



Regulatory issues concerning electricity retail markets

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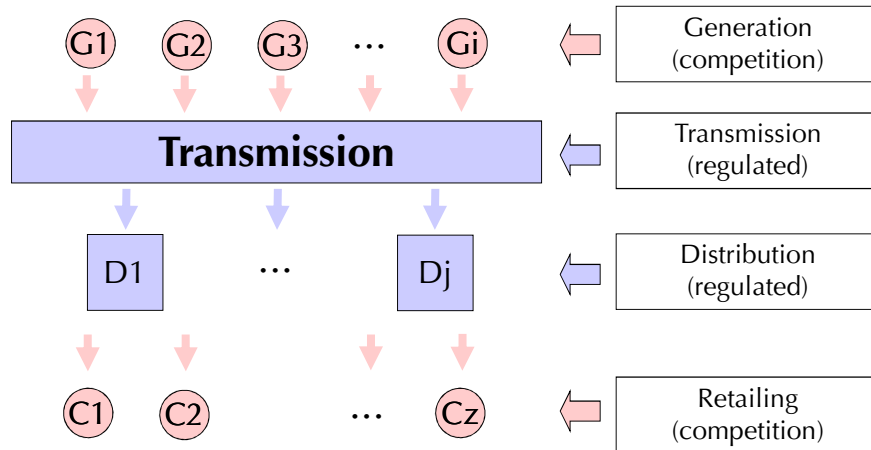
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- Introduction
 - General criteria
 - Retail markets slow-paced development
- Global description of the retail processes
 - Retailer activities
- End-user price regulation
- Barriers for retail market development
- Brief conclusion: measures to encourage retail competition

General criteria

The key to it all: separation of activities

- The key idea that has allowed to implementation of markets in the electricity sector is the separation of activities



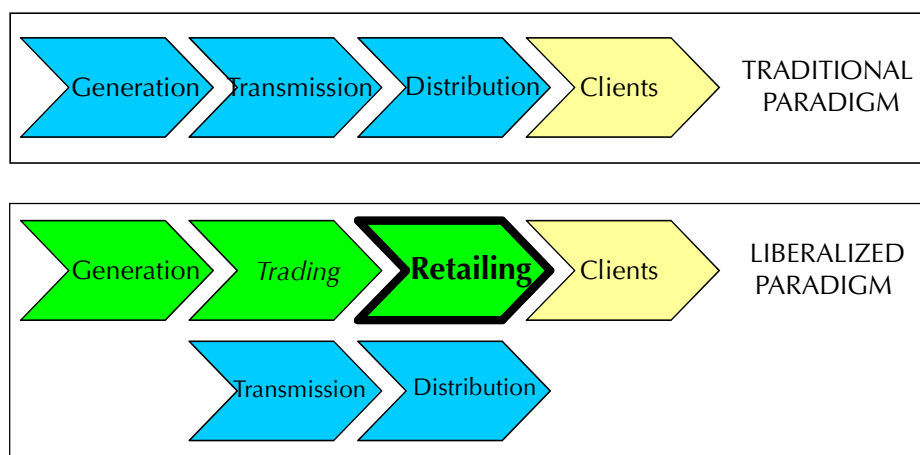
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General criteria

The new value chain



■ Deregulated activities
■ Regulated activities



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General criteria

General objective of retail competition

- Improving overall efficiency
 - on the supply side:
 - reducing the costs of customer service
 - adapting tariffs to particular consumer needs
 - promoting new products
 - different contract formats (flat rate, etc.)
 - product mix (dual fuel, etc.)
 - environmental criteria (green energy, etc.)
 - on the demand side:
 - Key objective: to involve demand in the market game
 - Allowing and enhancing demand elasticity
 - reflecting actual opportunity costs
 - Risk management
 - selecting the long-term / short-term portfolio

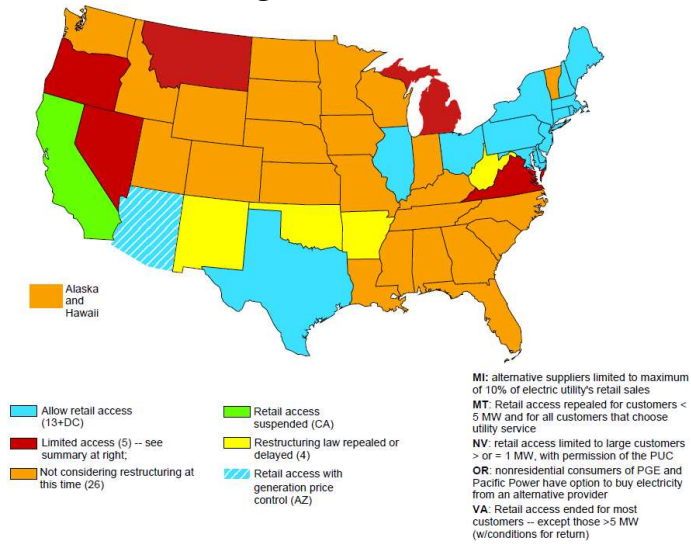
Retail markets slow-paced development

Retail business liberalization postponed or suspended

- Delays in the agreed processes
 - Full, phased, postponed, or partially ruled out retail competition
 - In most systems small consumers still have the opportunity to remain under a regulated tariff
- Crossed subsidies that leave no niche to the retail activity
- Political interference based on a flawed default tariff design
 - Due to lack of trust on market outcomes ...
 - Market power concerns
 - ... but also and mainly due to short-term political interests
 - Ex ante tariff deficit in Spain
- Doubts about the actual ability to extract a sufficiently significant added value



Retail markets slow-paced development Status of restructuring in the US



* (Rose, 2008)



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Retail markets slow-paced development Components of electricity prices

<i>Spain in 2000</i>		<i>Share of total cost</i>
<i>Items</i>		
Production and related costs		62,00%
Production under ordinary system and imports		40,00%
Production under special system		14,00%
Capacity payments		6,50%
Ancillary services		1,50%
Transmission		4,50%
Distribution		20,50%
Retailing		2,00%
Regulatory charges	Permanent costs	6,50%
	System Operator, Market Operator, CNE	0,20%
	Stranded costs (CTCs)	3,50%
	Incentives to indigenous coal	2,00%
	Subsidies to extra-peninsular system	1,00%
Diversification & security of supply		4,50%
Nuclear moratorium		3,50%
Nuclear fuel cycle		1,00%
Other		0,15%
Total		100,00%

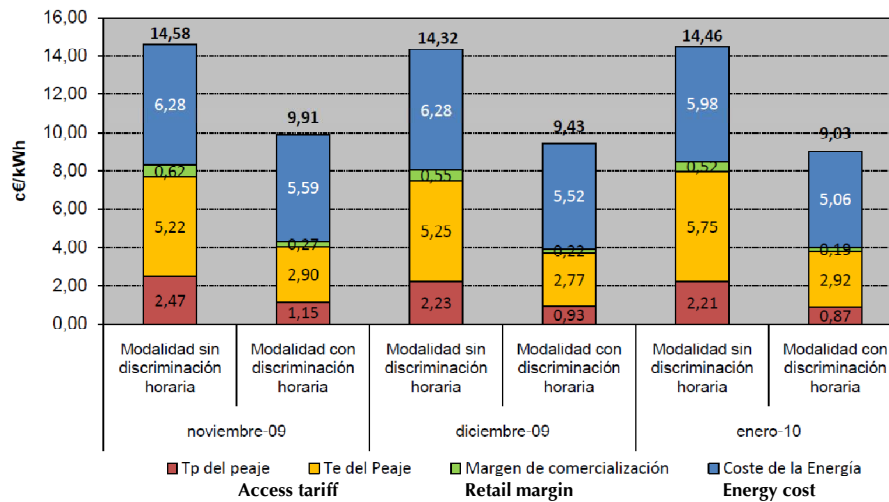


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Retail markets slow-paced development Components of electricity prices (ii)



* (CNE, 2010)



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Global description of the retail processes Retailer activities

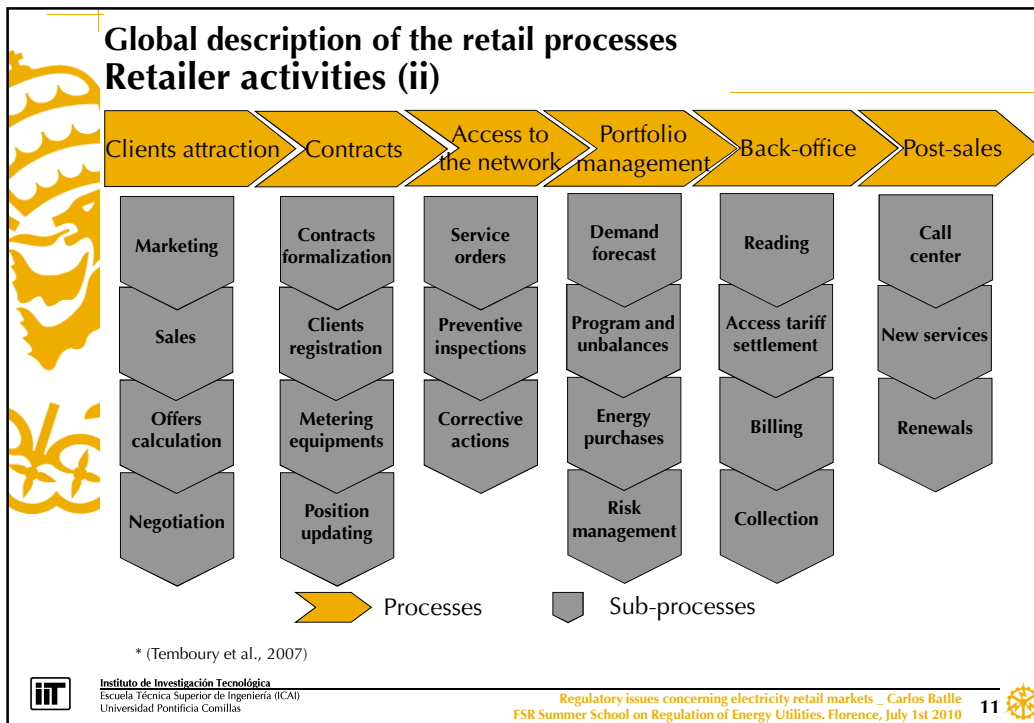
- One criterion to differentiate the retail business could be:
 - The so-called technical tasks: such as billing, data-mining (e.g. storing and using the information on the consumption of each customer), metering, and so on
 - The economic tasks, in particular those related to the acquisition of energy and the commercial relationships with existing and new consumers
- Another way of classifying the retailing procedures would be:
 - Intrinsic services to supply: demand forecasting, balancing, access to wholesale market (financial guarantees, settlement and information systems, personnel), management of network access, metering equipment, consumer information, etc.
 - Added service: training, energy audits, quality improvement, environmental responsibility advice, management of maintenance of electrical equipment, purchase of equipment, expansion or reinforcement of the network connection, financing, multiservice offers, etc.



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 - Supplier of last resort
 - Back-up supplier
 - Default tariffs
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- Brief conclusion: measures to encourage retail competition

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Supplier of last resort The 2003/54/CE Directive


- Retail competition
 - ‘The interests of the Community include, amongst others, competition with regard to eligible customers’
- Reasonable prices ...
 - ‘Member States shall ensure that all household customers, and, (...) small enterprises, (...), enjoy universal service ...
... that is, the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices’
 - ... but no mention to administratively designed tariffs
- Supplier of last resort
 - ‘To ensure the provision of universal service, Member States may appoint a supplier of last resort’
 - It is for each EU Member State to decide on the scope of customer protection and therein to define “vulnerable customers” [EREGG]



Supplier of last resort Scope of the regulator's tutelage

- Consensus among energy regulators about
 - the universal character of the electricity service and ...
... related to it, about the need of a supplier of last resort (SoLR)
- How far this SoLR tutelage should go?
 - The different definitions of the SoLR duties range from
 - the “*dire straits*” resort to satisfy supply in one end ...
 - Back-up supplier
 - Minimum SoLR, intended only to ensure electricity consumers receive electricity supplies when their existing retailer fails
 - ... to the “*tutorial*” supplier in the other
 - Default supplier
 - Enlarged SoLR responsibilities, offering a “more-or-less” regulated tariff to domestic or even industrial consumers
 - ‘Consumers who do not want to bother’ or consumers the regulator does not want to bother?
 - Non-sufficiently competitive markets niches








Back-up supplier

Key design issues

- It is indispensable, in the event of a supplier's bankruptcy
 - Many markets have no precise or not regulation at all about what to do in this case
 - The XS Energy experience in The Netherlands
- Main questions
 - Which customers have the right to resort to the back-up supplier?
 - Which is the procedure to designate the back-up supplier?
 - How are the failed supplier's customers allocated?
 - How long does the back-up supply lasts?
 - How is the back-up supplier remunerated?

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Default tariffs

What should be done with the default tariff?

- The bone of contention
 - Assuming that ...
 - a well functioning power market exists
 - a regulated tariff could be properly calculated (i.e. cost reflective)
 - ... are default tariffs superfluous?
- Do default tariffs constitute an obstacle to retail competition?
 - Two extreme approaches
 - Market true-believers (and market suppliers) defend the abolition of the regulated tariff
 - Others find "good" reasons to preserve it
 - Essential nature of electricity
 - '... ensure the provision of universal service' [2003/54/CE]
 - Need for protection for consumers who have high switching costs

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Default tariffs

What should be done with the default tariff? (ii)

- Pro: the pass-through alternative
 - If retailers can not compete with the regulated tariff, they do not create value, so the lack of retail competition is not a problem
- The counter-argument: the retail market option
 - Domestic customers are risk averse and not indifferent to choices
 - Retailing can lead to products that best suit the preferences
 - Introducing competition opens a door for innovation
- Pro+: One step further on the pass-through alternative
 - The risk objection is the key one
 - Balance the volatility of the spot price of the daily market by prescribing the acquisition of part of the energy by long-term contracts in organized public auctions
- The final counter-argument: an initial push to the market option
 - The market faith would be implicit in the value of an extra charge

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Default supplier

Main design issues

- Which customers have the right to resort to the default supplier?
- Which is the procedure to designate the default supplier?
- How is the energy cost and the retail margin calculated?
 - How are the energy cost deviations (if any) allocated *ex post*?
- Is there any implicit or explicit incentive for consumers to leave the default tariffs?
 - In case of considering an extra charge, how is this extra income set aside?

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 - The interference of the regulated tariffs
 - Structural barriers
- Brief conclusion: measures to encourage retail competition

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Barriers for retail market development


The interference of the regulated tariffs

- Governments have typically shown reluctance to remove regulated tariffs
 - (ERGEG, 2009) As of 1 July 2008, regulated end-user prices still exist
 - (electricity) in 17 countries for households and in 14 countries for non-household consumers
 - (gas) in 16 countries for hlds. and in 13 countries for non-hlds.
- End-user price regulation has only disappeared completely in a few systems (e.g. UK, The Netherlands and the Nordic countries*)
- A significant obstacle to the development of the retail market
 - discourages consumers from searching for alternative suppliers
 - prevents them from being exposed to more elaborate price signals
- The early stages of the liberalization process coincided with a period of declining fuel prices and capital costs ...

... but the situation has reversed

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Barriers for retail market development

The interference of the regulated tariffs (ii)

- However, the major problem is not the existence or preservation of the regulated tariffs, but the fact that these tariffs have frequently been poorly designed and calculated
 - This unfair competition is a barrier that has rendered practically impossible the retailing activity
- Political reasons are prominent
 - A widely used tool for governments to achieve complementary and frequently non transparent objectives
 - Protection of electricity intensive local industries, subsidies to domestic fuels, territorial policy or inflation control, etc.
- Regulators often have some reluctance to leave prices for all consumers entirely to the market
 - Determining factors
 - The political short-term agenda
 - The lack of confidence in the market mechanisms

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Structural barriers

Insufficient unbundling of distribution & retailing

- A lack of sufficient unbundling affects (to a small or large extent) retail competition
- Conflicting approaches on ownership unbundling
 - Against: it is not worth taking
 - Mulder et al. (2007): the impact of ownership unbundling on retail competition appears to be quantitatively insignificant
 - It is a significant problem
 - Davies & Waddams (2007): evidence that UK vertically integrated incumbents have retained a higher market share than those where these functions have been undertaken by separately owned companies
 - Ofgem (2008): the five former incumbents charged in their former monopoly areas an average of over 10% higher prices than comparable “out-of-area” customers

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Structural barriers

Insufficient unbundling of distribution & retailing

- Some (although sometimes isolated) illustrative examples of the many identified patterns of behavior in this category
 - Asymmetry in the access to commercial information of consumers by all retailers
 - Publicity or commercial offers that make use of services by other companies within the same holding
 - Quality of service of distribution as a commercial advantage
 - Abusive practices in the procedure to sign the contract for access to the distribution grid
 - New requirements regarding the contracted capacity or others
 - Renting, installation & maintenance of metering equipment
 - New requirements because of the change of supplier
 - Excessive charges for the metering service




Switching procedures

Obstacles and priorities


- Some of the identified obstacles (ERGEG, 2008a)
 - Poor procedures for distributor/retailers information exchange
 - High “transaction cost” for the switching customers
 - Lack of precision in deadlines specification (unacceptable delays)
 - Undesirable situations involving improper commercial behavior
 - Invoicing scams, charging consumers with amounts unrelated to their actual consumption
 - Abusive commercial practices by retailers when trying to win new customers
 - For instance “moving” consumers to the liberalized market (obviously to the retailer of the same holding than the distribution company) without their explicit consent or using misleading advertising
- ERGEG (2008b) has identified two strategic priorities
 - Promote easy, cost efficient and standardised switching and activating/deactivating procedure
 - Ensure customer confidence and sound monitoring systems







Switching procedures EREGG's basic guidelines

- There should be easy access to relevant and correct information for the customer prior to switching
- The regulator should ensure a list of alternative suppliers
- The process of switching supplier has to be easy from the customer's point of view
 - No unnecessary obstacles for switching
 - The switching period should be as short as possible
 - The customer shall not pay any direct fees for changing supplier
- Cost efficient and standardised data exchange processes
- Clear roles and responsibilities among actors
 - The customer should only need to be in direct contact with one party, preferably the new supplier
- Regulators should ensure sound market monitoring
 - Information about various market indicators should be available


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Measures to encourage retail competition

First conditions for a well-functioning retail market

- A reliable and transparent wholesale market
- A correctly designed tariff
- Adequate metering equipment and data processing
- Institutions that effectively protect consumer rights
- A stable regulatory framework

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Measures to encourage retail competition

Unbundling

- Adequate unbundling would effectively eliminate the incentive for the inappropriate behaviors
 - Only a complete (ownership) separation would remove all the identified additional obstacles to retailing
 - At least legal unbundling
 - Other measures for consumers' protection could be considered
 - Preventing users from choosing the supplier from the same holding than their distribution company
 - Key moment: full market liberalization start
- Clear minimum quality standards and metering responsibility must be established

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Measures to encourage retail competition

Information management

- Switching procedures should be supported by clear mechanisms of access to commercial information
 - Availability of information at reach for all the interested retailers
 - As long as it respects the data protection legislation
 - At least a common but decentralized scheme, with standard data management and switching procedures
 - If experience shows that this does not provide sufficient guarantees, a centralized switching agency should be created
- Deadlines and criteria for revision of the adopted measures should be properly specified



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