UK Opens Residential Market To Competition

*By Fereidoon P. Sioshansi**

After months of speculation and delays, competition has begun to be phased in to the remaining 24 million small customers in England and Wales. The process, which started in April 1990 with the largest customers, was extended to medium sized customers in 1994, and is now being offered to the remaining small customers (see accompanying table). By end of June 1999, if all goes well, all customers in England & Wales (E&W) will have the option to choose their supplier.

Some 750,000 customers currently served by Eastern Electricity, Manweb, Scottish Power, and Yorkshire Electricity were initially opened to competition. Early reports indicate that some 10,000 customers in these areas have thus far registered to switch suppliers. The customers are being lured away with all sorts of promotional and marketing gimmicks, and promised savings. According to Professor Stephen Littlechild, the industry regulator in charge of OFFER (the Office of Electricity Regulation), average price savings of 8 percent are being offered to motivate residential customers to switch suppliers. Using 8 percent as an average figure, it amounts to approximately US$30 off a typical customer's annual electricity bill of US$390. Small commercial customers are getting discounts of approximately 12 percent, according to OFFER's preliminary estimates. In some cases, the savings are far greater (see second accompanying table).

Nationwide, "well over 1 million domestic customers and small businesses" are reported to have signed up to change their suppliers. This, according to OFFER, represents roughly 5 percent of the market (by number of customers). By Christmas, some 7 million customers will have the option to shop around. Speaking to reporters, Professor Littlechild, who has been severely criticized for anything and everything that went wrong with privatization over the past 8 years, was elated at the early results. He indicated that the prices for domestic customers had already dropped due to competitive pressures. He predicted that the number of switchovers will continue to rise as new areas of the country are opened to competition and as "customers become more accustomed to exercising choice."

In Stages ... Phased Introduction of Competition in England and Wales

Sites Allowed Competitive Supply	Date	Number of Customers	Consumption (TWh)
Above 1MW	1 April 1990	5,000	75 TWh
Above 100 kW	1 April 1994	50,000	115 TWh
All	1 April 1998*	23,000,000	245 TWh

*The original opening was postponed to September 1998. Moreover, competition will be spread over a year with the full market open by the end of June 1999.

Moreover, Professor Littlechild expects to see more – and presumably better – choices as a number of newcomers enter the business of electricity retailing, with estimated annual revenues of US$15 billion. These new entrants include supermarket chains, petrol stations, financial service companies, and who knows what else. Professor Littlechild stated the obvious when he said, "The mere fact that customers can exercise choice means that companies will have to become more competitive and offer lower prices and better services if they want to retain their market." It is a fitting final act for the chief electricity regulator who will be leaving his post shortly. There are indications that the two main regulatory agencies in charge of electricity (OFFER) and gas (OFGAS) will be combined into one.

Savings Offered to Customers to Switch Suppliers

Annual discounts offered to customers to switch suppliers, in US $.*

Area Existing Supplier	Chester Manweb	Hull Yorkshire	Motherwell Scottish Power	Norwich Eastern
Typical Annual Bill	408	363	401	368
Savings by switching to:				
British Gas Trading	33	18	32	26
Eastern Energy	17	12	8	—
ScottishPower/Manweb	—	11	—	26
Yorkshire Electricity	21	—	(8)[1]	26

Source: Office of Electricity Regulations (OFFER).

*An approximate conversion rate of 1.50 has been assumed.
[1] increased cost.

These early results are very different than those experienced in the newly opened markets in California, Massachusetts and Rhode Island, where relatively few of the small customers have switched thus far. There are several reasons for the differences:

- No automatic savings – Aside from an average 6 percent price reduction imposed by OFFER in April, there are no legislatively mandated rate reductions available to customers in E&W. Customers must switch (or renegotiate with their incumbent supplier) to get a price reduction. By contrast, in California, for example, most small customers are better off to stay with their incumbent utility distribution company or UDC. They get an automatic and painless 10 percent rate reduction by doing absolutely nothing. This provision has made it nearly impossible for the competing electricity supply providers or ESPs to lure small customers away, profitably. No wonder Enron made a big fuss when it announced that it was pulling out of California's residential market.
- Customers already used to competition – since privatization and introduction of competition in the electricity sector started in 1990 and has been gradually phased in, more customers may be accustomed to the idea of shopping around for competitive suppliers than in the newly opened U.S. markets. One recent U.S. public opinion survey conducted by RKS Research & Consulting, for example, found that outside California, more than half of the US population "is unaware of electric industry restructuring." Oblivious may be a better substitute for unaware.
- Gas vs. electric competition – The recent opening of the gas

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market in the UK and the onslaught of competition, marketing and advertising in that market has probably conditioned customers in E&W for the electricity market. As further explained below (see reference to Centrica), the electricity and gas companies have been going after each others' customers energetically. The competition in the natural gas market in the United States, in contrast, has been tame and uneventful in most areas.

- Satisfied customers don't switch - Perhaps - this is pure speculation - some of the PESs in E&W have not been up to snuff in providing customers with good service. The RKS research mentioned above, for example, concludes that in California, (small) customers have not switched in large numbers - despite their awareness of their ability to do so - (perhaps) because they are, by-and-large, satisfied with the incumbent UDC's service quality.

As suggested by the table, some of the most generous price discounts are being offered by Centrica, better known as British Gas, the former monopoly. Centrica has been incensed when it lost approximately 15 percent of its domestic gas market since the natural gas industry was opened to competition. Many of it customers switched to the public electricity suppliers (PESs) who have entered the gas supply business. Now, Centrica is taking revenge by going after their electricity customers with vengeance. According to early reports, it has thus far acquired over 440,000 electricity customers from PESs.

Competition in the supply business is expected to be fierce, as previously reported. There are dire predictions that the number of PESs will shrink to half as many as there are today over the next few years. This is not a business for the marginal players. Only the best and the biggest will survive.

Opportunities for Private Power Producers in Italy

In his June 9 PowerGen speech, Enzo Gatta, director of the electric energy division of Edison Spa, focused on the opportunities for independent operators in the changing Italian electricity market; he also presented Edison's proposal for adopting the EU directive.

The liberalization of the Italian electricity sector, xxxxxxxxx presents a unique chance for the country, one perhaps never to be repeated. It, therefore, behooves the government, empowered by its parliamentary delegation, to create the most favorable conditions for the development of a truly free and expanded electricity market where operators will be compelled to find new ways to maximize efficiency in production and to use the most advanced technologies.

In such a context, Edison reckons it is easier to achieve the commitments Italy made during the Kyoto conference (the reduction of greenhouse gases by 6.5 percent by 2010 compared to 1990) thanks to the use of technologies such as the gas-fired combined cycle, which permits an increase in energy efficiency and a significant reduction in the emissions of polluting substances into the atmosphere.

Edison believes that recourse to this technology is necessary for Italy, not only to satisfy demand (new plants for an additional capacity of approximately 18,000 MW, necessary to meet the growth in demand from the 273 TWh of 1997 to around 360 TWh in 2010), but also for the revamping and the repowering of less efficient plants, for an estimated capacity of around 12,000 additional/substitutive MW from now to 2010.

That means that a real opening of the market is essential. Taking into consideration this fact, space assigned to the eligible consumers should be, in Edison's view, as broad as possible. The opening up of 25.37 percent of the market may be considered adequate at the outset to introduce competition into the sector. The liberalization of the electricity market, according to the European rules, foresees gradual and progressive but real and concretely verifiable liberalization. For this reason, Edison considers it necessary that the market share to be opened be calculated on the basis of what is the effectively free market and, therefore, net of auto-consumption. As far as the market supplied by the distributors is concerned, there should be a single national rate with no maximum ceiling.

The threshold for eligibility, according to the provisions of the European directive, refers to the consumption size. This definition includes suitable consortiums, the industrial districts, and industrial groups (in accordance with the laws currently in force and in response to the orientation recently expressed by the Industry Ministry). Edison believes that the extension of the concept of "site" to aggregate consumption could contribute effectively to opening the share of liberalized market foreseen in the directive.

One of the main points for the successful functioning of the system, according to Edison, regards the operation of the transmission network and dispatching, which must be neutral and not discriminatory. In order for this to occur, it its necessary that the operation of the network be carried out by an autonomous and independent body. Just as important, in Edison's view, is that the conditions and rates for transmission and auxiliary services be strictly connected to the real costs of the service, and not liable to improper charges.

Edison also considers it necessary to liberalize not only imports and exports but also electricity swaps between those parties which are suitably qualified on the basis of criteria defined in the process of the enactment of the directives.

In conclusion, Gatta stressed that these are the minimum requisites to ensure that the transition to a competitive market comes about in a progressive manner, though with the fastest possible passage from the current regime to final reorganization. That will benefit not only the large industrial groups but also the small and medium size enterprises, which are the backbone of Italy's industrial system.

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