

competition in the UK and europe

INTRODUCTION

- 2.1 The government's objective is to promote fair and competitive markets in the UK and the EU. Domestically the new Utilities Act 2000 has introduced a number of reforms to the legal and regulatory framework including the separation of supply and distribution, and underpinning for the new electricity trading arrangements. In Europe liberalisation has continued to make progress with all member states adopting the provisions of the Electricity Directive, whilst the Gas Directive was to be implemented by August 2000. Work is continuing to ensure that the energy market is opened fully with attention being focused on measures to promote cross border trading and the preparation of new liberalising Directives.

COMPETITION IN THE UK

- 2.2 The introduction of supply competition in the UK's electricity and gas markets over the past two years has benefited consumers through lower prices and by broadening the choice of available services, with many suppliers now offering both fuels. The Utilities Act, which brings the framework for electricity into line with that for gas, now requires distribution and supply to be separated. This will stimulate competition at the domestic level and help to ensure that the low prices achieved over the past years will be maintained. In addition, the planned introduction of the new electricity trading arrangements (NETA) has prompted considerable restructuring in the electricity sector. In particular, many former REC supply businesses have been bought by generating companies or other suppliers, and a number of distributors have formed partnerships through mergers or joint ventures to reduce costs. These developments are discussed further in Chapter 7.

New Electricity Trading Arrangements

- 2.3 The Electricity Pool is shortly to be replaced by NETA. The Pool has long been criticised for lacking transparency; for being more of a price setting mechanism than a genuine market; and for distorting the market to the disadvantage of flexible plant, including coal. In contrast, NETA is similar in structure to other commodity markets. It is designed to increase competition both by opening up the market to the supply side and by removing distortions from the market through greater market transparency and liquidity.

The key features of NETA will be:

- a forwards market where generators will be able to contract bilaterally with suppliers and large customers for the physical delivery of electricity;
 - screen-based short-term power exchanges for near real time trading (i.e. until 3½ hours before real time);
 - a balancing mechanism operating 3½ hours ahead of real time up to real time, managed by the National Grid Company (NGC);
 - associated derivatives markets, which are expected to develop to enable market participants to manage commercial risks;
 - a settlement process to deal with the financial settlement of balancing mechanism trades.
- 2.4 Since the original proposals for revised trading arrangements were published by OFFER in July 1998, an exhaustive consultation process has been undertaken. The overall blueprint for NETA was set out in October 1999 in the DTI/Ofgem NETA Conclusions Document, and more recently the governance arrangements for NETA, enshrined in the Balancing and Settlement Code (BSC), were the subject of an extensive review by industry groups.

- 2.5 In early August 2000, the Secretary of State for Trade and Industry used the power contained in section 15A of the Electricity Act (as amended by section 68 of the Utilities Act 2000) to insert into electricity licences the conditions necessary to implement NETA. Among other things, these required licensees to sign up to the BSC and the NETA Implementation Scheme. This took place on 14 August 2000.
- 2.6 In the immediate run up to the implementation of NETA attention has primarily focused on the testing and trialling of central and participant IT systems. Logica and ESIS are contracted to supply the central IT systems and services necessary for the new arrangements and a number of participants have been involved in Market Integration Testing of the systems. NETA will “go-live” as soon as the testing and trialling programme has been successfully completed.

COMPETITION IN EUROPE

- 2.7 The European Commission estimates that 65 per cent of the consumer market for electricity in the EU is now open, and notes other encouraging developments such as an increase in cross-border trading and lower electricity prices. All Member States have now adopted legislation implementing the provisions of the Electricity Directive, although France and Belgium have yet to adopt the necessary secondary legislation. Progress on gas liberalisation is slower because Member States had until August 2000 to implement the Gas Directive. Even here the Commission estimates that around 78 per cent of the consumer market for gas is now open for competition. The market opening percentages in both cases far exceed the minimum requirements laid down in the Directives.

Cross Border Trade Issues

- 2.8 The fact that a high percentage of customers are free to choose their supplier does not necessarily mean that there is real cross-border competition. The Directives merely set the framework for opening markets and there is a considerable amount of detailed work underway to create the conditions necessary for competition to develop. This is primarily being carried out by the Electricity and Gas Regulatory Forums held every six months in Florence and Madrid respectively. These meetings are attended by national regulators, representatives of the electricity or gas industries, traders, consumers, Member States and the European Commission.
- 2.9 The main focus of the work on electricity has been to devise a mechanism for cross-border pricing which should have taken effect from 1 October 2000 for a period of one year (there is some slippage in the timetable). The aim was to enable electricity to be transmitted anywhere in mainland EU in return for the payment of one fee. The UK will not be part of these provisional arrangements. A more cost-reflective permanent mechanism, giving locational signals, is to be developed to take effect from 1 October 2001. The UK hopes to be able to sign up to the permanent arrangements. Work is also underway on devising mechanisms for congestion management. Similar work has just started on gas.

Energy Liberalisation Indicators

- 2.10 Towards the end of 1999, the UK and Dutch Governments jointly commissioned work on competition indicators to monitor the development of competition in EU energy markets. A preliminary report “Energy Liberalisation Indicators in Europe” was presented

to the Energy Council in May 2000¹. A full report is available. The basis of the work is to use energy liberalisation indicators to provide a simple analysis of the overall trends in each member state. The indicators are designed to follow progress in implementing the EU liberalisation directives, to track the fundamental development of market competition and regulation, and to allow the performance of different countries to be compared. The Commission intends to follow up this study with its own project. Once suitable indicators have been developed, they should show where the barriers to competition remain so that action can be taken to remove them.

Lisbon Special European Council

- 2.11 At the Lisbon Special European Council in March 2000, Heads of Government agreed that electricity and gas liberalisation should be accelerated with the ultimate objective being full market opening. The Commission was asked to come forward with proposals to be presented to the Special European Council in Stockholm in March 2001.

New Directives for more effective market opening

- 2.12 The Commission is planning to propose two new Directives on electricity and gas which will include, as a minimum, provisions on a final date for full liberalisation of both markets, greater unbundling of competitive and monopoly activities in vertically integrated companies and more transparent terms of access to grids and pipelines. These draft Directives are expected in the near future. Provided that agreement can be reached quickly, this should represent a considerable step forward in the drive to make a reality of the single market in electricity and gas.

Social and environmental policies in a competitive market

- 2.13 During 2000 the Commission has been looking at the impact of electricity and gas liberalisation on employment and how public service obligations are met in each Member State. The Commission is expected to report on these two exercises in a Communication to be released shortly. To help stimulate an analysis of some of these issues the UK circulated a short report on "The Social Effects of Energy Liberalisation - The UK Experience" at the May 2000 Energy Council. The UK is also proposing to present a further report on delivering social and environmental policies in a competitive market at the next Energy Council in December 2000.

Internal security of supply

- 2.14 As part of its work programme for 2000 the European Commission has embarked on a wide-ranging review of EU sources of energy supply in the context of enlargement and climate change. This is expected to consider issues related to each particular energy source: for example, possible over-dependence on gas, political insecurities in supplying countries, decline of the coal industry in individual member states, uncertainties over oil prices and the part played by nuclear generation. The results of this review are likely to be presented in the form of a green paper to the December Energy Council but detailed consideration is unlikely until the first half of 2001.

¹ Available from Department of Trade and Industry