ENERGY SECTOR INQUIRY
“THE GLOVE AND THE FIST”

Joint Cambridge/MIT Energy Conference

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1. “THE ROAD TO CHANGE”
   - UK: A long and lonely route.
   - Europe sleeps.
   - UK: Jolted to further action.
   - Europe stirs:
     - Brussels awakes.
     - Fear wakes up many.
     - Test case: Germany.

2. GOING DOWN THE UNBUNDLED ROUTE
   - D. Newbery presentation.

3. “BROUGHT TO THE CROSS ROADS”
   - The Fist – DG Comp moves.
   - The Glove – DG Tren sets roadmap.
UK: A LONG AND LONELY ROUTE

**MARKET CONCENTRATION:** British Gas and National Power/Powergen broken up and gas contracts reset in 1997.

**UNBUNDLING:** NG split from generators in 1989 ... in 2005 the local gas network companies split up in de-merger.

**INFORMATION:** Electricity information available to all but short comings in off-shore gas information.

**REGULATION:** Independence supported by successive Governments since 1986
• **Market concentration** – national incumbents remain dominant.

• **Vertical integration** – insufficient “unbundling” (ie. separation) of competitive and monopoly businesses.

• **Lack of transparency** – creates market uncertainty and deters investment.

• **Network issues** – lack of access to and capacity on the pipes and wires.

• **Varied and weak national regulators** – including increased political interference.
1. **Self induced.**
   * Structural
   * Behavioural

2. **Politically induced**
   * Control
   * Views on capital markets
   * Reaction against Anglo-Saxon modus

3. **Encouraged by 3rd Parties.**
   - Norwegians – gas information
   - Algerians – destination clauses
   - Russians – support of leviathan model

**LETHARGY CAN BE AND WAS THE ANSWER**
Why?
2. Prices sharply up (See D.Newbery p22).
3. Island status on gas and electricity gone.
4. Evolution of market structures.

What?
1. Ofgem does two upstream gas probes/reviews.
2. Ofgem approves MOD 006 – more upstream gas information required.
3. UIOLI – ‘Use it or lose it’ – enforced by Ofgem at LNG facilities.
5. Ofgem focuses on European regulatory institutions and sends staff to Brussels.

OFGEM’DOORSTEPS’ COMMISION FOR ACTION
Why?

1. Under renewed pressure due to pricing and security of supply – concerted UK lobby.

2. ‘Blackouts’ places a focus on networks – Sweden, Italy, UK in 2003 and 2007 in Germany.

3. Unease over E.ON/Ruhrgas ruling ... with more ‘difficult’ M&A cases due.

4. Unease over windfall gain from National Allocation of environmental certificates.

5. Kroes and Pielbags support change.

6. Global context – pressures on security of supply and new dynamic of East European states exaggerates this.
EUROPE: FEAR WAKES UP MANY

- **Information vastly improves.**
  - French provide gas storage and day ahead gas information in 2007.
  - Fluxys/Zeebrugge information improved.
  - Germany – big strides made… see page 10

- **Unbundling supported.**
  - Dutch senate support in summer 07.
  - Belgium releases new draft law on unbundling in 2007.

- **Regulators given greater powers.**
  - Even French regulator given more powers – 2 month objection period on prices in 2006.

- **Behavioural changes.**
  - ENI launches aggressive electricity marketing campaign in 2007.
  - Algeria stops destinations clauses in Europe contracts.
  - Holland insists on UIOLI at Rotterdam and Eemshaven LNG

DESPERATE TO PROVE MARKET CREDENTIALS?
TEST CASE: GERMANY

- **5 Years ago**
  - **Gas**: A new entrant had to negotiate access individually, had little view of local tariffs, had significant problems over storage and quality ... a nightmare.
  - **Electricity**: The killing of ‘yellow stom’ in 2001 signalled the big players intent ... retail competition stopped well below 5%.

- **Today**
  - **Gas**
    - New entry – exits rules:- movement of gas is possible.
    - Destination clauses struck out of Ruhrgas/Gazprom contracts.
    - FCO banned L/T contracts above limits.
    - New gas trading hubs and platforms.
    - New entrants.
  - **Electricity**
    - New incentive based regulation on ‘T’ networks introduced.
    - Retail competition starts – E.ON’s (“E’ as in Easy” Campaign)
    - New entrants

GERMANY’S STARTING POINT VERY DIFFERENT FROM UK
GOING DOWN UNBUNDLED ROUTE

- Joined up presentations!!
KROES AND PIELBAGS SET THE NEW PARADIGM – JANUARY 2007

- There is concentration in wholesale markets.
- Barriers to entry in retail exits.
- A lack of cross border trading or competition.
- Inability to enjoy gas transit.
- Paucity of information
THE CHARGES
1. Hoarding – GdF and RWE
2. Access to networks – ENI ... follows last years case against ENI.
3. Raising rivals costs – RWE.
4. Market sharing – E.ON, GdF.

FIRST BLOOD TO KROES
1. Literally ‘broke down doors’ in May 2006 dawn raids.
3. Forced unbundling – E.ON/MOL ... and probably GdF/Suez.
4. Settlement with Distrigas
5. 19 September industry announcement on unbundling.

KROES MUST LAND BLOWS
Jan 10th: 2007 “Companies will face legal action for damaging consumers and business through anti competitive behaviour... this report will make uncomfortable reading for many energy companies”.

On Networks: “The current level of unbundling of network and supply interest has negative repercussions on the market functioning. This constitutes a major obstacle to new entry and also threatens security of supply”

3rd Directive: “Ownership unbundling ... is the simplest and cleanest way to achieve effective unbundling”.

Microsoft: “It could be reasonable to draw the conclusion that behavioural remedies are ineffective and that a structural remedy is warranted”
PIELBAGS – WITH THE GLOVE

THE ADVANCES: 19 SEPTEMBER

1. Improved information – 3rd Directive.
2. Unbundling to be enforced.

GENERALLY GOOD NEWS
DANGERS REMAIN

1. Who holds the pen?
2. Will the jail keys get thrown to the prisoners?
3. Independence not institutionally protected.
4. Devil will be in detail – who controls devil?
5. Delay is the incumbents friend!

A BIG CHANCE FOR SUCCESS ... BUT PLENTY OF RISKS
Promoting choice and value for all gas and electricity customers