gas_electricity/regional_initiatives_en.html COM(2010)

⁶ See also "Status Review on the ERGEG Regional Initiatives 2010" –November 2010

However, some serious concerns remain as most of the infringements procedures opened by the Commission against Member States identified the lack of a common co-ordinated congestion management method.

On the gas side, progress has been generally somewhat slower than in electricity. Some achievements include the 2010 Open Season between France and Spain that is leading to an increase of the cross-border capacity between the two Member States and is facilitating important investments in the coming years even though the open season did not indicate sufficient demand for an additional interconnector in the East. The South-South East region also features progress in coordinating regional investments in new infrastructure with plans to build an interconnector between Hungary and Slovakia and TAG is offering physical reverse flow capacity on a firm basis.

Moreover, some Member States signed up to initiatives aimed to increase transparency of fundamental data, to optimise usage of transport capacity and facilitate cross border trade⁷. Still many of them are developing too slowly, inter-alia due to their purely voluntary character. For a harmonised system enabling proper hub-to-hub trade, more stringent and common requirements would be necessary.

2.3. Concentration and consolidation

An analysis of the electricity wholesale market data showed⁸ that Bulgaria, France, United Kingdom, Ireland, Poland, Portugal, Slovakia, Spain reported an increase in market concentration as compared to 2008 (as the market share of the three biggest generator by capacity). However, ten other countries reported a decrease (Austria, Czech Republic, Germany, Hungary, Italy, Lithuania, Romania, Slovenia, Sweden, Netherlands) and in seven countries the situation was unchanged. Together, the three biggest generators of each country hold 600.000 MW out of a total capacity of 840.000 MW. The total number of generators with more than 5% ownership by capacity remained stable at 96. The increase in some countries was counterbalanced by the decrease in others. Regarding the Herfindahl- Hirschman Index (HHI)⁹ only 20 countries reported their figures by capacity. The average index for these 20 countries fell from 4208 in 2008 to 4177 in 2009, which means a small average decline in concentration. Nine countries showed an HHI decrease (Belgium, Germany, Italy, Hungary, Luxembourg; Poland, Romania, Slovenia, Netherlands) seven reported an increase (France, United Kingdom, Latvia, Lithuania, Portugal, Slovakia, Spain) and for two countries the situation was unchanged. At retail level the situation remains almost unchanged from the last year¹⁰. Only five countries registered a change in the number of companies with a market share over 5% in the retail market and in only seven countries the concentration rate showed a small decrease.

⁷ In France and Germany balancing zones have been merged, and Interconnection Point Agreement have/will be signed between Austria- Slovakia and Austria –Italia.

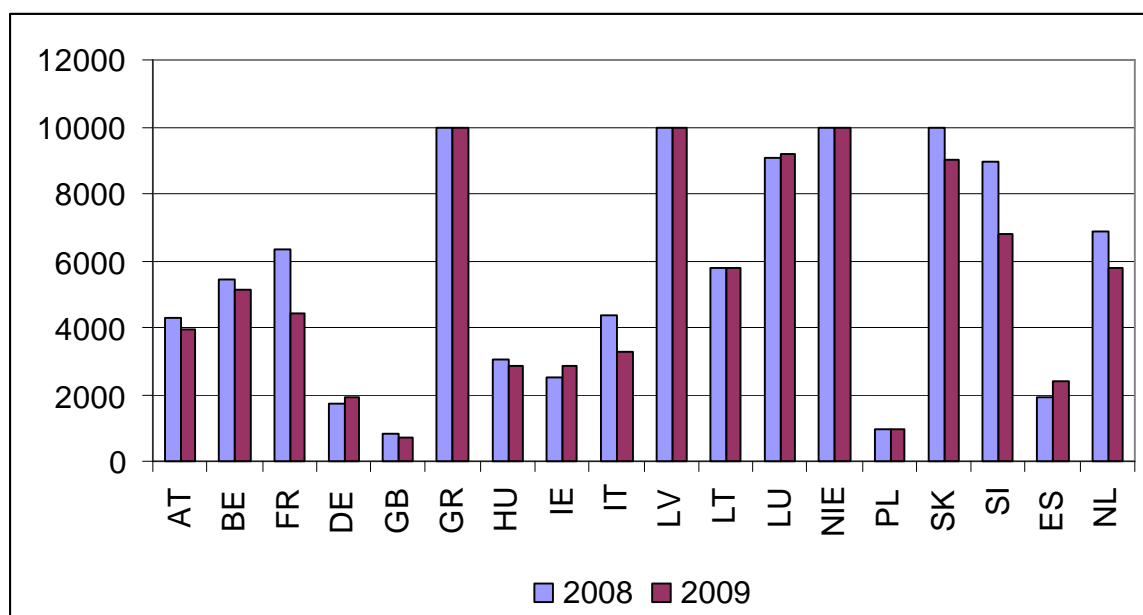
⁸ See table 3.1 and 3.2 of the Technical Annex

⁹ Herfindahl Hirshmann Index: It is defined as the sum of the squares of the market shares of each individual firm. As such, it can range from almost 0 to 10,000, moving from a very large amount of very small firms to a single monopolistic producer. Decreases in the Herfindahl index generally indicate an increase in competition, whereas increases imply the opposite.

¹⁰ See table 3.4 of the Technical Annex

On the gas wholesale market the HHI's decrease showed in 2009 for most of the countries that submitted data, may be ascribed to the increased share of short-term gas volumes in total supply on the EU wholesale market. However the concentration remains high¹¹. Out of the 21 countries who submitted data only United Kingdom has a concentration ratio for the 3 biggest wholesale companies less than 40%; a couple of countries have almost 70% (Spain, Germany) and the rest of the countries are very close to or above 90%. On the retail market the situation is quite similar to the previous year with the exception of the Bulgarian market where total market share of the three largest companies rose by 37.5% and Luxembourg where it decreased by 11%.

Figure: HHI in national gas wholesale markets



Source: Regulators data

2.4. Price trends

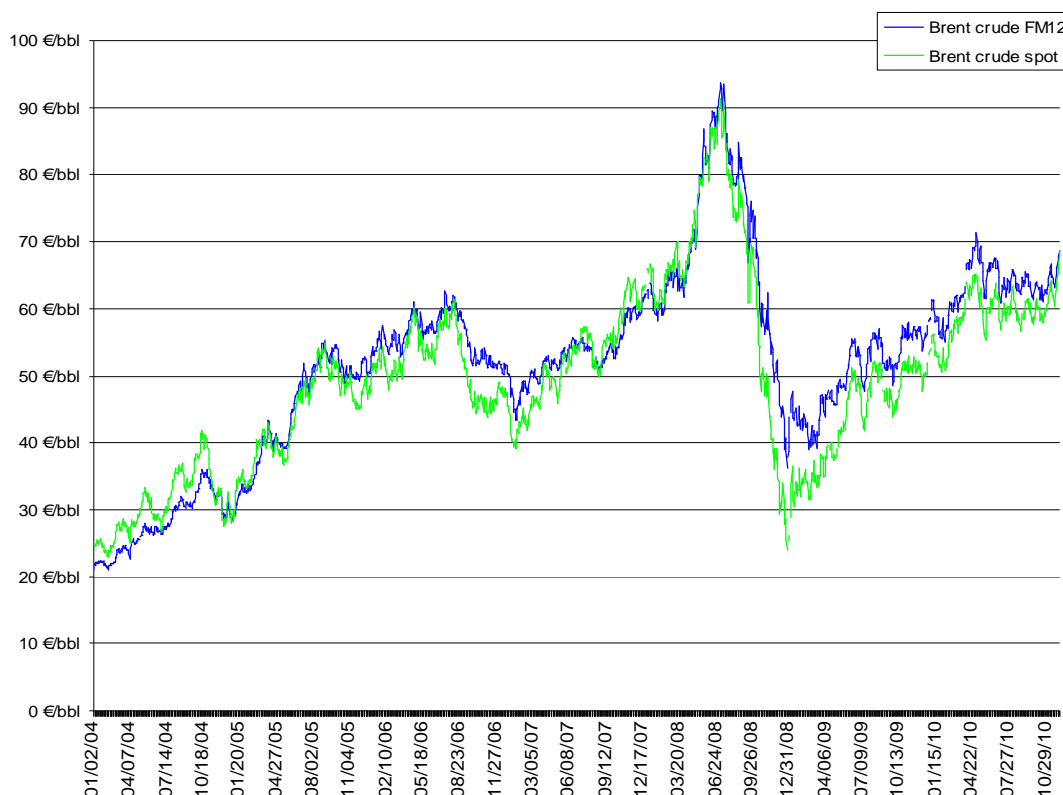
The oil industry was confronted in 2009 and the beginning of 2010 with an unstable economic environment. Instability was both reflected in the slight recovery that followed the global recession and in the increasing growth disparities between OECD and non-OECD countries.¹² 2009 has been a remarkable year in at least two respects. First, oil markets experienced the sharpest increase in spot oil prices in decades, and then prices fall sharply and stayed stable from July 2009 to the first-half of 2010. However as the economic perspectives in the period considered in the report were improving, oil prices were increasing again. Oil prices directly affect gas wholesale prices through the link between oil and gas prices existing in many long-term gas supply contracts. Electricity wholesale prices are in turn influenced by gas wholesale prices.

¹¹ See table 4.1 of the Technical Annex.

¹² China and India grew 8.5% and 5.4% respectively whereas the US (-2.4%) and the Euro Area (-4%) were in recession (Source: 2010 Annual Report of the Market Observatory for Energy)

Lower gas demand, increased LNG upstream capacity and the success of unconventional gas in the United States have put pressure on prices at wholesale level. Gas prices under long term contracts (LTC), which are indexed with respect to the price of crude oil or refined products, lagged by several months and this explains why LTC prices have not mirrored the reduction of spot gas prices. Spot gas prices, have become much more competitive and by the end of June 2010 LTCs still exceeded spot prices by more than €4 /MWh¹³.

Graph 4 – Evolution of Brent price in €/bbl



Source: Platts

The data available indicate that between the first semester of 2009 and the first semester of 2010 gas prices for domestic consumers fell in the majority of EU member states, on average by 7.7% to 12%,¹⁴. Contrary to this trend, quite significant increases in gas prices for domestic consumer were registered in Poland, Sweden and Denmark. The reductions in gas prices were bigger for industrial consumers and were 11.8% to 13.8% on average.

On the electricity side reductions for domestic consumers were significantly lower than for gas: at EU level the average decrease ranged from only 0.33% to 0.44%¹⁵. This stems from the fact that only few countries, Portugal, Netherlands, Ireland,

¹³ 2010 Annual Report of the Market Observatory for Energy. DG ENER publishes also regular updates on price developments. Please see http://ec.europa.eu/energy/observatory/electricity/electricity_en.htm or see http://ec.europa.eu/energy/observatory/gas/gas_en.htm

¹⁴ See table 5.9 and table 5.12 of the Technical Annex

¹⁵ See table 5.7 and 5.12 of the Technical Annex

Greece, and Luxembourg experienced a significant price reduction contrary to the majority which registered a lower decrease or significant increase such as Sweden, Poland and Lithuania. For the European industrial consumers the reduction was on average around 4%. Here also the picture is mixed with some countries like Slovakia, Luxembourg, Netherlands, Ireland, with considerably higher prices decrease than the average (i.e. reduction from 12% to 20%) and at the other side countries like Lithuania, Sweden, Denmark with substantial increases in electricity prices for industrial consumers.

2.5. Effective Regulation by Regulators

In 2009, there were no real changes regarding both national regulatory authorities' competences and unbundling regimes as we are in a transitional period of implementation of the Third Package. The Commission recognises that when fiscal consolidation measures are taken in Member States affecting the budget of all public authorities it can be expected that Energy Regulators may also be affected. Care should be taken to ensure that they maintain their capacity to fulfil their new tasks under the Third Package.

2.6. Consumer dimension

In 2010, consumer issues were given a high political priority by the EU Council of Ministers both at the Informal energy Council in September and during the Energy Council in December 2010. The Council conclusions welcomed the two Commission staff working papers "An energy policy for consumers" and "The functioning of the retail electricity markets for consumers in the European Union"¹⁶. Ministers recognized the importance of the Citizens' Energy Forum.

The third Citizens' Energy Forum, held in London in October 2010 considered a range of issues designed to improve the retail market for consumers. One of the innovative recommendations consists of the creation a European network that includes national independent energy ombudsmen and/or other fully independent dispute settlement bodies which would cooperate on the exchange of information and best practices.

Consumer response-switching

The data on switching continues to be incomplete for the majority of the countries. However the switching rate is generally low especially at household level¹⁷ with very few exceptions. This can be ascribed to the fact that the prices offered by different suppliers are not sufficiently attractive in economic terms to justify the consumers' effort to move to a new supplier (customer inertia). This analysis is also confirmed by the fact that the switching rates based on volume are higher than the ones calculated by meter points therefore indicating that at higher levels of consumption the convenience to switch to a new supplier is a bigger stimulus.

¹⁶ http://ec.europa.eu/energy/gas_electricity/forum_citizen_energy_en.htm

¹⁷ See tables 2.1, 2.2, 2.3, 2.4. of the Technical Annex

For electricity, the switching rate at the level of whole retail market is quite low with the exception of Ireland and Sweden. The annual switching rate for large industrial customers is generally higher and quite significant in Czech Republic 73%, Portugal (32.7%) and Italy (25.7%). Taking into account annual switching rates per volume higher rates are reported for all the countries that submitted data both at retail than at large industry level. It is worth noting that in two countries, (Austria and Romania), it decreased.

For gas, although the data are also very incomplete it is worth taking note of the following considerations. The switching rate by meter points at the level of whole retail market surpasses 10% only in one country (Netherlands). At the level of large industry it is worth noting a big drop in the rate for Germany, which passed from 15.8% to 4.2% between 2008 and 2009. Italy has the highest rate (34.4%) followed by Slovenia and Austria (17.6%). If we look at the rate taking into consideration the volume, Hungary (21.6%) and Italy (33.6%) have the larger rates of switching for the whole retail market.

Regulated prices

Regulated end-user gas prices remained in place in 16 Member States for household and in 13 for non household consumers¹⁸ and the total number of households supplied at regulated prices increased slightly. In 2009 Estonia removed price regulation. The 3 Member States that have regulated prices for household consumers only are Italy, Slovakia and Spain.

As far as electricity is concerned, more member states apply regulated end-user prices which continue to exist in 19 countries for households and in 16 countries for non-household consumer. While Spain removed them, Slovakia introduced regulated prices. The 3 countries that apply regulated electricity prices exclusively for households are Latvia, Poland and Spain.

As mentioned earlier, the Commission has opened a number of infringement procedures in 2009. In its judgment of 20 April 2010 (C-265/2008) the European Court of Justice stated that regulated prices can be in line with electricity and gas directives provided that they are strictly proportionate and limited in time. At present the Commission is reassessing the suspended cases in light of this judgment. Nine Member States are concerned and 14 cases are still pending in 2010.

Task Force for the implementation of smart grids in the internal energy market

Substantial progress has been achieved during the past year by the Task Force on Smart Grids. The support of the Member States and the stakeholders will be necessary to implement the conclusions of the Task force that are expected by mid 2011 (i.e. assessment of the needs for new legislation for smart grids and smart meters; data protection and security issues; roles and responsibilities of the parties involved; recommendations for funding of smart grids deployment and standards and interoperability).

¹⁸ See table 2.5 and 2.6 of the Technical Annex. See also last year report COM (2010)84 final

In order to implement the third energy package the Commission invited Member States to prepare comprehensive assessments of the rollout of smart meters, including cost benefit analysis, as envisaged in the third energy package. Sound implementation of smart metering is essential to facilitate the future development of the market.

In 2010 ERGEG completed a comprehensive consultation of all stakeholders on regulatory aspects of smart metering. ERGEG draft recommendations pointed out the differences of the benefits and opportunities for gas and electricity meters and urged Member States to define at national level a list of customer services required from the industry (DSO, metering operator, supplier). These recommendations will be of key importance for a consistent implementation in the 27 Member States.

3. SECURITY OF SUPPLY

Overall, electricity and gas consumption in the EU decreased in 2009. This decline is generally attributed to the global economic recession. In the long run, as it seems also from the provisional data for 2010, energy demand is expected to exhibit an upwards trend again. Therefore, with the indigenous EU gas supplies decreasing, security of supply is an increasingly important issue for the EU.

As far as electricity is concerned generation capacity still seems to be sufficient to meet peak load demand in most Member States. Indeed, generation and demand were well balanced in 2009. However more widespread generation from renewables energy sources poses a new challenge in securing stable supply and creates the need for new infrastructure as well as back up production. Interconnection capacity between Member states remains largely insufficient in the electricity sector and certain regions, such as the Baltic States, the Iberian Peninsula and Great Britain remain largely isolated. In 2002, the EU Council set the target for all Member States to have a level of electricity interconnections equivalent to at least 10% of their installed production capacity by 2005. In 2010, 9 Member States still had not met the target. Nevertheless a light increase of 2.5 has been reported for 2009¹⁹. Also within Member States, bottlenecks exist and those are likely to increase with the integration of renewables energy sources which are often produced far away from where they are consumed. Security of electricity supply benefits from the development of concrete initiatives promoting the cooperation between TSOs to enhance network security and efficiency at regional level.

As far as security of gas supply is concerned the 18 months covering 2009 and the first half of 2010 were an eventful period for the EU gas sector that had to face the consequences of the economic slowdown and two main gas disputes involving producing and transiting countries. Both these crises happened outside the EU but impacted consumers from Member States. These events prompted the European Parliament and the Council to adopt new regulation for security of supply, which was based on a proposal from the Commission and came into force on 2 December 2010²⁰. The focus of the Regulation is on prevention and crisis management in the

¹⁹ Source: Regulator data

²⁰ Regulation n° 994/2010 of the EU Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC.

internal energy market and ensuring that, in case of a crisis, gas supplies are guaranteed to protected customers, in particular households. The general trend of increasing reliance on external supply source was confirmed. As the volume of imported gas into the EU is gradually increasing, Member States are trying to diversify as much as possible the supply sources and routes. In 2009 the relative part of liquefied natural gas (LNG) deliveries in the total volume of imported natural gas in EU reached 20%. This is a positive development but not sufficient to reduce the risk of major pipeline import cuts that could affect the EU considering dependence on pipeline imports. Therefore there is a clear need for more investments in storage, LNG, technical equipment to reverse flows and interconnections between Member States and countries outside the EU in order to increase flexibility and mitigate potential supply disruptions.

The realisation of these projects which can substantially enhance the flexibility and security of gas supply and better interconnect all EU Member States has already started. In 2010/11 the European Energy Programme for Recovery (EPR) supports the construction of 31 gas infrastructure projects with EUR 1.39 billion. Learning from the lessons of the January 2009 gas crisis, the EPR supports projects for reverse flow in 9 Member States with around EUR 80 million and gas interconnectors with around EUR 1.3 billion, including new import pipelines. In addition, on 17 November 2010, the Commission has adopted the Communication *"Energy infrastructure priorities for 2020 and beyond - A Blueprint for an integrated European energy network"*²¹ where it defines EU priority corridors for the transport of electricity, gas and oil and a toolbox in order to enable a timely implementation of these priority infrastructures.

Moreover, the Commission monitors regularly the security of gas supply at EU level in the framework of the Gas Coordination Group²². During 2010 the group has met on seven occasions where the level of preparedness of the Member States has been assessed. The last meetings held after summer²³ analysed the preparedness of the EU for a potential supply disruption in the winter 2010/2011. The Gas Coordination Group examined the gas consumption and storage levels in the EU and assessed the emergency response procedures that have been put in place by the Member States since the January 2009 gas crisis. The main findings show in general a good level of preparedness of EU Member States. Storages were almost full in all Member States at the beginning of the winter, supply and demand side measures are available in case of crisis and a number of infrastructure projects notably reverse flow projects financed by EPR have been finalized recently. In addition, the analysis of the gas

²¹ http://ec.europa.eu/energy/infrastructure/strategy/2020_en.htm

²² The Gas Coordination Group was established on the basis of Council Directive 2004/67/EC by Commission Decision of 7 November 2006 in order to facilitate the coordination of security of supply measures between European Union Member States. It is composed of senior officials of Member States' administration and representatives of industry and consumer associations, under the chairmanship of the Commission. The task of the Gas Coordination Group is to facilitate the coordination of security of supply measures at Community level, improving preparedness of the EU and Energy Community countries with regards to supply disruptions, and to examine and assist Member States in coordinating the measures taken at national level during a crisis. The Group regularly exchanges information on security of supply with supplier, consumer and transit countries. For more info: http://ec.europa.eu/energy/security/gas/gas_coordination_group_en.htm

²³ The Gas Coordination Group met on 15 September, 10 November and 15 December 2010

infrastructure system carried out by ENTSOG suggests that, in most parts of Europe under extreme weather conditions (high daily demand), the network offers sufficient capacity to enable certain flexibility²⁴ for the supply demand balance of each country.

4. CONCLUSIONS

There are signs which demonstrate the emergence of European energy wholesale markets such as: convergence of prices, decrease in gas prices for Member State that have diversified supply, better cooperation among power exchanges and TSOs. Nevertheless the situation remains to be improved and significant obstacles to open integrated and competitive markets in electricity and gas remain. Interconnection capacity between Member States remains generally insufficient and bottlenecks exist which prevent fluid transmission of energy within and between countries. Even if interconnections exist, the absence of harmonisation of market rules in the different Member States leads to market segmentation and higher transaction costs which constitutes a barrier in particular for smaller player. This can even lead to the inefficient situation where gas and electricity flow from high-price areas to low-price areas.

At retail level, the integration of the European electricity and gas markets has not developed sufficiently yet. European gas and electricity retail markets are still characterised by substantial disparities in the different Member States as far as price levels and switching rates are concerned. Decreasing wholesale prices in electricity and gas have not always been passed on to retail consumers. In gas, most households and industrial consumers were able to benefit from a significant decrease of their gas bills, but in electricity, retail prices rose in most of the countries. Moreover electricity and gas retail markets remained highly concentrated with little evidence of new entry of independent suppliers.

In view thereof, the Commission services intend to focus on:

- the implementation of the third energy package
- the development of the gas and electricity internal market, including networks
- the harmonisation of the design of the market and
- The improvement of the functioning of retail markets

²⁴ According to "ENTSOG G winter supply outlook 2010-2011" flexibility is defined as the unused capacity at the entry points of a given country for additional entry flows expressed as a percentage of the total technical capacity at entry. For more info: <http://www.entsog.eu/>