Ongoing inquiry in the EU energy sector

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On 16 February 2006 the European Commission ('the Commission') presented to the public the preliminary findings of its inquiry into the European Union (EU) energy sector, launched last June. The Commision's Commissioner for Competition, Neelie Kroes, also announced the imminent launch of antitrust investigations directed at individual companies, which the Commission suspects might be in breach of the EU's antitrust rules.

The inquiry

The Commission launched its inquiry in response to persistently high prices in gas and electricity markets in the EU. It believes that high barriers remain in these markets despite the ongoing liberalisation process.

The preliminary findings of the inquiry confirm the Commission's concerns and identify several 'important distortions' of competition in the electricity and gas markets, notably:

- Gas incumbents remain dominant in their national markets and a high level of market concentration persists in electricity generation in most EU countries. The high degree of market power enjoyed by incumbent gas suppliers is mainly linked to factors such as their control over import infrastructure and long-term supply contracts. In most national markets, electricity generation capacity remains in the hands of a few players, who are able to use this in order to influence prices.
- A high level of vertical integration leading to vertical foreclosure at different levels of the electricity and gas supply chain, from wholesale to distribution – both in the electricity and gas markets, new entrants allege insufficient unbundling of transmission system operators (TSOs) and distribution system operators (DSOs). Particularly in gas, key infrastructure such as networks and storage facilities often remain in the hands of the incumbent.
- Limited market integration linked to factors such as operators' lack of ready access to the different transmission systems (import pipes for gas and interconnectors for electricity) and/or the inadequate capacity of these systems. In the gas market, the lack of integration is particularly linked to the fact that most capacity in transit pipelines is controlled by incumbents. In the electricity market, the existence of long-term capacity reservations and inadequate capacity allocation and congestion management rules are seen as barriers to efficient market integration. The Commission's inquiry also showed that, in the gas market, new entrants have not even been able to secure capacity when transit pipeline capacity has been increased.
- Lack of transparency – in the gas market, new entrants are critical about the lack of information on capacity available on gas networks. In the electricity market, the inquiry confirmed the lack of transparency in the wholesale market. More precisely, the Commission's inquiry revealed a general perception among new entrants that the incumbent's generation data are first being shared with affiliates, granting them an undue competitive advantage over new market entrants.
- Price issues partly related to factors such as the linking of gas prices to those for oil and oil derivatives and the coexistence of regulated and free prices in the electricity market. The ongoing practice of linking the price of gas to that of oil derivatives has the result that prices between different producers and suppliers are artificially correlated and do not react to the interplay between supply and demand. In the electricity market, the implementation of the EU Emission Trading Scheme (EU ETS) appears to have given rise to distortions in the price for electricity, with carbon dioxide (CO_2) prices having an influence on the price of wholesale electricity. The existence of two parallel markets of the same utility, the liberalised and regulated electricity market, also seem to be causing distortions in the wholesale electricity market.

Commission's response

The Commission has already advanced a series of regulatory and competition based actions to tackle some of the distortions identified in its preliminary findings.

As regards competition, Kroes made statements in favour of increasing the Commission's jurisdiction under EU merger control, with a particular focus on the energy sector. She has proposed lowering the requirement according to which EU merger control would not apply where companies achieve more than two-thirds of their EU revenues within one and the same member state. Incumbents in gas and electricity markets usually realise a high proportion of their EU revenues within one member state. As a result, concentrations in the energy sector are more likely to escape the Commission's jurisdiction than transactions in other fields (as recently highlighted in the Gas Natural/Endesa deal.) Removing the two-thirds rule would directly impact the energy sector by increasing the number of mergers and acquisitions subject to the Commission's jurisdiction.

Kroes has also heralded 'the beginning of a period of more intensive antitrust enforcement' directed at individual companies. In particular, the Commission is likely to be looking at long-term contracts for the import of gas and agreements affording incumbents exclusive rights over key infrastructure, such as gas pipelines and storage, and electricity interconnectors. Companies under investigation are likely to put forward security of supply arguments to avert the Commission's allegations of violations of the law. Recent events, such as the Ukraine gas crisis (see *Petroleum Review*, February 2006), have stressed the importance of securing steady sources of energy supply in the EU. It remains to be seen, however, whether such arguments will influence the Commission's antitrust review of distorting practices in the energy sector.

Although the Commission has not disclosed the names of the most likely candidates for scrutiny, all eyes are turned on the big energy conglomerates of the larger member states such as Germany and France. If successful, Commission investigations can result in severe fines of up to 10% of the revenues of the companies found to be in breach of the competition rules.

With regard to regulatory measures, the Commission has confirmed that it will review the implementation of the gas and electricity liberalisation directives by the member states. Among other things, it will also be looking at regulatory measures through which to increase transparency in the market and optimise the use of interconnectors.

By the end of the year, the Commission will be issuing a final report with the conclusions and findings of the inquiry. In the meantime, energy companies are well advised to step up their efforts to comply with EU competition law and outline their strategy in case of investigation.