

Competition Policy in Network Industries

Price regulation and exclusionary pricing practices

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Agenda

Price regulation and exclusionary pricing practices in the electricity and gas sector

- After more than a decade of liberalisation, competition still weak with energy prices that are too high in Europe
- Role of price regulation in network activities
- A grey area: price regulation in not yet fully competitive markets (the cases of end users sales and storage)
- Hub and exchange: towards more regulation?
- Recent developments and new challenges
- Final remarks

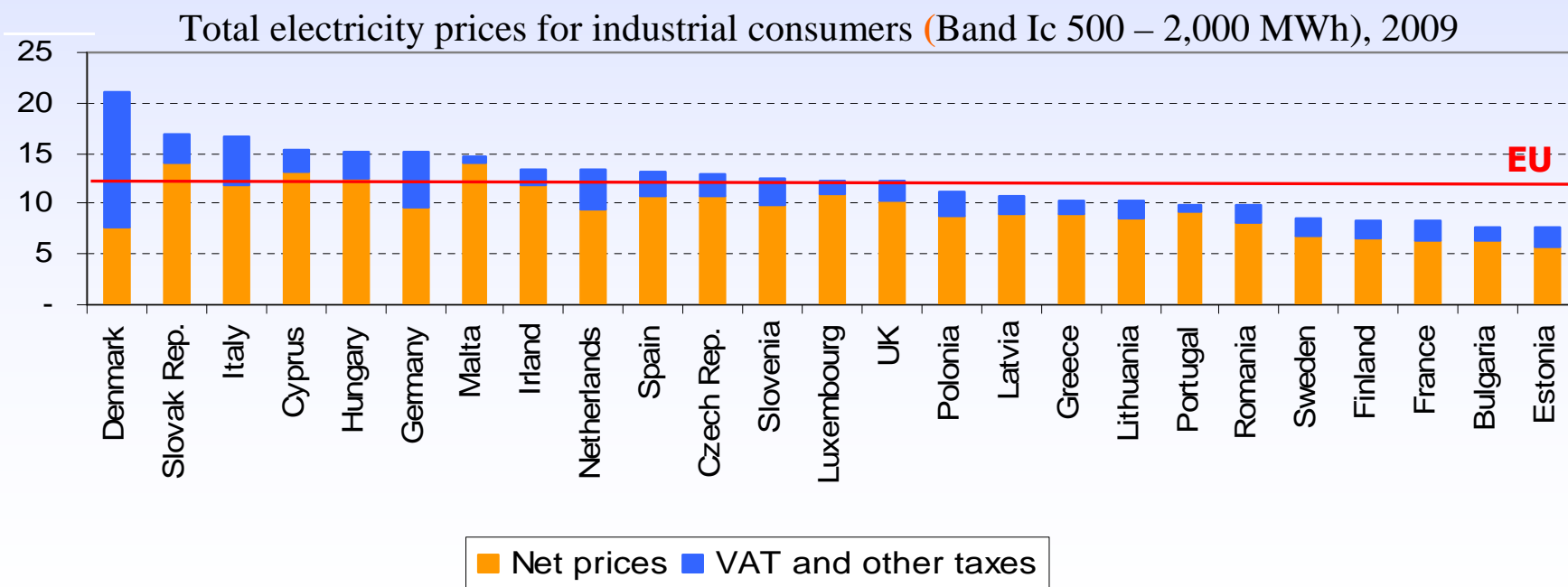
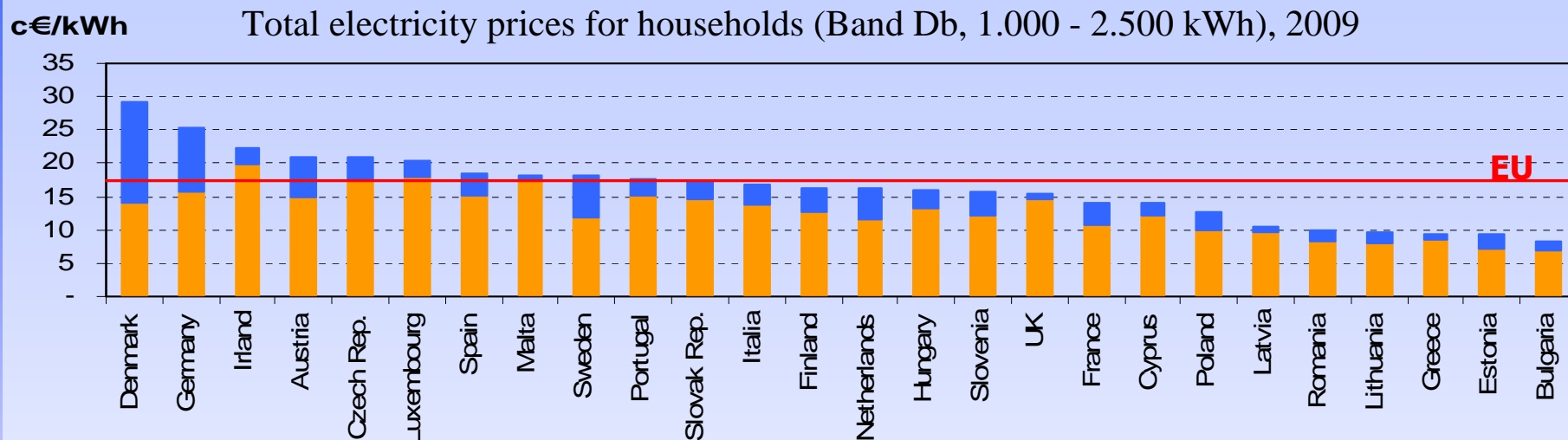


Obstacles to effective competition

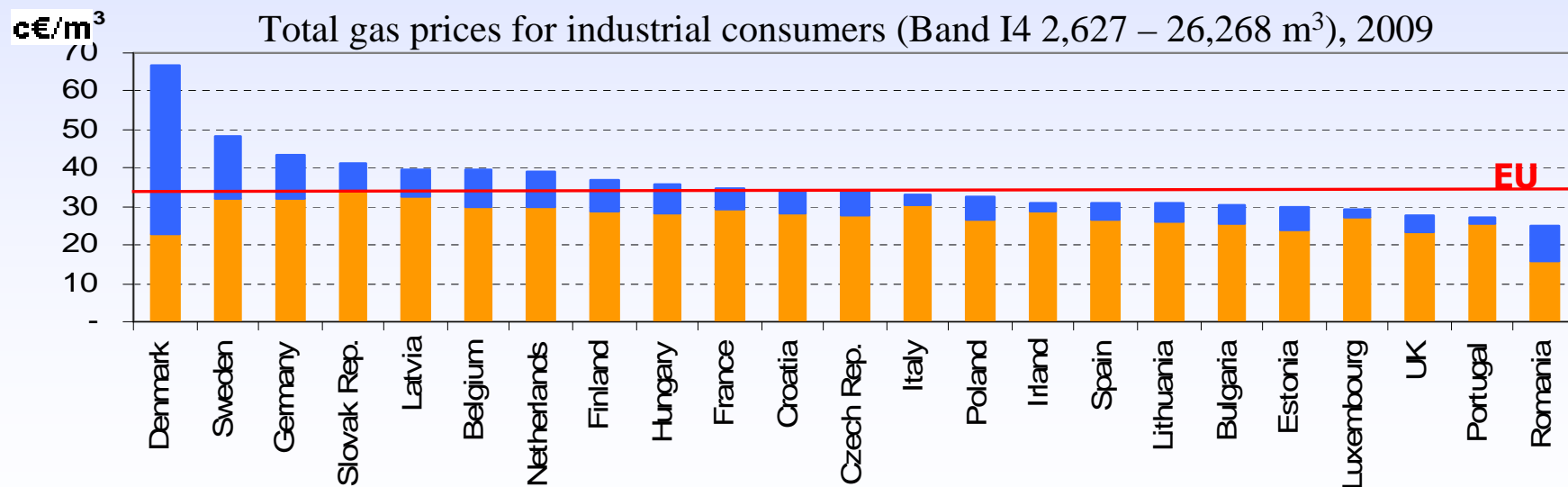
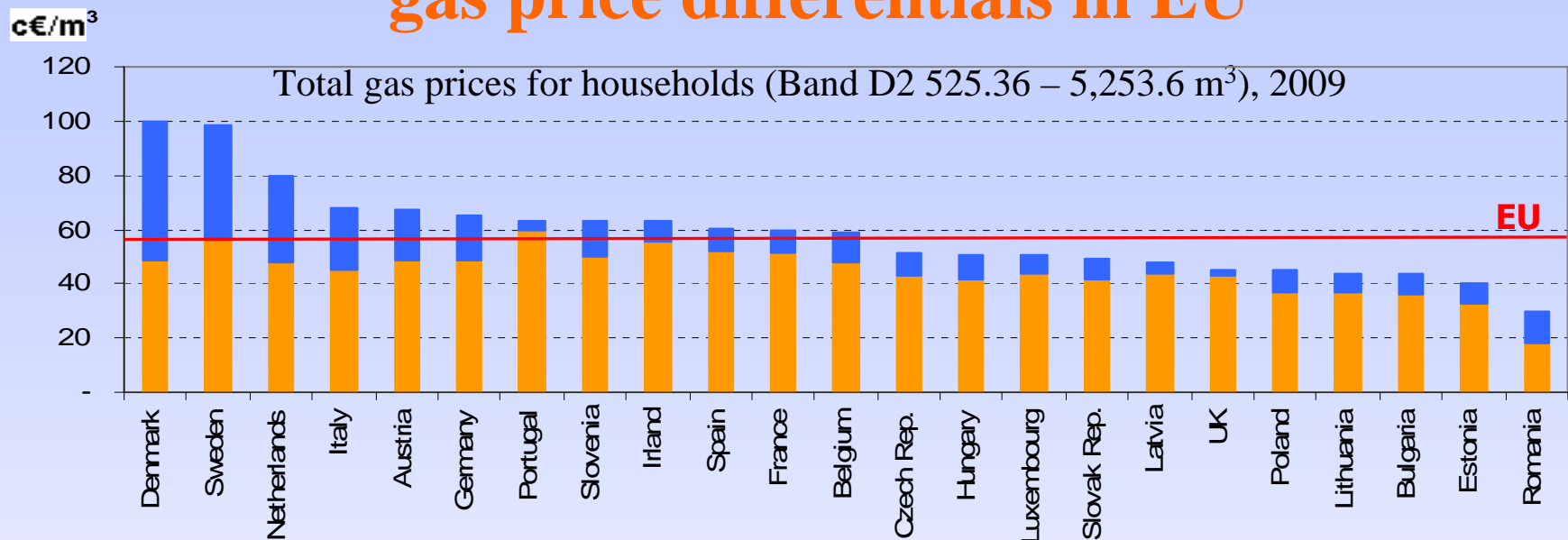
- Although significant progress has been made, relevant barriers to entry have traditionally been the cause of prices that are too high in the European electricity and gas markets
 - scarce integration of national markets: incumbent vertical integration resulted in underinvestment in network capacity and cross border commercial congestion
 - sharp differences in national regulatory framework in terms of regulators' powers and competencies
 - lack of transparency and insufficient market liquidity
- Antitrust ceilings or mandatory capacity release adopted in some Member States may have had a role in reducing the attraction of exclusionary prices for companies



Limited integration of national markets: electricity price differentials in the EU



Limited integration of national markets: gas price differentials in EU



Net prices VAT and other taxes

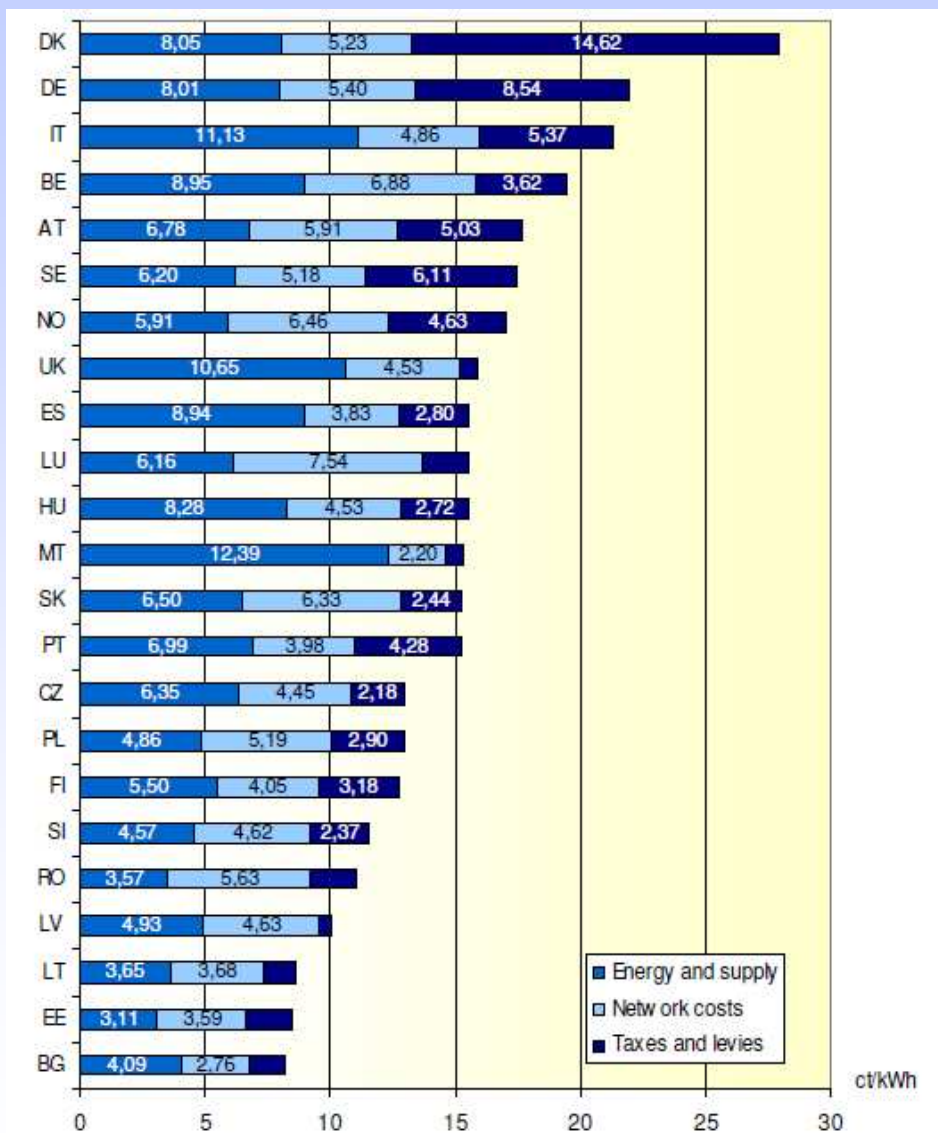
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Source: AEEG Relazione Annuale 2010



Composition of electricity prices for households (1/3)

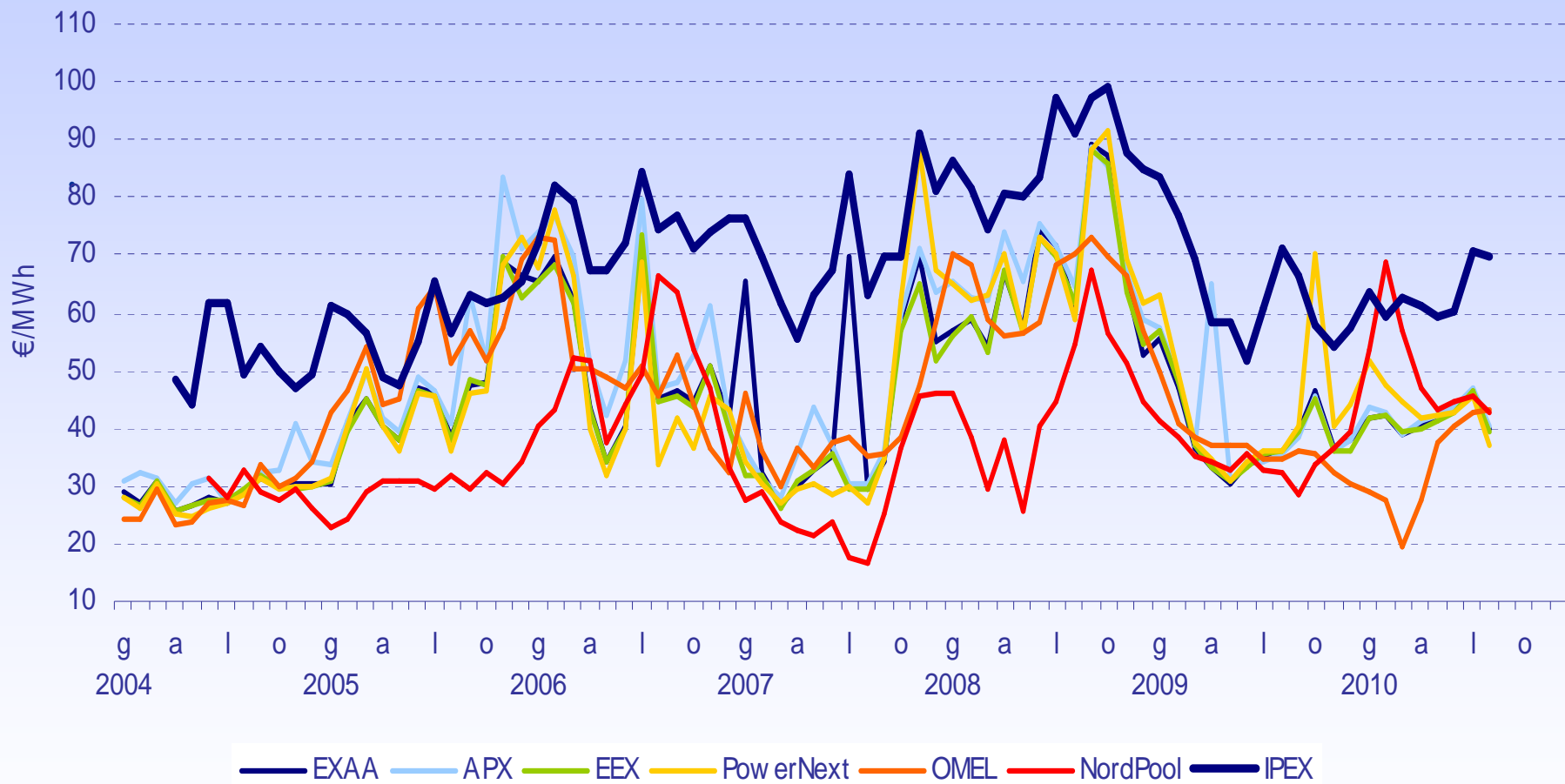
Band Dc annual consumption between 2,500 – 5,000 kWh, 2009



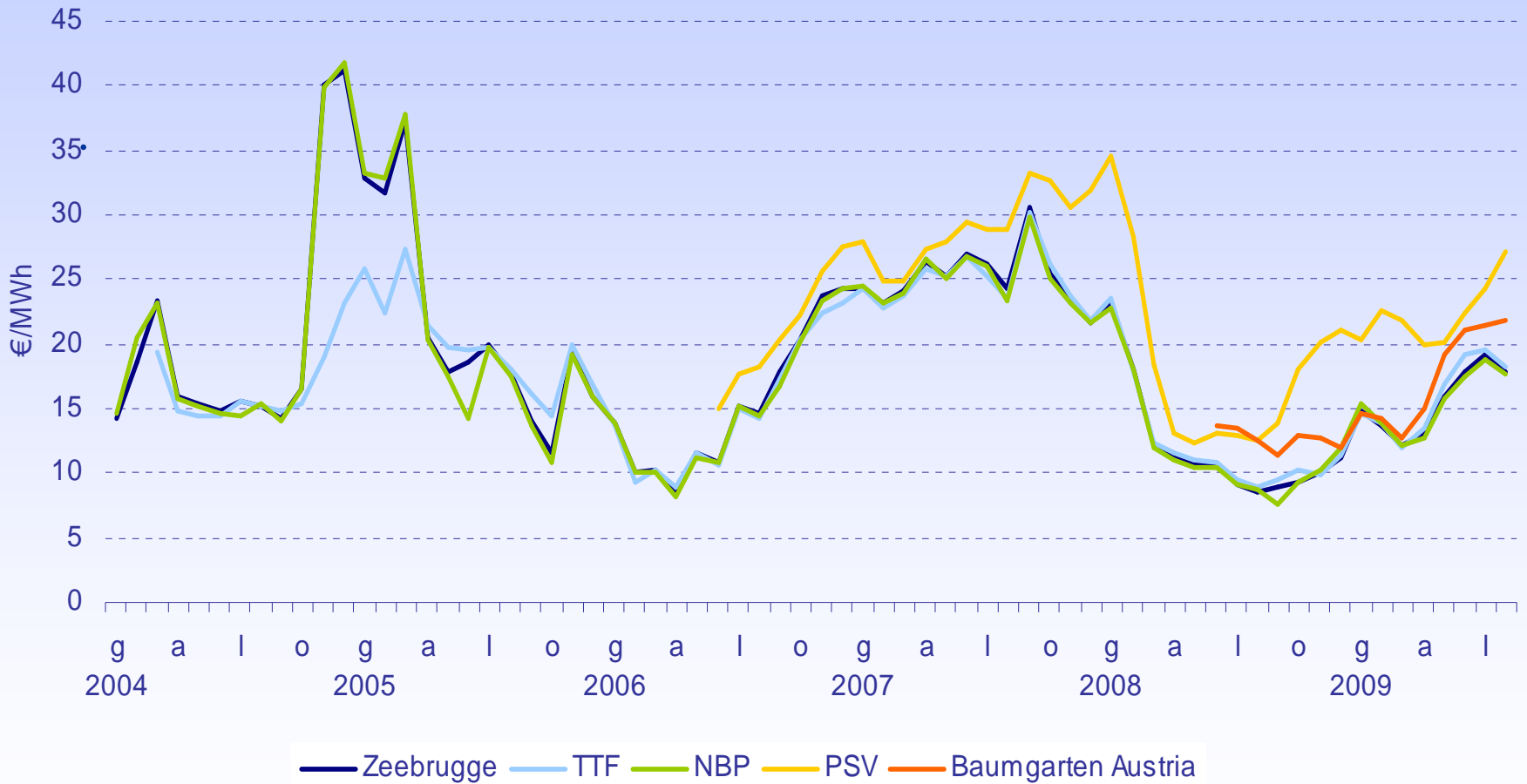
Composition of electricity prices confirms the existence of sharply differentiated situations within the EU energy market.



Electricity prices at the main European exchanges



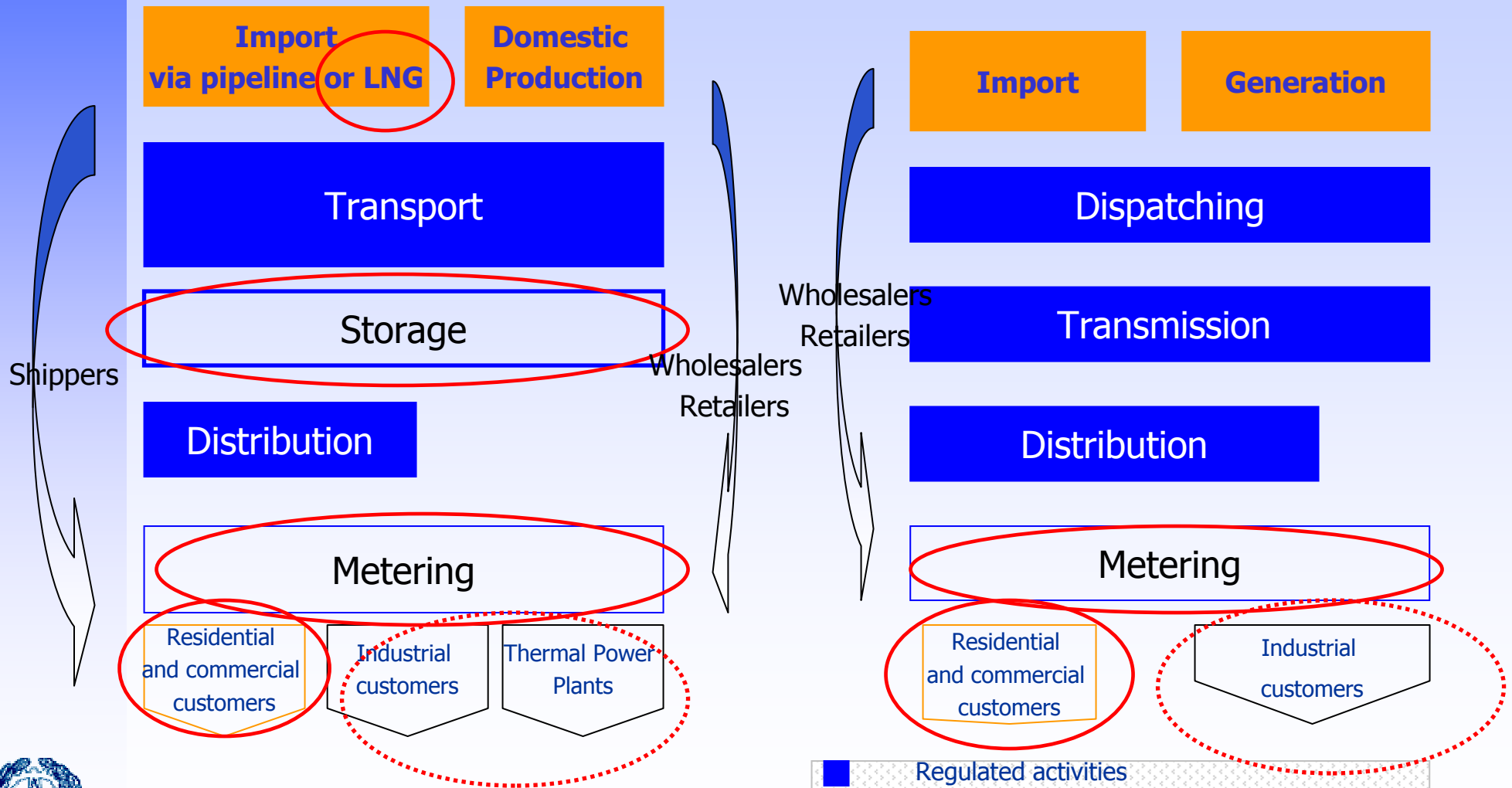
Gas prices at the main European Hubs



Price regulation in the gas and electricity liberalised sectors

Gas

Electricity

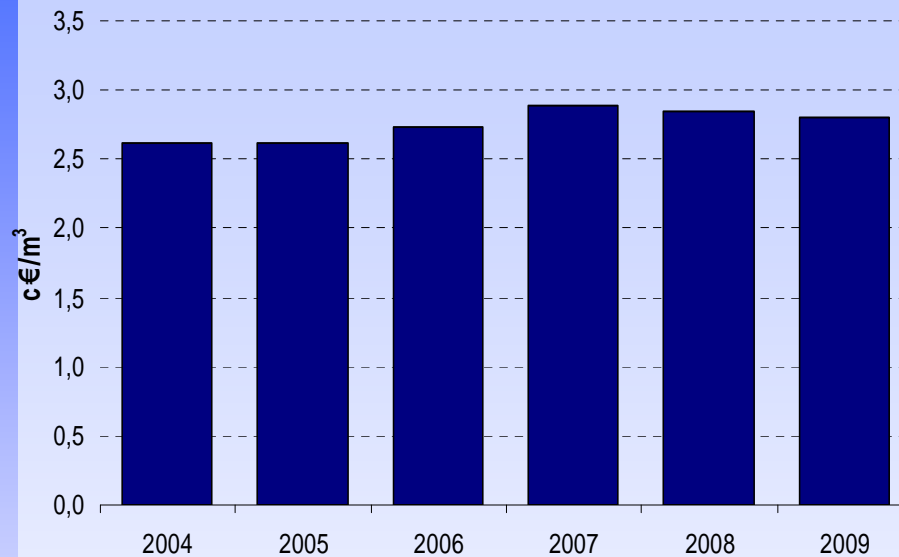


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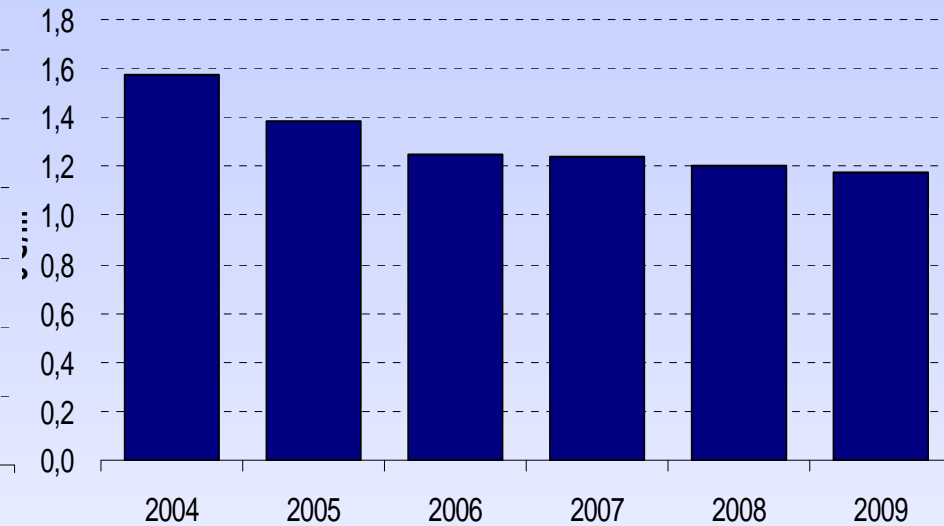
- Regulated activities
- Liberalised activities
- Activities potentially under regulatory control

Dynamics of tariffs in Italy: transmission tariffs

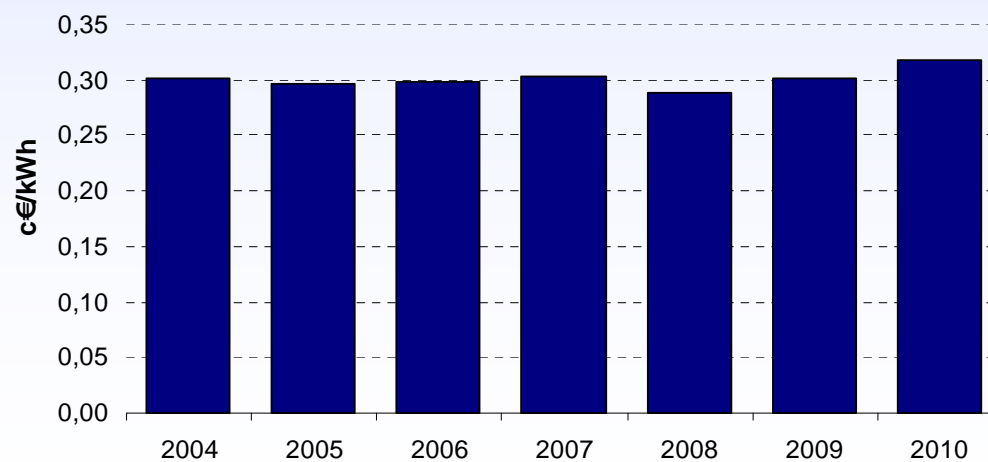
Gas trasport tariff for households



Gas trasport tariff for power and industrial sector



Electricity transmission tariff



Network activities and Third Energy Package

- Third Package main provisions:
 - *harmonisation of powers and competencies among national regulators*
 - *enhanced cooperation among transmission system operator (European Network Transmission System Operators: ENTSO-G e ENTSO-E)*
 - *establishment of the European Agency for the Cooperation of Energy Regulators (ACER)*
 - *Ten-Year Investment Plan*
 - *new unbundling regime (choice from 3 options: Ownership Unbundling, Independent System Operator, Independent Transmission Operator)*
- *Tariff convergence and a European network perspective is crucial for the market*
- *A harmonised, clear and shared implementation of the new Directive is also essential for future market developments (see, e.g. criteria for certification of TSO)*



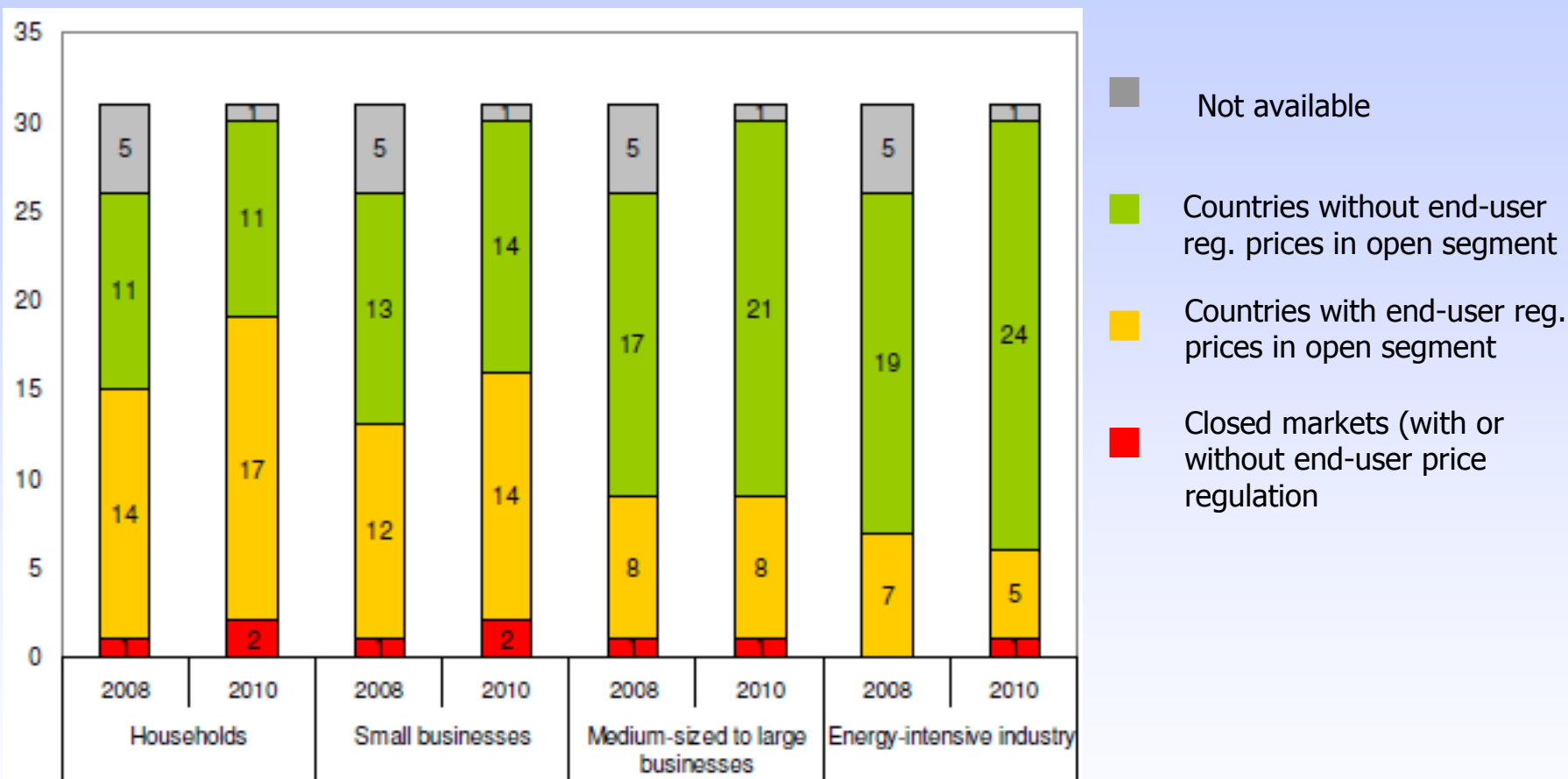
A scenario still without ownership unbundling...

- *“ ..promotion of competition necessarily requires ownership unbundling of transport and storage undertakings” AEEG Recommendation to Parliament, 2005.*
- *“In the competitive structure of current electricity and gas markets [...] it is essential to resolve the systematic conflict of interest inherent in the vertical integration of supply and network activities” (Energy Sector Inquiry, SEC(2006)1724, DG Competition)*
- *“..As a matter of fact, the transport networks and storage facilities, which all the upstream or downstream operators that are in competition with one another must compulsorily use..... cannot be left in the hands of just one or a few competitors in the arena, especially if they are dominant on their respective markets”. (Alessandro Ortis, President AEEG, Annual Report to Parliament, 2008)*
- *“The Commission shall, by 3 March 2013, submit, as part of the general review, to the European Parliament and the Council, a detailed specific report outlining the extent to which the unbundling requirements under Chapter IV have been successful in ensuring full and effective independence of transmission system operators, using effective and efficient unbundling as a benchmark. (art. art. 47.3 of Directive 2009/72/EC and art. 52.3 of Directive 2009/73/EC)*



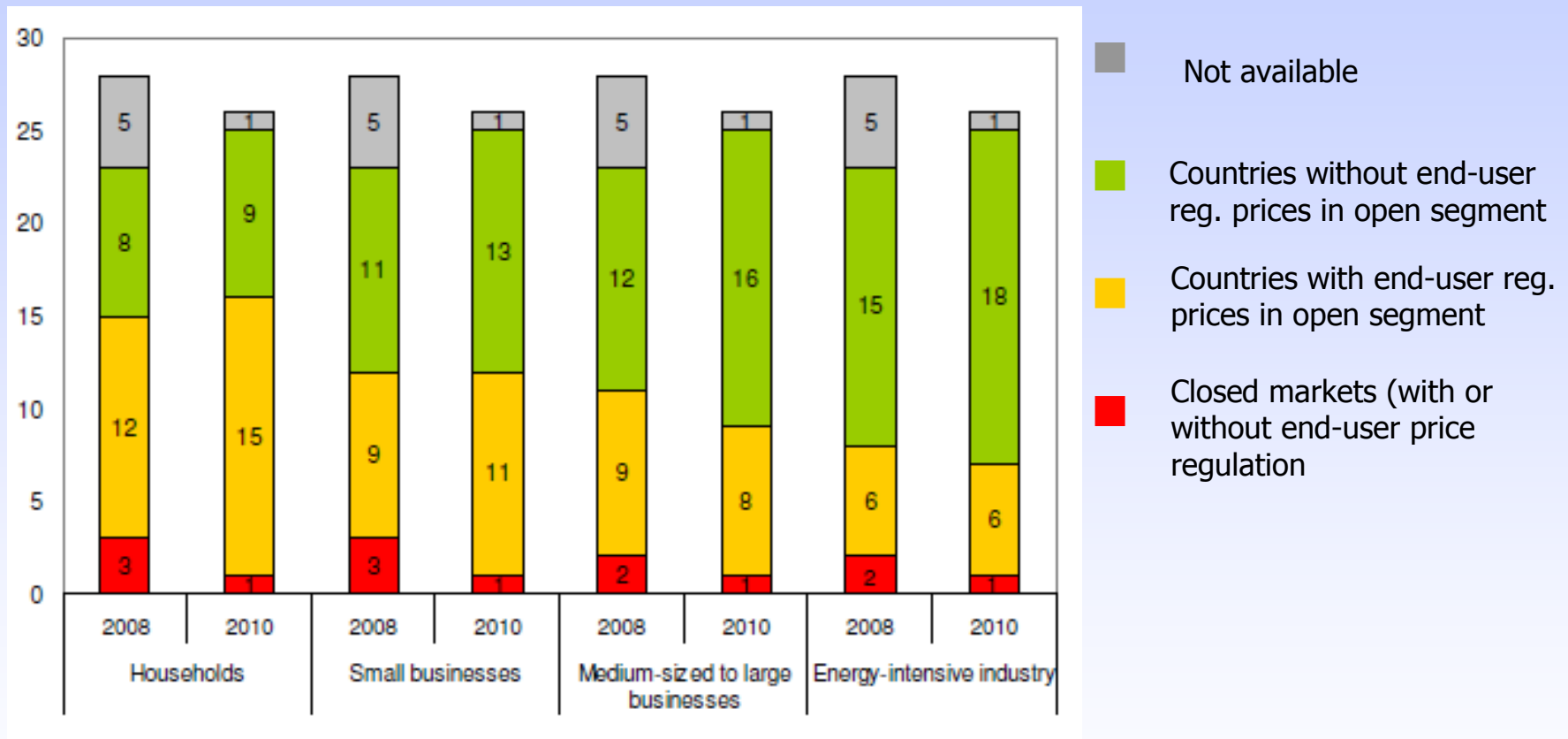
End-user price regulation in European electricity retail markets

Evolution between 2008 and 2010



End-user price regulation in gas retail markets in Europe

Evolution between 2008 and 2010



Price regulation in a liberalised activities: final sales

- Protecting small consumers remains necessary in liberalised energy market as limits to a truly competitive environment persist
- In addition, difficulties for small customers to make optimal choices:
 - *limited saving opportunities in bills;*
 - *specialised knowledge required (criteria for indexation, risk management, etc..) which many small customers do not have*



European Court of Justice endorses maximum prices for gas as a public service obligation

- The Court states (Case C 265/08 – 20 April 2010) that articles 3(2) and 23(1) of the Second Gas Directive do not preclude national legislation which permits the determination of the price level for the supply of natural gas by defining ‘reference prices’ after 1 July 2007, provided that such intervention:
 - *pursues a general economic interest consisting in maintaining the price to final consumers at a reasonable level, having regard to the reconciliation which Member States must make ...between the objective of liberalisation and that of the necessary protection of final consumers ;*
 - *compromises the free determination of prices for the supply of natural gas after 1 July 2007 only in so far as is necessary to achieve such an objective in the general economic interest and, consequently, for a period that is necessarily limited in time;*
 - *is clearly defined, transparent, non-discriminatory and verifiable, and guarantees equal access for EU gas companies to consumers.*



Role of regulated prices: storage

- The availability of flexibility mechanisms (primarily given by storage) is essential to enter and to operate in the gas market: operators have to adapt supply to foreseeable variations in demand and respond to fluctuations of demand with adequate supply.
- Although not an essential facility, storage is a *de facto* monopoly in several national markets (*see Joint Investigation on Storage, Autorità garante della concorrenza e del mercato – Autorità per l'energia elettrica e il gas, 2009*); in addition, only in very few cases can new entrants develop new storage sites and be competitive in the short term, due to long lead times or geological constraints
- Third Package asks Member States to define and publish criteria underlying the choice between regulated/negotiated access (*see ERGEG recommendations on storage, 2005*)



Price regulation in liberalised activities: critical issues

- The choice of regulated prices in liberalised activities should be made after an in depth analysis of the level of competition in the market and only for the period required for the transition towards a well functioning market.
- Due to the complexity and potential development of the market, a flexible approach is needed.
- Reason underlying the choice of regulated price in liberalised sectors should be substantiated and made public.
- Protecting “vulnerable” (e.g. poor) customers should not be confused with regulated tariffs for all or certain categories of customers (ERGEG Status review of End User price regulation as of 1 January 2010, 2010).
- Promotion of effective competition in the market remains crucial



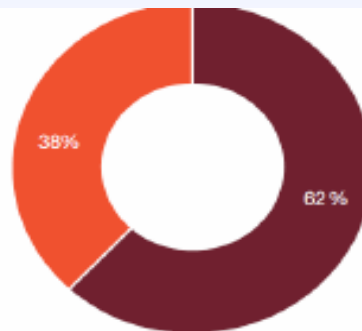
Hub and exchanges: a regulatory/legislative gap?

Exchanges and hubs:

- are key market institutions to ensure competition at wholesale level. They should be reliable, transparent, immune from manipulation, and perceived as such, and prohibit the strategic use of commercially confidential information. They should also allow the monitoring of market structure and player behaviour.
- ...however, "never featured in the market design defined by EU Directives and Regulation" (A. Pototschnig, FSR Workshop, March 5th, 2010)
- ..may be distinguished in merchant exchange (private initiatives) or cost of service regulated (public initiatives) (L. Meeus, "Why (and how) to regulate power exchange in the EU market integration context), EUI Working paper, 2010
- ..should be under regulatory oversight and its ownership structure would be well balanced (W. Boltz, FSR Workshop, March 5th, 2010)

Traders' view: Influence of the ownership structure of a hub to its functioning, PWC 2009

■ Yes
■ No



Workshop on Gas Hubs

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Is 'ownership unbundling' needed for hub/exchange (see Italian model) also in the light of increasing role of gas spot price in price mechanisms?



Main recent developments in the electricity and gas sectors

- As a consequence of the economic crisis and of the entry into force of new infrastructures and impact of past investments (including unconventional gas in USA), excess of supply in most markets (unfortunately, Italy only partially benefited from this trend)
- Despite persisting congestion in some parts, increasing market integration at EU level
- Consolidation of main companies' strategy of expansion abroad (concentration index low, at least at EU level, but with incumbent still dominant locally)
- Increasing role of spot markets in price formation (for gas, mitigation of Take or Pay constraints? - *See Joint investigation Autorità garante della concorrenza e del mercato – Autorità per l'energia elettrica e il gas, 2005, page 176 and following*)

a new strategy for companies?



Final remarks

- *Recent market trends, together with the new phase of implementation of the new Directives may require close examination and new investigation, especially from a European perspective*
- *More mature markets imply new efforts in monitoring activities (especially for retail) and, in particular, an evaluation of current status of competition in the different areas of Europe*
- *Role of hub/exchange and relative market design may need further discussion*
- *Company strategies may change/react to the new market situation*
- *Promotion of competition and customers protection remain crucial*
- *Close cooperation between antitrust authorities and regulators is now a reality, as well as in depth knowledge of the sector, its technicalities and main issues: new competencies for both may require continuous adaptation and new efforts, also in coordinating tasks.*

