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Press release

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ESMT presents results of study on European electricity wholesale markets

- Market integration growing
- European markets not yet fully integrated
- Stronger market integration could also lead to price increases
- Results do not point towards inflated wholesale prices

The lacking integration of European electricity wholesale markets, the market power of national players, and the low level of investment in generation capacity was criticized by the Sector Inquiry of the European Commission in 2007. ESMT Competition Analysis, Professor Lars-Hendrik Röller (President of ESMT) and Professor Axel Ockenfels (Universität zu Köln) have jointly examined the development of European electricity wholesale markets. The study "The Electricity Wholesale Sector – Market Integration and Competition" was commissioned by RWE AG and focuses on German wholesale prices. Wholesale prices have a direct effect on the electricity prices for end consumers. The study reveals an advanced, albeit imperfect, degree of market integration.

"Since the Sector Inquiry, considerable effort has been put into increasing the degree of integration of electricity wholesale markets in Europe. European exchanges collaborate more closely, and this has led to a closer integration of electricity markets," explained Lars-Hendrik Röller. The electricity sectors in the Netherlands, France and Austria are competitively linked to the German sector, which is reflected in similar levels and co-movements of certain exchange prices. In 2010 the German spot exchange market will be coupled with the Dutch, Belgium, Luxemburg and French ones (CWE Market Coupling). The Transmission System Operators (TSOs) and the exchanges will then work together so that an interconnected market with an optimized use of cross-border capacities evolves. This will bring forth identical exchange prices as long as cross-border capacities are not physically congested.

The hypothetical monopoly test that has been called for by the German Monopolies Commission has not yet substantiated a fully integrated European market from an antitrust perspective. However, the test, which is often used in competition law in order to define relevant markets, did show that Germany's wholesale electricity market is already often integrated with the markets of neighboring countries. The test examined whether a supposed concerted price increase of all German suppliers would be countervailed by competitive pressure through foreign suppliers. The results for 2008 show that even if all German suppliers tried to increase the price by 5 percent, this would be thwarted by foreign suppliers in half of all trade hours. A greater price increase of 10 percent would still be prevented in almost a third of all hours.

At the same time, the results of the study suggest that in 2008 more cross-border capacity between Germany and its Western and Southern neighboring countries would have rarely lowered prices and then only marginally. This is because German wholesale prices tend to be lower or, in the case of Austria, at the same level. In this respect, more cross-border capacity to these countries could also raise the price in



Germany as a consequence of increased export demand. However, the expansion of cross-border capacities to Germany's Eastern and Northeastern borders might cause a net price decrease in Germany.

Finally, the study compares the German wholesale prices and the costs of constructing and operating new power plants. Axel Ockenfels: "As regards the period analyzed in our study, 2005-2009, electricity wholesale prices were at a level that would not, in the long run, justify investments in new power plants." This suggests that wholesale prices in Germany were not inflated, but might have to rise even further in order to induce necessary investments in new generation capacity.

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About ESMT Competition Analysis

ESMT Competition Analysis (CA) is an economic consultancy which provides case-related advice and research on key topics in fields of competition policy and regulation. Members of the Competition Analysis team not only advise Europe's major antitrust law firms and companies but also research and teach at ESMT. ESMT CA offers seminars within the framework of the school's portfolio and organizes conferences on competition and related fields. ESMT Competition Analysis has been named in The Economics 20 by the Global Competition Review survey as one of the world's leading competition economics firms. Less than two years after its founding, it is the only German practice featured in this leading competition ranking.

About ESMT

ESMT European School of Management and Technology was founded in October 2002 by 25 leading global companies and institutions. The international business school offers Full-time MBA and Executive MBA programs, as well as executive education in the form of open enrollment and customized programs. The School also features in-house research-oriented consulting services in the areas of competition and regulation. ESMT is a private university based in Berlin, Germany, with an additional location in Schloss Gracht near Cologne.

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