

What can retail electricity competition do for customers and how do we achieve it?

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Outline

- Retail competition in Ireland today
- Extent & benefits of GB retail competition
- Main determinants of success
- Comparison of structure and regulatory framework: GB, N Ireland and RoI
- Item by item implications for policy
- Conclusions & recommendations

Is the Irish market different?

- Differentiating factors
 - Single island market is small (but not uniquely so)
 - Generation is relatively large and lumpy relative to total supply
 - Limited fuel substitutability (esp. gas) for customers
 - East-West interconnector not until 2012
 - Other connections possible but uncertain
- These need to be taken into account in identifying an appropriate bespoke solution
- Nonetheless many common factors with other markets and scope for comparison and learning

Retail competition in N Ireland

- Market opening in effect 1999
 - Interim arrangements for purchasing other than from Power Purchase Business
- Market fully liberalised 2007
 - c790,000 customers
 - Some brokers
- NIAUR verdict: Very limited success
 - Domestic sector: no active or potential competitors
 - Competition not effective in most other sectors
 - Some industrial customers unable to obtain offers

Retail competition in RoI

- Market opening commenced 2000
- Market fully liberalised from 2005
 - c2,150,000 customers
 - Tariff regulation lifted in large-user market Sept 2006
- CER verdict: Effectiveness mixed
 - Good competition in industrial market and some brokers; lesser competition in commercial sector; negligible competition in domestic sector
- EU benchmarking report 2007
 - Concerns about high concentration in Ireland (later)

Retail competition in GB

- Large users & SMEs market open 1990,94
- Very active from the beginning
 - Users willing to choose & suppliers keen to serve
 - Substantial initial price reductions - about 15%
 - Initially annual beauty contests for best price
 - Proliferation of flexible deals
 - Now more framework contracts with customer options whether/when to fix prices to deal with risk
- Additional services soon developed
 - e.g. national billing, monitoring usage, energy efficiency advice
 - Active intermediary sector (many brokers)

Retail competition GB domestic

- Domestic market open since 1998/9
 - About 12% customers switched first year, now c.18%
 - Active competition & choice for domestic customers
 - 77% satisfied with switching process & outcome
 - About 50% domestic customers with other suppliers
 - More active than for most other consumer services
- Some teething troubles being dealt with
 - Mis-selling, mis-transfers, transfer blocking, debt-hopping
- Active switching sites (9 accredited)
 - Provide information, compare offers, help customers choose and then implement switching decisions

Nature of benefits in GB

- Price reductions typically at least 10%
 - Discounts for dual fuel
 - Discounts for direct debit & for online a/cs
- Variety of offers
 - Green electricity, air-miles, charitable contributions
 - Fixed or capped prices for 1 – 3 years
 - Chosen by 4.6mn domestic customers in GB
 - Capped price customers have generally benefited
 - Also wholesale price tracker terms
- Competition to improve service quality
 - Improved UK call centres, new IT systems

Some concerns in GB

- Despite general success, some concerns
 - Insufficient wholesale market transparency and liquidity for retailers, especially smaller ones?
 - Is cash-out mechanism biased against entrants?
 - Costs of multiple, overlapping credit calls?
 - In practice, more exit than entry
 - Meter reading & data collection access & costs?
- Ofgem is considering many of these issues
- But concerns have not prevented a competitive retail market, at least among Big Six suppliers

Domestic market concerns in GB

- Ofgem's view: market working well but:
 - Wholesale price reductions passed on soon enough?
 - Higher prices in area than out of area
 - Price differentials not necessarily reflecting cost
 - PPM premiums excessive, Online discounts only temporary
 - Vulnerable customers less active
 - Lower switching in Scotland and Wales
 - Some SMEs lack awareness of contract terms
- Various remedies proposed
 - Measures to enhance customer response
 - Licence conditions: relative prices & cost reflectiveness
- Some supplier response but still licence mod

Other overseas markets

- Great variation in retail markets overseas
- Some have failed: inappropriate regulation
 - California (market power, discouraged contracts and forced price equal to spot price, which increased)
 - Ontario (tight plant margins and uncertainty surrounding timing of restructuring)
- But some very active in retail competition
 - Sweden, Norway, Victoria, S Australia, Texas, NZ
 - Several of these are small markets like Ireland
 - High annual switching rates there
 - 26% Victoria, 12% Norway, 11% NSW
- Generally based on chosen contract terms
 - Sweden > 50%, S Australia 69%

Interim conclusions

- Retail markets in N Ireland & RoI exist but not working as well as they could and should
- Customers not enjoying benefits of retail competition per GB and some other markets
- We now ask: what is GB and EU thinking on most critical determinants of competition?
 - Ownership, market structure, business separation, suitable retail price controls, liquidity and contracting
- Note other factors important, but largely secondary to present discussion
 - Profiling, metering, supplier codes of practice, etc
 - Note concerns about meter reading service in Ireland

EU thinking on Ireland

- EU benchmarking report 2007
 - “Incumbents dominate market, by long distance”
 - Lack of new entry in supply market
 - Need to strengthen unbundling of distribution
 - Concentrated plant ownership a problem
 - despite VPP auctions & divestment (RoI) & PPAs (NI)
 - Need for regulation of end-user prices but concern about complexity as a barrier to entry
- EU thinking consistent with GB lessons

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Ownership

- Public ownership can be problem (underpricing)
- Competition possible if it is not dominant
 - Nordic market - hybrid structures work but competition between markets and increasing private ownership
 - NSW problematic – now intention to privatise
- Private ownership in all successful markets
 - GB, Victoria, S Australia, Texas, NZ
 - Greater incentive to seek new customers efficiently
 - Reduces any incentive to under-pricing
 - More robust regulation of incumbent monopolists

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Your User Name, 10/02/2009

Ownership Ireland

- N Ireland
 - NIE privatised since 1993
- Rol
 - ESB publicly owned and retains dominant position
 - VPPs right to output only and have now ceased
 - Endesa purchase of 1GW plus sites
- Intrusive regulation to help compensate for public ownership – but has it worked?
 - Further extensions of private ownership in Ireland would help to promote competition

Market structure GB

- Positive action taken to modify structure
 - Initially many suppliers (12 RECs, 2 Scots)
 - Significant generation restructuring at privatisation
 - Further disposals of generation plant required
 - Licences modified to allow sale of businesses, hence specialisation and mergers
- GB now one of most competitive retail markets
 - 6 major integrated suppliers, none dominant
 - Plus smaller independent generators & retailers
 - Active entry and exit of generators and suppliers

Generation market structure Ireland

- N Ireland (2.8 GW)
 - PPAs (majority do not expire until 2012)
 - PPB obliged to sell at regulated prices
 - Newly commissioned Coolkeeragh (ESBI)
 - Rol (6.3 GW)
 - ESB Group 70% generation market share
 - New entry under long-term contract with ESB
 - Only Viridian (Huntstown) entered without contract
 - VPPs now ceased post-SEM & disposal
- Limited impact on structure - do measures go far enough to create basis for retail competition?

Supply market structure Ireland

- N Ireland
 - 16 supply licensees but mostly dormant, 4 active of which only 2 independent of incumbent NIE
 - Important GB entrants (E.On, RWE) have exited
 - NIEE has all domestic mkt & (+ Energia) most SME
 - Rol
 - 9 suppliers, 6 active independents
 - ESBCS still has about 3/4 of market by energy
 - Some new entrants, some supported by VPP output
- Although retail competition has taken hold in (larger) business market, it is fragile in domestic market, where new entry more costly and risky

Wholesale market structure Ireland

- SEM has been an important stride forward:
 - Effectively expands the market
 - a transparent market place for all entrants on both sides of the market
- Directed contracts and purchaser options
 - Also important (aim to reduce HHI of ESB to 1150)
 - But there remain problems of liquidity and credit
- Is Irish market too small to sustain vigorous competition, especially in domestic market? No
 - In other markets viable retail businesses between 100,000 and 1mn customers (e.g. Australia and NZ)

Liquidity in GB

- EW Pool, later Neta/Betta, provides a market
 - Enough players for competitive market
 - Particularly important for new entrants
- But now increasing concerns about liquidity
 - Particularly shaped products for over 1 year ahead
 - And smaller quantities for smaller suppliers
- Vertical integration reduces demand for market by such suppliers but also reduces liquidity
 - May need measures to increase liquidity
 - Obligations to auction/sell/trade minimum volumes?

Liquidity in Ireland

- SEM an important step forward
 - Price transparency and access to balancing
 - Default market for generators and ready access for suppliers
 - And directed contracts helped to mitigate price volatility
- But still two concerns
 - Most price setting plant owned by ESB PG
 - Will this be changed by Endesa entry?
 - Competitive market needs forward contracts
 - Supplier diversity, product choice, active secondary trading
- **To ensure full benefits of SEM, there is a need to stimulate a more active CFD market**
 - Requirement on ESB PG to offer contracts? Facilitated exchange? Probably both, consider how best to achieve

Separation of businesses in GB

- Separate accounts for distribution & retail
- Adequate initially but more was needed
 - Particularly with opening of full retail market
- Legal separation and clearer conduct rules
- Process assisted by separate ownership of some distribution & supply businesses
- Is this sufficient with vertical integration?
 - Less transparency & liquidity in market
 - Current regulatory focus on intra-group transactions
 - May need further steps in GB?

Business separation in Ireland

- Separate accounts for distribution & retail
 - N Ireland uses GB model
 - RoI has bespoke arrangements that go further
 - Ring-fencing between all licences *and* divisions
 - Generation and supply licences impose range of restrictions on company's operations
- EU still has concerns in general and further action is likely to emerge from third package
 - Priority in Ireland perhaps implementation and enforcement of existing arrangements?
 - allocation of costs & risks between businesses?

Retail price control in GB

- GB price controls removed for business customers when 100kW market open 1994
- Transitional 2 yr domestic price cap in 1998
 - Changed to fixed price, not pass-through
 - Included costs of hedging for that period
 - No need for k factor adjustments
 - Headroom allowed other suppliers to compete
 - Reallocation of costs between distribution & supply
 - All controls removed after 4 years
- Unduly severe price controls (with no headroom or even requiring or allowing pricing below cost) have deterred competition in many other markets

Retail price controls in Ireland

- Northern Ireland
 - Prices still regulated - k factors may protect customers but they give undue advantage to incumbent against competitors
- RoI
 - ESBCS tariffs regulated, similar k factor disadvantage
 - Since launch of SEM must offer large users either regulated tariffs or Pool Price Pass-through Tariff
- Two regulators, two approaches to price control
 - Increases complexity in retail market, especially costly for smaller competitors and new entrants
 - Need for single market surveillance and over-sight
- **If price controls retained as transitional measure**
 - Nature and level should take into account the impact on competition
 - Consider allocation of costs & risks between distribution and supply
 - Need more transparency, less complexity, more uniformity

Is retail competition possible?

- Retail competition not fully developed in Ireland
 - Some achievements large customers, not domestic
 - Two players dominant pre-SEM, likely to continue?
 - No threat of new entry of significant scale in prospect
- But retail competition could develop as in other markets (large & small) if appropriate steps taken
- Local characteristics impact policy choices
 - Limited prospects for large number of independents
- But they do not change nature of required policy
 - Realistic aim should be handful of significant participants, not just one large one in each market
 - Experience in Norway & Australia/NZ shows this is viable

Underlying problem area

- SEM an important step forward
 - But contracts market still tied to ESB
- Entry of Endesa also important
 - It remains to be seen what positions Endesa will take
 - But will bring more choice & pressure for further change
- However, significant market dominance remains in both generation and supply
 - Duopoly in SEM could lead to tacit collusion
 - Little impetus or opportunity for change, choice or innovation
 - Adverse effect on retail competition and new entrants
- Dependence on regulatory interventions ex post is unlikely to assure new entrants

Main policy proposals

- The above factors point to need for structural remedies
 - Less dominance and more independent players in the market
- 1 Further divestment of generation is the key
 - Possibly with transitional limits to further investment by incumbents until divestment has taken place?
- 2 Plus divestment of part of incumbent supply portfolios?
- 3 Establish organised financial trading market
 - Again transitional measures also needed:
 - ESB commitment to offer contracts to develop this market
 - Possibly with restrictions on customer acquisition?
- Perhaps transitional price caps for domestic market
 - To prevent excess profits for incumbents, but
- 4 Remove k factors & allow headroom, & reconsider appropriate cost allocations (distribution & supply)

Conclusions

- N Ireland and RoI have taken initial steps to create competitive electricity market
- Successful markets have taken more steps and continue to monitor situation
- Structural remedies are key to success
 - Supplemented by provisions on conduct
- There is scope for further steps in Ireland
- On this basis, effective retail competition IS possible in Ireland