Energy: rules for the internal market in natural gas. 'Gas Directive'

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The Commission presents its report on progress in creating the internal gas and electricity market. The liberalisation of the EU's electricity and gas markets, which began several years ago, has contributed to the rejuvenation of the energy sector. It has helped to develop entrepreneurial potential in this sector, with beneficial effects on a variety of energy-related activities ranging from the production of diverse forms of renewable energy to the creation of financial markets for energy derivatives. Market participants are now better prepared to adapt to the rapid economic and environmental changes – particularly in dealing with the specific challenges that climate change poses to the energy sector.

The present reports bears witness to the fact that, over the past five years, **significant improvements** have taken place in the EU electricity and gas market.

While these developments are encouraging, **the full potential of liberalisation has not yet been realised**.

The Commission is taking action to ensure the **correct implementation** of EU legislation at national level through the application of infringement procedures and complementing the internal market legislation with the **third internal energy market package** (see COD/2007/0196 and COD/2007/0199). In June and July 2008, the package passed its first reading in the European Parliament; in October 2008, a political agreement was reached in the Council. The second reading started in January 2009, and is on course to be adopted by mid-2009. Thereafter, the third internal market package will need to be implemented in national law.

One of the purposes of the present report, therefore, is to identify the shortcomings of the current situation and to indicate the areas in which further action is needed.

More than four years after the deadline (1 July 2004), implementation of the second Electricity and Gas Directives is still not entirely complete. Several Member States, including Denmark, Luxembourg and the Netherlands, have now correctly implemented both Directives through appropriate national legislation. There has also been progress in other Member States: the Czech Republic, Finland, Germany, Greece, Latvia, Lithuania, Slovenia and the United Kingdom brought their national laws into line with EU legislation after a reasoned opinion was issued by the European Commission. In the case of some other Member States, the Commission has had to take legal steps to ensure the full and correct implementation of certain provisions.

In 2007 and 2008 a great deal of effort was put into enhancing competition on the wholesale market; significant progress was made through the regional initiatives. There also seems to be a new trend towards **building new energy infrastructure**. This is crucial to overcoming the longstanding fragmentation of EU energy markets. The trend is set to continue but it may take some time because the planning and building of such infrastructure requires long time horizons.

This report presents a **mixed picture** of the progress of completing the internal energy market. There are still a number of areas and Member States where significant obstacles to the efficient functioning of the electricity and gas market persist. A major concern is the incomplete implementation of European electricity and gas legislation. The recent experience of rising energy prices underlines the need to **make market integration and the enhancement of cross-border trade the top priorities**. It is therefore essential that the Electricity and Gas Regulations are properly implemented by all Member States. The

Commission urges Member States, regulators and industry to **take the appropriate steps as quickly as possible**. The European Commission will consider initiating **infringement proceedings** for non-compliance with provisions in the gas and electricity Directives and Regulations.

With respect to **market concentration**, progress has generally been slow. A number of wholesale markets, in particular, still suffer from limited competition and the lack of liquidity.

On the electricity wholesale market, the three biggest generators still control more than 70% of generation capacity in 15 Member States. In the gas wholesale market, the concentration is even greater. The three largest wholesalers have a market share of 90% or more in 12 Member States.

There are signs that the situation on the **retail market** is about to improve. Member States should put even more effort into providing comprehensive data for supplier switching. Switching levels vary considerably across Member States, with some mature markets – such as the UK - experiencing relatively high rates and a number of others showing little or no activity. At the level of small industry and households, the reported figures suggest that electricity consumers tend to be more active than gas consumers

A major issue in the reporting period was the **increase in energy prices**, in part due to the rising price of oil on the international market. This triggered major increases in energy end-prices. Industrial consumers in some Member States were faced with more severe price increases than in others. Prices for primary energy sources have fallen significantly since the summer of 2008. Competition and market opening should ensure that these lower prices are passed on to the end consumers.

While short-term solutions, such as **regulated prices**, might appear to be advantageous in the light of rapidly increasing energy prices, the present report has stressed the likely consequences of such measures: investor confidence is undermined, market entry is deterred and the full benefits of the internal energy market are placed at risk.

Lastly, if the EU is to continue to have a **secure energy supply**, major investments are needed over the next two decades. This is confirmed in the Commission's Second Strategic Energy Review and by the International Energy Agency (IEA).

Over the coming two decades, the EU - like other parts of the world - has to address the need for major investments in infrastructure. In the long term only a properly functioning internal electricity and gas market can send the right price signals to encourage investment.