FUTURE CHALLENGES FOR THE ELECTRICITY INDUSTRY

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The Electricity Sector is especially active with regard to business initiatives and technologic innovation. Due to its own nature, it requires as a necessary condition, the transparency and stability of its regulation rules in every market of the world. This is the natural consequence of having to operate always in short-term, anticipating the medium/long-term. Because of all this circumstances, it is important to make the necessary previsions so that the different future scenes can be defined with the sufficient anticipation. This is the final point of having indicative proposals that design the actions in an immediate future.

The European Union Green Paper can be a good tool to establish the basis of the energetic model. In this discussion, either in the Spanish scene or in the European context, the position of the Spanish electricity industry is clear: to support the actions aimed at guaranteeing the energy supply based on diversified sources, in a liberalised market that operates in competitive conditions.

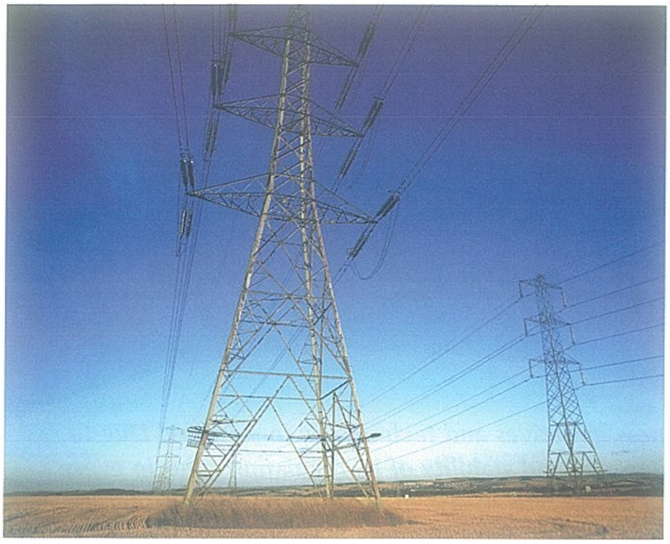
As everyone knows, the electricity industry has historically been characterized by its stability because no sudden changes occur in the operating scenario. However, it is an especially active industry in terms of business initiative and technological innovation, as evidenced by a continuous expansion to other markets and inclusion of new non-electric business ventures. The industry today is characterized by these dynamics; on facing the final phase of the transition to competition and liberalization, the utilities have begun a new round of investments in Spain, which in fiscal year 2002 alone are estimated at 524,000 million pesetas.

An attempt to efficiently provide a service such as electricity must be based on the fact that the primary goal is to secure the supply and this essentially depends on good simultaneous management of installed generating power, transport and distribution. One must also consider that electric power cannot be stored. Our criterion is that we must always be one step ahead in our forecasts, so that we can respond to any evolution of the business.

Thus, a necessary condition for any activity such as the electricity business on all world markets is regulatory transparency and stability; this is a logical consequence of always having to operate in the short term while anticipating the mid- and long-term. This is why it is important to make accurate forecasts, so that different future scenarios can be defined sufficiently in advance. This is the ultimate reason for making proposals that help to design actions in the immediate future.

No one questions today the significance of the industrial changes that have occurred since the Electricity Law took effect. However, some common issues of a general nature must still be more deeply addressed in order to achieve a balanced solution in what otherwise would be a mere matter of adhering to the procedures established by Law and implementing the complementary measures required by the new situation imposed by changing economic conditions.

The pace of electrical model evolution has exceeded expectations and



competition has taken hold more rapidly than originally expected, driven by liberalizing provisions and by market dynamics. In short, the experience gained in recent years allows us to take a fresh look at the reality of the industry and suitably focus the short-, mid- and long-term.

Of course anything that is said about the Spanish context can be extrapolated to the European reality, now that the challenge of the Single Market is being given a new boost. The Green Paper ("Towards a European Strategy for a Secure Energy Supply") released by the European Commission at the insistence of Vice-president and Commissioner for Energy and Transportation, Loyola de Palacio, has been an undeniable success.

This is a valuable document that accurately diagnoses the current energy situation in Europe and underlines our gradually increasing dependence on outside supplies and the problems this involves. In addition, it describes the two major conditions that will guide energy strategy in the future: the goal of achieving an Interior Energy Market and environmental concerns. Finally, it proposes different scenarios of energy market evolution and possible mid- and long-term initiatives.

With the debate based on these terms, we clearly have a good instrument to more deeply address an essential aspect of European development, which is its strategy to secure the energy supply. The European Union's proposal is to support diversification of primary energy sources in order to ensure the security of the supply, i.e. sensibly use all energy resources and options in accordance with their availability and potential at any given time.

Since the beginning of this debate, the Spanish electricity industry has chosen to support initiatives aimed at achieving an Interior Energy Market. Therefore, we advocate that electricity and gas be simultaneously deregulated, that energy network interconnections be developed between the European Union's member countries, and that criteria be harmonized between the European countries in areas such as rate of market liberalization, conditions of access to transport and distribution networks and the role of the public powers in utility ownership.

In this respect, we must not lose sight of the importance of the far-reaching changes that have occurred in recent years in most European countries – with Spain in the lead – concerning the State's role in energy markets: from owner and regulator to mere regulator.

The regulator's function is, if anything, more important than ever, as the regulator must provide the necessary conditions for ensuring that liberalized activities will function well by protecting free competition between operators and preventing situations of abuse of dominant positions. Therefore, it is advisable that regulators keep this important function in mind and limit their interventions to proper oversight of market operations, leaving the utilities to freely make their own decisions.

Finally, it is essential that the public powers consider the long-term in their plans and actions. When legislating, they must bear in mind that the utilities need to operate in stable economic and legal conditions and that, when making their investment decisions, the only risk should be market conditions and market competition.

In short, in both the Spanish and European framework, the positions of the Spanish electricity industry in this debate are clear: support actions aimed at securing the energy supply based on diversified sources in a deregulated market that operates on the principle of competition.

Therefore, we pay special attention to anything that works in favor of enhancing energy source diversification, but in a balanced way and based on criteria of economic rationality. We believe that renewable energies should be leveraged, within reasonable limits, by funding their development without distorting market efficiency. We are in favor of promoting social consensus on the future of nuclear energy and the role it should play in the energy balance. We believe that interconnections should be developed and that criteria regarding the speed and extent of European deregulation should be unified, in order to achieve the goal of the Interior Energy Market.

But we should not forget that these courses of action must necessarily be guided by the idea of sustainable development and that they must thus be subject to decisive restrictions aimed at preserving the environment. This is a field that is constantly addressed in the operations of electric utilities that are firm supporters of long-term sustainable development. And we must continue to take a stand in this field, in order to promote international dialogue and coordinated actions between countries to preserve the environment and to combat climate change, because only in this way will these actions be effective and efficient.

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