

Comments on the 4th Benchmarking report

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January 2005

The following notes represent detailed comments on the 4th Benchmarking Report (Annual Report on the Implementation of the Gas and Electricity Internal Market) published in January 2005 by the Commission. They build on comments already submitted to DG TREN in November 2004 on the proposed indicators for the 4th Benchmarking report (see Annex). They focus on the electricity sector, but in principle, many of the remarks are also applicable to the gas sector.

As an overall comment, the 'Benchmarking' series represents a valuable source of data on the implementation of the gas and electricity Directives. However, its usefulness is compromised by inconsistency in the indicators published and the sometimes arbitrary nature of the indicators chosen. This reduces the usefulness of the reports because users often cannot get time-series of data. There is also an impression that the indicators published are those that support the Commission's policy and the credibility of the reports as impartial assessments is damaged.

1. Main report

Page 3. Paragraph 2.

The statistics on labour productivity raise more questions than they answer. Consumers are concerned about price, reliability and perhaps environmental impacts, but they are likely to be indifferent to how much labour goes into a kWh. Apparent improvements in productivity might occur if there is contracting out, a change in generating technology (e.g., use of gas instead of coal), a reduction in investment (e.g., a company not building any power stations is likely to employ fewer people than one that is). Improvements in productivity would also occur if companies reduce R&D expenditure and, in the short-term, if they reduce maintenance activities. None of these causes necessarily reflect a change in underlying efficiency.

Page 3. Paragraph 3.

I think the focus on retail competition is inappropriate. Arguably, if there are significant differences in retail prices, it can only be because the wholesale market is not working efficiently. If the wholesale market is working efficiently, there should be minimal difference between the prices retailers pay for their wholesale power and the retail element of the bill is far too small to make much difference in price, especially for large consumers.

Page 4. Paragraph 3.

The report states: 'In this context it is vital for rules on cross border electricity exchanges to continue to be improved to ensure that existing infrastructure is utilised to its maximum possible extent.' Surely interconnectors should be used as much as is economically efficient, not as much as possible.

Page 4. Paragraph 4.

I think the likely outcome of forcing the separation of distribution and retail is that retail will be taken over by generators because retail is not a sustainable stand-alone business. A good regulatory regime should be able to deal with discriminatory tariffs, but if generation and retail is integrated, the wholesale market will become irrelevant and this will place the onus on consumer switching to force competition. This will inevitably favour large consumers, who have strong negotiating capabilities, over small consumers.

Page 4. Paragraph 5.

I think it is inconsistent to say nothing about the dangers of integration of generation and retail yet condemn long-term Power Purchase Agreements (PPAs). How is a company building a generating plant to supply its own consumers any more competitive than a retailer signing a long-term PPA. A least a retailer can choose the cheapest deal on offer.

Page 5. Table 2.

As a semantic point, I think the report should be clear about the meaning implied here for integration, i.e., integration of EU markets, not integration of elements of the business, the more usual use of the term in this context.

Page 6. Paragraph 3 & 4.

I think a ‘health warning’ that the wholesale prices you quote are based on minimal liquidities and should be treated with caution should be added.

2. Technical Annexes

Page 8.

A definition of ‘significant’ is necessary if the table is to be useful. I am surprised that Electrabel is the largest company in Netherlands. Without knowing the definition being applied, this seems unlikely. I am also surprised Centrica is mentioned for UK as a significant electricity company, but Scottish & Southern and Scottish Power, which on most measures are larger electricity companies, are not.

Page 18. Table 3.1.

I am highly sceptical about the UK figure for trading. Without knowing the definition, this seems unlikely as in most days, the volume trade on NETA is less than 1% of electricity sales.

Page 18. Paragraph 2.

As always, I am bemused by the Commission’s attitude to trading links. They are just one of many possible tools for improving reliability and increasing competition – interconnectors do not necessarily improve either. They should be built if they are found to be the best way of achieving the desired goal, not because trading links are good *per se*.

Page 19. Paragraph 2.

Again, there is a condemnation of PPAs, but nothing about integration of retail and generation. If we take the UK, market, it is arguably fundamentally unhealthy because of its degree of integration and the dominance by 6 companies. How could a new generator or a new retailer enter the market in the UK? Who would buy the power of a new generator and who would sell a new retailer power? If Centrica keeps losing customers at the rate it did last year (1 million), it will go the same way as TXU did in 2002 and be taken over by one of the remaining five companies. When either of the two Scottish companies makes a significant error, they will not have the financial strength to absorb it in the way EDF, RWE or E.ON could and will be taken over by EDF/RWE/E.ON. So the likelihood is UK will end up with

three companies insulated from new entry and with no incentive to compete against each other.

At least with a de-integrated market and long-term PPAs, a company that can offer cheap generation has a chance of getting a contract with a retailer and a new retailer could compete in the market for PPAs

Page 22. Table 3.4.

The analysis behind this table may be useful but the information presented here is too summary to be useable.

Page 23. Table 3.5.

This table is misleading because it largely tells you what the structure was before liberalisation. A country with a lot of distribution companies will appear competitive while one with a national company will not. But, is an industry composed of 10 *de facto* regional electricity monopolies any more competitive than one with 1 national monopoly? For the information to be useful, it has to show how far regional monopolies have been broken up.

Page 24. Table 3.6.

Unless information is included on integration of retail and generation, this table is misleading.

Page 38. Table 6.1.

I am not sure how comparable the figures on reserve capacity are.

Page 39. Paragraph 1.

The report states: ‘However, the key to encouraging investment above all is a stable regulatory framework with commitment by regulators and Member States on a medium to long term basis of their particular approach to this question.’ I do not see how regulators and governments are responsible for encouraging investment in generation if there is a free market. I thought market signals were supposed to trigger investment. Of course, there are plenty of reasons why market signals will not. Market signals change on a daily basis so companies are hardly likely to make an investment decision on an asset that will take 6 years to bring online and will last for, say 30 years on such an unreliable and transient signal. So if market signals will not trigger investment reliably, the Commission should acknowledge it and not continue with the fiction that the market will do the job.

This fiction of a market makes monitoring generation adequacy impossible. Companies are motivated to take ‘options’ on new projects, most of which will never be built. For example, in the UK, there are 40GW of projects that have been announced by companies that could be online by 2010. How can any central authority judge what proportion of this will actually be built? If it can’t make that judgement, then it cannot take any necessary remedial steps to avoid capacity shortage as it is required to do by the Electricity Directive.

Page 39. Table 6.2.

I do not think the information here is sufficient to be useable.

Page 41. Paragraph 2, line 3.

I assume the report should say ‘subsidiarity’ not ‘subsidiary’.

Page 42. Paragraph 2 & 3.

There is a great deal of confusion about suppliers of last resort. The three functions are noted here: the supplier who will take over the consumers of a failed retail company; the company that is obliged to offer terms to ‘undesirable’ consumers that other companies refuse to

supply; and the company that will supply a remote consumer who other companies might not expect to be profitable. These three functions are entirely different and should be considered separately.

Page 43. Table 7.1.

I do not think the first row of the Table is meaningful unless you define what you mean by supplier of last resort. I do not think there are any arrangements in UK for any of the three functions so the entry for UK is misleading.

The second row of the Table needs explanation for it to be meaningful.

On the third row of the Table, I do not think a pre-payment meter can be described as a 'solution'. A customer with a prepayment meter cuts himself off if he cannot afford electricity – hardly a solution.

On the fourth row, the entry for UK claims there are social tariffs in UK. The situation on social tariffs in UK is that companies can (i.e., they are not prevented) offer lower tariffs to groups of consumers (who might be disadvantaged) provided the tariffs are not uneconomic. In practice, all that happens is that a company, to mitigate the bad publicity of a price rise, might offer not to impose the price rise on, for example, pensioners. This is no way to run a national social policy - arbitrary concessions decided on by profit-maximising companies.

On rows 4 and 5, I do not understand what is meant by 'Compensation'. Compensation for what?

Page 47.

I think it is essential to look at the costs as well as the benefits of competition if a proper judgement is to be made. In UK, the annual cost to household consumers of retail competition is of the order £300m (€15 per consumer). I am extremely dubious that the benefits of competition are this high. If the Benchmarking report is to have credibility, it should not just present evidence that supports the Commission's views.

Page 48.

Having price comparison information is all very well but is it useful? 18 months ago, I moved to the cheapest supplier for my region. A year later, I checked and it had become about the most expensive. I checked again last month and it was about the cheapest. So what use was information to me and did it allow me to get a cheaper electricity deal? Am I likely to switch suppliers again on the basis of static price comparisons?

To say there is no supplier change charge is extremely misleading. There clearly is a cost, it is simply that the person changing supplier does not pay it. Is that equitable? If a consumer is going to move to a cheaper supplier, why should all other consumers that are not getting cheaper electricity have to pay? As the UK Energy Minister said last year, if small consumers started to change supplier en masse, the costs would be huge and the whole system would fall over. This has led to the ridiculous situation in the UK of the Regulator exhorting consumers to switch, but hoping they will not do so because the whole system would collapse if they did and the costs, borne by consumers, would be immense.

Page 48.

Line 5 is labelled 'Response time for complaints'. Complaints about what? What sort of response? I do not think the data presented is useful without further information and definition.

Page 50.

I am not sure the information is meaningful in the form presented. What does it mean 'consumers feel they have no control over the services offered'? The supply is either working or it is not, why or how would I want to control it?

Page 51.

The report talks about 'a frequent feeling of repeated sizeable price increases, often related to taxes.' Is that what consumers said (i.e., the price rises are related to taxes) or is that the Commission's interpretation. If it is the latter, it is presumptuous of the Commission to make this judgement.

Page 52.

I think the information is too summary to be useful. The Table is headed 'Consumer's (sic) attitude towards competition and public service'. Under 'public service' for UK, we read 'Maintenance in remote areas; quick intervention; "vigilance" with respect to prices'. Is this an opinion, or a requirement?

Page 57.

Paragraph 1, last but two line, independently is mis-spelt.

Annex Comments on the proposed indicators for the 2005 Benchmarking Report

General Comments

Omissions

It is essential in evaluating the Commission's proposed indicators for the 2005 Benchmarking Report to know which, if any, indicators that were included in the 2004 report will not be included in the 2005 report. For example, Table 2 in the 2004 Benchmarking report covered 'Competences and Resources of Regulators'. No mention is made of this in 'Implementation of electricity market opening: key indicators'. No price indicators (Previously Table 9) are included, nor are electricity security of supply indicators (previously Table 6).

Incomplete data

What measures, if any, are being taken to get more complete data where the 2004 report was incomplete, for example, in Table 10, 'number of disconnections for non-payment in 2002'.

Additional data

Data on employment in the industry would provide valuable additional information on the impact of electricity market opening. This should be broken down by activity (generation, distribution, transmission and retail supply), and by direct employment and sub-contracting.

Background studies

Some indicators need further background studies to provide context. For example, on switching for residential consumers, studies are needed to show whether small consumers are able to use switching to reduce their energy costs. For example, in the UK, Waddams (http://www.ccp.uea.ac.uk/public_files/workingpapers/ccr04-1.pdf) showed that whilst consumers who switched expected to save money, more than half actually paid the same (14%) or paid more (42%) after switching. These studies should not only include how successful consumers were in identifying the lowest price supplier at the time of switching, but how much money was saved over the subsequent period of, for example, a year. For example, if a consumer selects a supplier that is cheapest at the time of transfer only for that supplier to increase their price a week later, the consumer will have done poorly from the switching process. If consumers are often not capable of identifying the best deal or if they can have no confidence that selecting the cheapest supplier will actually save them money in the long term, this calls into question the appropriateness of providing consumers with choice.

Detailed comments

Estimated customer switching

Switching rates for commercial/household consumers should be split into separate household and commercial figures.

Annual figures are more relevant than cumulative figures because they reflect better awareness amongst consumers of the scope to switch. For example, in the UK, the Regulator has shown evidence that awareness of competition was falling. The implication in its comments by Eurelectric that consumers who switch make permanent gains is clearly not correct. Consumers need to constantly monitor prices to ensure they are getting the best available deal.

The Benchmarking Report should include the average cost of switching supplier (ie, the technical cost of registering a consumer with a new supplier) and who bears that cost. These costs are substantial and need to be identified properly if a full cost-benefit analysis of the benefits of retail competition are to be assessed.

Network access

It is necessary to differentiate between the owner of the transmission and distribution assets and the operator. This table should therefore include number of transmission and distribution companies and number of TSOs and DSOs.

Unbundling TSO and DSO

As above, the information should indicate whether the TSO and DSO are owners of the assets.

Generation market

The data should identify what proportion of the market is supplied under long-term contract, what proportion is supplied by integrated generation/retail companies and what proportion is supplied through the power exchanges. It should also provide price information for power traded in spot markets and through long-term contracts.

Retail supply market

The data should show the average market share of retail companies in their previous franchise areas to show to what extent regional monopolies have been broken up.

Universal service/consumer protection

The indicator on default supplier is ambiguous. Does this refer to the arrangements that apply if a retail supplier exits the market or does it apply to the ability of an individual consumer to be guaranteed the offer of a supply? Both interpretations are relevant and would be valuable. The indicators 'special tariffs', 'free supply amount' and 'restrictions on disconnections' are not useful without further information. The extent and nature of the special tariffs needs to be specified, the market share of pre-payment meters, and the quantity of electricity supplied under free supply need to be specified. For number of disconnections, much more complete coverage is required and for countries with pre-payment meters, some estimate of the extent of self-disconnection (those consumers that disconnect themselves because they cannot afford to recharge their meters) needs to be made.

Prices

Clarification is needed on what pricing information is to be included. The information contained in the 2004 report on 'Estimated breakdown of expected electricity prices' (Graph 1) should be extended with separate information for household consumers. The data should be presented in table form for ease of use of the data.