Electricity liberalisation in the EU

Presentation at a conference: “EPSU European Energy Conference”
International Trade Union House, Brussels, March 1, 2007

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Outline

• What is the model?
• How far have we got?
• Unbundling
• The DG Energy investigation
• The DG Competition investigation
• Issues
• Next best solution or Frankenstein’s monster?
The Ideal Model

• Wholesale market. Provides price signals for purchases made outside this market and for investment decisions in new power plants

• Retail market. Consumers can switch. This places competitive pressure on suppliers: inefficient suppliers are squeezed out

• Access to the networks is available to all retailers and wholesalers on equal terms

• A sector regulatory body should exist

• Integration of retail and wholesale should be limited or wholesale markets are meaningless
2003 Directive

• Wholesale markets implied but not specified

• Retail competition for all non-HH consumers by 2004 and all consumers by July 2007

• Networks should be legally unbundled from generation and retail activities. Transmission by 2004, distribution by 2007

• A sector regulator with specific powers and capabilities must be present

• No provisions on separating retail/wholesale and networks
Where are we? Neelie Kroes

• 'It is clear that no-one in their right mind could say that a competitive single European energy market is already in place today.'
Where are we? Manuel Barroso

• 'In energy terms I can tell you that I am more convinced than ever that we need new legislation concerning regulation. What we know is that the status quo isn't working. What we have to do is decide how we can most effectively reform the system to the benefit of business and consumers'
Where are we? : DG TREN

- 'Recent increases in wholesale electricity and gas prices have fed through into the bills of end-users and now offset some of the earlier reductions, particularly for the very largest industrial energy users. It is highly questionable that gas and electricity prices are the result of a truly competitive process rather than being the direct result of decision of companies with market power.'
Implementation

• Many countries have not implemented the Directive fully and the EU is taking proceedings against them.
• Transmission is generally legally unbundled but distribution is often not.
• Retail competition for non HH consumers implemented but several countries are not prepared for HH competition. In most countries, consumer switching rates are minimal.
• Wholesale markets have low liquidity and are distrusted.
• Regulatory bodies are variable in powers and resources.
• There has been massive concentration amongst the companies and integration of generation and retail.
DG TREN: Security of Supply

• The 2003 Directive put the onus on Member States to ensure adequate capacity. ‘Member States shall ensure the monitoring of security of supply issues.’

• Now the Commission wants to take over: ‘Security of supply can no longer be considered to be only a national issue’

• ‘..the Commission will also establish a working group to monitor the investments needed in electricity generation and examine the investment framework to have sufficient capacities being created in Member States.’

• What does this mean?
DG TREN: Consumer issues

• The Commission finally admits that prices are too high
• It advocates ‘smart meters’. Has it thought this through?
• 'the Commission intends to develop an Energy Customers' Charter to (i) tackle fuel poverty, (ii) improve the information available to citizens to help them choose between suppliers (iii) reduce red tape when customers change supplier and (iv) protect customers from unfair selling practices'
DG TREN: Other positions

- Markets solve everything: security of supply, investment, diversity, environmental issues, consumer protection
- The major barrier to markets is inadequate unbundling of networks (‘foreclosure of markets’) and retention of regulated prices
- The provision that allows discos with fewer than 100,000 consumers not to unbundle might be withdrawn
- A single European regulator is desirable
DG Competition

General agreement with DG TREN. Areas of difference are:

• In a preliminary report, it identified integration of generation and retail as a problem, but it has retreated from this
• ‘Energy release’ programmes are advocated as a way to ‘kick-start’ wholesale markets
• No mention of a single European regulatory body
• Need for ‘harmonisation of market design’
The Commission’s 2007 proposals

- Ensuring non-discriminatory access to networks through unbundling.
- Improve regulation of network access at national and EU level.
- Reducing the scope for unfair competition
- Co-ordination between transmission system operators
- Providing a clear framework for investment in generation plant/gas import and transmission infrastructure
- Issues relating to households and smaller commercial customers
Unbundling networks: arguments

- If competition is not possible, why unbundle?
- Has it been proven that legal unbundling is insufficient?
- Are ownership unbundling costs justifiable? Loss of scale economies, separation costs, higher cost of capital?
- Should transmission & distribution be examined separately?
- Is there a case for public ownership especially for transmission networks?
- Will unbundling the ISO function, not the assets be enough?
- If networks are ownership unbundled, will there be a massive wave of mergers and takeovers of ‘sub-critical’ size network companies?
- Who will own the networks if utilities can’t?
- Will ownership unbundling kill off local public ownership?
Unbundling retail and wholesale

• Wholesale markets will not be used if integration of wholesale & retail is allowed
• But if wholesale and retail are separate, all power plants are ‘merchant generators’ and we risk creating ‘California’
• DG Competition identified the risk of integration in its preliminary report but ignored it in the final report. Why?
• Are stand-alone retailers in a truly competitive market viable?
• Would unbundling retail from distribution lead to massive concentration in retail?
Issues

• Unbundling retail and generation: Integrated generator/retailers will defeat competition but are more likely to give security of supply

• Regulators: How to make them more representative and accountable?

• Retail competition: Can retail competition be taken away from large consumers?

• Smart meters: Too risky for small consumers?

• Spot markets: Can spot markets with low ambitions (marginal balancing) serve a useful purpose?
Next best solution or Frankenstein’s monster?

The ‘ideal’ model is not fully achievable

- Unbundling networks is achievable but largely pointless if competition is not introduced
- Effective regulation can be achieved
- Retail competition is achievable, but expensive and unfair on small consumers
- Liquid wholesale markets will be too risky to allow investment in new generation
- With integration of retail and generation, there might be security of supply but there will be no competition
Can efficient electricity markets be created?

Marketeers said special characteristics of electricity were unimportant. Markets can’t work because:
1. Inability to store power. Storage allows demand & price peaks to be smoothed using stocks
2. In an electricity system, supply and demand must match. Without control over producers, a system operator cannot ensure security of supply
3. Lack of substitutes. For most products substitutes can be used if supplies are short or prices high
4. Vital role in society. Modern society is dependent on reliable supplies of electricity for it to function
5. Electricity is a standard product. Switching supplier can’t produce ‘better’ electricity. Markets are price driven: in an efficient market, prices will be driven to short-run marginal cost, too low for new investment;
Competition is not a free lunch

• If electricity is a monopoly, investment risk to financiers is low: ~7% real cost of capital
• There is now serious investment risk and in Britain real cost of capital is more than 15%.
• NETA cost British consumers at least £770m spread over 5 years. Investment in NETA (BETTA) has continued
• Retail competition cost British consumers £900m over 7 years
• In UK, retail used to be 5% of bills, now it is said to be about 30%