



End-user energy price regulation

An EREG Position Paper

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Executive Summary

Building competitive electricity and gas markets is in the interest of customers. Since 1 July 2007, electricity and gas markets in Member States in Europe are fully opened for all customers, including households. Even after the 1st July deadline, some Member States seek to regulate end-user energy prices (so called “regulated tariffs”), arguing that it is a tool to protect vulnerable customers. **However, protecting “vulnerable customers” should not be confused with regulated tariffs for all (or certain categories) of customers.** It is ERGEG’s view that **fully open markets with well functioning competition cannot in the long term coexist with regulated end-user energy prices.**

- End-user price regulation in electricity and gas markets **distorts the functioning of the market** and **jeopardises both security of supply and the efforts to fight climate change.** Therefore **end-user price regulation should be abolished**, or where appropriate, brought into line with market conditions.
- Protecting “vulnerable customers” remains necessary in competitive markets. The tools used for the protection of vulnerable customers must work in line with and support the pre-requisites of open, competitive markets.
- Transition periods towards well functioning competition (for the co-existence of regulated and market prices) may be necessary to protect customers from potential abuses of dominant positions. **ERGEG calls on all countries which are in a transition period to publish (by 1 July 2008) an individual road map towards competitive markets to remove regulated prices.** This road map should contain specified and attainable steps to establish the necessary conditions for a well functioning market with no need for end-user price regulation. The steps taken by the Member States during the transition period should be properly monitored both at the national and EU levels.
- It is recognised that in some countries, **although in theory the market is open, in practice there may still be only one supplier and a consequent lack of choice for consumers.** Even then, regulated end-user energy prices should only continue for as short a duration as possible, so as to enable effective competition to develop in the now liberalised energy market. **In Member States where there is only one supplier ERGEG urges the Member State governments and regulators to act rapidly so as to create an environment to attract the new entry of suppliers.**

1 Background

Following the 13 Member States who had already liberalised their markets, 14 European Member States totally opened their energy markets to all customers (including households) on 1 July 2007. Even after the 1st July deadline, some Member States seek to regulate end-user energy prices (so called “regulated tariffs” or “end-user price regulation”). The European Commission has highlighted in its Sector Inquiry¹ (10 January 2007) its concerns with regulated prices, pointing out that if regulated tariffs are kept low, new entrants are excluded from the market and market players will not invest in new capacity which is detrimental to security of supply. The Commission pointed out that it would be important to assess the impact of remaining regulated tariffs on the development of competition. On 15th June 2007, ERGEG published a Status Review on End-User Price Regulation (E07-CPR-08-04)² which assesses the impact of maintaining end user regulated prices (alongside market prices) would have on competition.

ERGEG found that (as of June 2007) 17 of the EU-27 Member States (concerning electricity) and 9 EU Member States (concerning gas) with partially or totally open markets, had end-user energy price regulation in at least one open market segment (i.e. not only to households and small business but also to those large and industrial users who since 1 July 2004 are eligible to procure energy on the competitive market). In most of these Member States the share of eligible customers on regulated prices was more than 80 percent in each open market segment. **End-user price regulation is one factor which prevents equal access of suppliers to all customers. This has a negative effect on the functioning of the competitive retail markets.**

¹ <http://ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html>.

²

http://www.ergereg.org/portal/page/portal/ERGEG_HOME/ERGEG_DOCS/ERGEG_DOCUMENTS_NEW/CUSTOMER_FOCUS_GROUP/E07-CPR-08-04_StatusE-UPrices_final.pdf, 15 June 2007.

In many EU Member States where there are incumbent electricity and gas companies, the state retains tight control over the electricity and gas prices charged to end-users, mainly in order to protect customers. The price setting is declared as an instrument to fulfil the public service obligations. In many countries, the co-existence of regulated and market prices is clearly not a transitory measure. It has been in place for many years and there are no clear indications that Member States with regulated prices intend to progress towards market prices.

The electricity and gas market Directives³ strike a balance between the objectives of competition, security, environment and protection of final customers. In April 2006 the European Commission launched a number of infringements against Member States relating to regulated end-user energy prices given that the regulated prices were found not to comply with the provisions of the Directives.

³ Directives 2003/54/EC and 2003/55/EC.

2 Building competitive electricity and gas markets is in the general interest of customers

Free movement of goods, freedom to provide services and freedom of establishment are only possible in a fully open market; a market in which all consumers can freely choose their suppliers and all suppliers can freely, without restrictions, deliver to their customers (Directives 2003/54/EC and 2003/55/EC preamble point 4). Building sustainable competitive markets is crucial to improve customers' position and protect them from potential abuses of dominant positions of incumbent suppliers.

A fully open market with well functioning competition cannot in the long term coexist with regulated end-user energy prices. Price regulation hinders the goal of customer protection and participation through competition by:

2.1 Distorting the functioning of the market

- If regulated end-user prices are not in line with wholesale market conditions, suppliers without significant low cost generation capacities or equivalent long term contract will not be able to make competitive offers which cover their supply costs. Consequently, with a limited number of suppliers, there will be no development of wholesale markets. Liquidity will remain at a low level. As a result, neither the wholesale nor retail markets will be competitive.
- Regulated prices limit the possibilities and incentives of customers to switch supplier and thereby limit competition in the market. If customers benefit from artificially low regulated prices there will be no incentive to switch supplier.
- The lack of competition on retail markets hampers the customers' position. It is through exercising their right to choose that customers stimulate retail competition between suppliers. Competitive pricing on the retail side is an important driver for market integration.

2.2 Jeopardizing both security of supply and efforts to fight climate change

- Regulated end user prices that do not result from the competitive process and reflect costs will not give reliable price signals to the market and to the final customer.
- Artificially low end-user regulated prices will potentially increase demand by end-users and will ultimately be an obstacle to the EU objectives of climate change and security of supply.

3 Protecting vulnerable customers is necessary in a competitive market

3.1 How are “vulnerable customers” protected in open energy markets?

Under EU law, “vulnerable customers” are safeguarded under the liberalised market framework. This is because “vulnerable customers” are considered more susceptible to suffer in open markets and to become victims of misleading commercial practices. Vulnerable customers may be protected through specially established social schemes like social aids ensuring their continuous access to electricity and gas.

Even after a transition period for the removal of regulated end-user energy prices (as described in Section 4 below), there may be justifications for **protecting certain “vulnerable customers”, using alternatives other than regulated end-user prices**. The tools used for the protection of these customers must work in line with and support the prerequisites of open, competitive markets. ERGEG believes that, in general, issues of consumer protection and the needs of vulnerable customers are social issues rather than energy policy issues. It is the Member State governments’ responsibility to define these tools. It is not a regulatory issue.

3.2 Who are “vulnerable customers”?

European law requires Member States to identify vulnerable customers. Different approaches have been adopted across the EU in defining vulnerable customers, for example:

- Low income households (Belgium, France) or otherwise unable to pay (Belgium, UK)
- Different climate zones within a country
- Urban versus rural population.

ERGEG does not comment on these varying definitions of vulnerable customers.

3.3 What kind of protection is appropriate for vulnerable customers in competitive markets?

It is for each EU Member State to decide on the scope of customer protection and therein to define “vulnerable customers”. **However protecting “vulnerable customers’ should not be confused with maintaining regulated energy prices for all (or certain categories of) customers. ERGEG considers regulated energy tariffs to be distortionary and should be abolished.**

It is ERGEG’ view that any policy aimed at protecting vulnerable customers be brought into line with market conditions. It is of utmost importance that any wish and attempt to protect vulnerable customers does not hinder the efficient functioning of a competitive market. The following examples describe situations in which the formation of the market prices is not, or is hardly, affected:

- Tax discrimination such as different energy taxes or VAT based on for example income, geographical conditions, industry situation, competitive situation etc. compatible with EU-legislation (state aid etc.)
- Subsidies either proportional or lump sum compatible with EU-legislation (state aid etc.)
- Social benefits.

The above suggestions do not affect the market in that they do not put any cap on prices; all customers are exposed to price changes, although at different levels.

4 Transition periods towards well functioning competition can be necessary to protect customers from abuse of dominant positions

Within the European Union the deregulation process leading towards competitive markets varies in timing and in speed. The level of competition differs between Member States. According to the European Commission, “Although price controls prevent suitable price signals being given to customers about future costs, targeted price regulation may be needed to protect customers in certain specific circumstances, for instance in the transition period towards well functioning competition. Price regulation must, however, be balanced so as not to obstruct market opening, create discrimination among EU energy suppliers, reinforce imbalances in competition or restrict resale”⁴.

According to ERGEG’s Status Review on End-User Price Regulation, most Member States with open markets still (as of June 2007) offered customers regulated prices. This situation continues after 1st July 2007. It is ERGEG’s view that **fully open markets with well functioning competition cannot in the long term coexist with regulated end-user energy prices.**

ERGEG advocates:

- **Member States who continue (after 1 July 2007) to offer regulated end-user prices should urgently progress towards a competitive market. The “transition period” with regulated prices should be a predetermined fixed period and should be as short as possible.**
- It is essential that those countries, who during a transition period continue to have regulated end-user tariffs, draw up an **individual road map towards a competitive market without end-user price regulation. The road map should be published by 1st July 2008 at the latest.**

⁴ Communication from the Commission to the Council and the European Parliament – prospects for the internal gas and electricity market, SEC (2007) 12, page 20.

This road map should contain specified and attainable steps (against clearly defined criteria) to establish the necessary conditions for a well functioning market without the need for continued end-user price regulation. Such conditions should include the empowerment of the regulator to closely monitor developments in energy markets. The responsibilities and the mandates for each authority concerned should be defined by each Member State.

Part of the road map should include a rigorous application of competition law and the education of customers to prepare them for the competitive market. Finally, a step by step process towards a transparent price model that reflects the market prices level should be defined.

It is recognised that in some countries, although in theory the market is open, in practice there may still be only one supplier and a consequent lack of choice for consumers. Even then, regulated end-user energy prices should only continue for as short a duration as possible during a transition period, so as to enable effective competition to develop in the now liberalised energy market. **In Member States where there is only one supplier ERGEG urges the Member State governments and regulators to act rapidly so as to create an environment to attract the new entry of suppliers.**

It is essential that the steps taken by the Member States during the transition period are properly monitored both at the national and EU levels.

5 How consumers themselves can stimulate competition

ERGEG working closely with the European Commission continues to work toward creating real competitive energy markets in Europe. The ERGEG Regional Initiatives (http://www.ceer-eu.org/portal/page/portal/ERGEG_HOME/ERGEG_RI), set up by ERGEG in 2006, provide the framework to make concrete improvements in the development of a single energy market in Europe by first integrating national markets in electricity and gas into regional markets. This is achieved through the identification and removal of impediments to electricity and gas flowing between one country and its neighbours in a region.

ERGEG considers that consumers too have a key role in stimulating competition between suppliers by “shopping around” for the best value and exercising their right to choose. But first, consumers must know what their rights are (and suppliers must meet their obligations). The European Commission, strongly supported by ERGEG, has launched a major customer awareness campaign to explain to energy customers their rights and to better understand how to change supplier.

As well as new website www.agathepower.eu contains information for each EU country (in multiple languages) not just on the market but also on consumer’s rights, thus raising awareness among customers of how they can help themselves.