Eurelectric Annual Convention and Conference: 'Politics vs Industry: On the Cliff Edge-Europe's New Energy Challenges'. Malta, 4th June 2012

Opening address by Philip Lowe, Director General for Energy, European Commission

Minister, Excellencies, Chairman, Distinguished Guests, Honourable Members of national parliaments and of the European Parliament, Ladies and Gentlemen,

I am very pleased and honoured to take part today in this conference, on behalf of Commissioner Oettinger.

In Europe, in the European Union and in our own individual countries as Member States of the EU, we are committed to the overall objective of ensuring safe, secure and sustainable energy for our societies, at competitive prices for businesses and affordable prices for households and ordinary people. We share this objective with almost all other countries on the planet. Why? Because energy is so essential to human survival, to the quality of human life and to the capacity of societies and economies to sustain themselves and to prosper.

In Europe, we have two levels of political decision-making –the national and the European- which create the framework in which energy suppliers can respond to consumer demand, whether from businesses or individual consumers. Today there are

undoubtedly serious elements of uncertainty in the prospects for European energy markets which go beyond commercial and technological risk and weigh heavily on the decisions taken in the boardrooms of energy companies: national governments are intervening more and more to stimulate investments in low carbon electricity generation in order to meet the climate challenge. At the same time many of them still regulate retail prices – and not just for the less well off- and they do not hesitate to tax energy as a reliable source of revenue for national budgets. So industry and the investor community has some grounds for complaint about uncertainties and lack of clear market-based signals.

But on the side of governments, citizens and consumers, the picture is no rosier. Energy prices remain high and volatile. Downward movements in wholesale prices don't tend to be followed by similar downward movements on retail prices. So big energy companies are not popular. And without public support, companies and investors shy away from the heavy investments which will ensure the supply of safe, secure, sustainable, competitive and affordable energy which Europe needs.

Surely the right reaction in the present situation is not to pit industry against politics, but to refocus politics and industry together on the overall objectives for energy policy which both have agreed on in the past and should agree on in the future.

A core element of the consensus between government, consumers and industry on energy in Europe is that we want to create effectively functioning and competitive energy markets across the internal frontiers of Europe. Prices in these markets need to reflect underlying supply and demand and not simply regulation or subsidy. For the short term, they should determine the balance between all sources of supply and demand. For the long term, they should give the correct signals for investment and innovation, whether in relation to generation, transmission, distribution or storage.

That implies that the open market that we are trying to create includes and reflects the vast bulk of transactions between buyers and sellers. And it should be significantly liquid, with low barriers to entry, encouraging diversity and innovation in products and services, both at the wholesale and the retail level. Hence our combined interest in promoting access for new entrants, in the development and interplay of power exchanges, and the establishment of network codes which are a precondition for competitive trading and investment within national markets and across the EU's internal frontiers. Finally of course, energy markets will not work unless there is sufficient transparency and available information so that consumers as well as producers can trade effectively.

Can we expect that public policies and politics will let markets develop on their own, with sufficient confidence that 'the market' will produce the

outcomes which society wants? In the energy sector, this is obviously unrealistic. Energy is a highly concentrated network industry, which has to make heavy investments in infrastructures which have a significant impact on the physical environment, and in particular on our climate. The externalities extend well beyond private costs and benefits.

In the first instance, we need regulation to ensure that there is free and fair competition: with common technical standards, with regulation of natural monopolies, with guarantees of third party access, with independent management and investment in networks, with controls on the abuse of market power and on anticompetitive mergers, with rules on market transparency and integrity and with removal of controls on retail prices except for vulnerable groups of customers.

And we already have regulations and rules on all these issues: the directives and regulations culminating in the Third Package and to be completed with the Guidelines and Network Codes; the work of the national regulators and ACER; the competition and state aid rules. Personally I do not believe that we need any fourth package to tackle them. Markets work well with good regulation and a perspective of less regulation, not more. Let the market work!

Secondly, we need public intervention to direct markets to outcomes, such as a drastic reduction in CO2 emissions, that they will not automatically reach through the competitive process. If so, that

intervention ideally should not impact directly on price or volume but use market-based instruments, such as ETS, which must be designed to provide the right level of incentives to short-term trade and long-term investment. And where there is no choice but to intervene directly with regulation or subsidy, then European law tells us that public intervention to correct market failures must be necessary, proportionate to the objective and transitional. The logic here is clear: provide sufficient regulatory support and/or subsidy so that industry adapts it technologies, processes and cost structures- and consumers adapt their purchasing patterns- to meet the objectives which society wants. But make sure that the amount of support is strictly linked to costs and limit the intervention in time. Otherwise you distort competition, you create subsidy dependence and you undermine industrial competitiveness. In the energy sector today, this need for proportionate and time-limited intervention applies as much to support to investments in generation – where ideally interventions should be technologically neutral but the technologies should be publicly acceptable – as to regulation of retail markets.

The rules are in place under the European treaties to deal with this habitual confrontation between the functioning of competitive markets and the need for public intervention. We have to thank both Robert Schuman and Jean Monnet for their foresight in this respect.

So what do we do now? We have undoubtedly made progress towards the goal of creating an open, interconnected and integrated European electricity market. There is increasing interconnection, increased coupling of national markets, more convergence in wholesale prices, and a major effort among regulators and TSO's in particular to reach agreement on European-wide network codes. But the Commission now needs to put pressure on all Member states to implement the Third Package. And where necessary, it will have to apply the state aid and competition rules to ensure that neither governments nor companies put obstacles in the way of making energy markets better for the benefit of consumers. These challenges will be addressed directly by the Commission's paper planned for the autumn on progress on completion of the internal energy market.

We will in particular need to pay attention to the way in which Member states choose to support investments in low carbon electricity generation, whether in respect of renewables, nuclear or CCS. National policies need to integrate the growing reality of integrated electricity markets across Europe. In parallel, the Commission will be pushing forward the proposals to promote public and private investment in network infrastructure, which is one of the main priorities of the Cypriot presidency. Regulation alone will not create an integrated electricity market in Europe. We need some key physical interconnections to make the market work.

At the same time, investment in low carbon generation will not be sustained without appropriate incentives. On the one hand, the Commission's newly announced review of the ETS system before the summer break is a timely response to the industry's call for a more integrated policy response to the low carbon economy challenge. On the other, the communication which the Commission will approve this week will lay out the options for support for renewable technologies in the period post-2020.

Ladies and Gentlemen, in its Energy Roadmap for 2050, the Commission has arguably made a significant contribution to charting the course towards a competitive low carbon energy sector. We know we will need far more electricity with a high proportion of renewables in the overall energy mix in Europe, even though there will be major differences from Member state to Member state. We know too that we will need smarter grids and more flexibility in terms of generation and demand response. And we know as well that using energy better –energy efficiency – is certainly the most cost-effective component in Europe's energy mix. The immediate challenge is to make energy markets work in a way which makes sense for suppliers, systems operators and consumers, while at the same time enabling us to stay on the path towards the 2050 low carbon energy objective.

Thank you for your attention.

PL/04/06/12