



Promoting choice and value  
for all gas and electricity customers

# **ENERGY SECTOR INQUIRY "THE GLOVE AND THE FIST"**

**Joint Cambridge/MIT Energy Conference**

Alistair Buchanan  
CEO Ofgem  
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# CONTENTS

## 1. "THE ROAD TO CHANGE"

- UK: A long and lonely route.
- Europe sleeps.
- UK: Jolted to further action.
- Europe stirs:
  - Brussels awakes.
  - Fear wakes up many.
  - Test case: Germany.

## 2. GOING DOWN THE UNBUNDLED ROUTE

- D. Newbery presentation.

## 3. "BROUGHT TO THE CROSS ROADS"

- The Fist – DG Comp moves.
- The Glove – DG Tren sets roadmap.

## UK: A LONG AND LONELY ROUTE

**MARKET CONCENTRATION:** British Gas and National Power/Powergen broken up and gas contracts reset in 1997.

**UNBUNDLING:** NG split from generators in 1989 ... in 2005 the local gas network companies split up in de-merger.

**INFORMATION:** Electricity information available to all **but** short comings in off-shore gas information.

**REGULATION:** Independence supported by successive Governments since 1986

**TO SUCCEED MARKETS AND REGULATION EVOLVED**

## EUROPE SLEEPS

- **Market concentration** – national incumbents remain dominant.
- **Vertical integration** – insufficient “unbundling” (ie. separation) of competitive and monopoly businesses.
- **Lack of transparency** – creates market uncertainty and deters investment.
- **Network issues** – lack of access to and capacity on the pipes and wires.
- **Varied and weak national regulators** – including increased political interference.

## HOW COULD SLEEP BE SO EASY

1. Self induced.
  - \* Structural
  - \* Behavioural
2. Politically induced
  - \* Control
  - \* Views on capital markets
  - \* Reaction against Anglo-Saxon modus
3. Encouraged by 3<sup>rd</sup> Parties.
  - Norwegians – gas information
  - Algerians – destination clauses
  - Russians – support of leviathan model

**LETHARGY CAN BE AND WAS THE ANSWER**

## UK: JOLTED TO FURTHER ACTION

### Why?

1. Security of supply gas shock.
2. Prices sharply up (See D.Newbery p22).
3. Island status on gas and electricity gone.
4. Evolution of market structures.

### What?

1. Ofgem does two upstream gas probes/reviews.
2. Ofgem approves MOD 006 – more upstream gas information required.
3. UIOLI– ‘Use it or lose it’ – enforced by Ofgem at LNG facilities.
4. Market rules improved – ISO gets greater knowledge. (Distillate stocks, mothballed plant etc).
5. Ofgem focuses on European regulatory institutions and sends staff to Brussels.

## OFGEM‘DOORSTEPS’ COMMISSION FOR ACTION

## EUROPE: STIRS – BRUSSELS AWAKES

- Why?**
1. Under renewed pressure due to pricing and security of supply – concerted UK lobby.
  2. 'Blackouts' places a focus on networks – Sweden, Italy, UK in 2003 and 2007 in Germany.
  3. Unease over E.ON/Ruhrgas ruling ... with more 'difficult' M&A cases due.
  4. Unease over windfall gain from National Allocation of environmental certificates.
  5. Kroes and Pielbigs support change.
  6. Global context – pressures on security of supply and new dynamic of East European states exaggerates this.

**DG COMP/DG TREN CRITICAL IN CREATING 'ATMOSPHERE FOR CHANGE'**

## EUROPE: FEAR WAKES UP MANY

- **Information vastly improves.**
  - French provide gas storage and day ahead gas information in 2007.
  - Fluxys/Zeebrugge information improved.
  - Germany – big strides made... see page 10
- **Unbundling supported.**
  - Dutch senate support in summer 07.
  - Belgium releases new draft law on unbundling in 2007.
- **Regulators given greater powers.**
  - German regulator hits networks in 2006/2007.
  - Even French regulator given more powers – 2 month objection period on prices in 2006.
- **Behavioural changes.**
  - ENI launches aggressive electricity marketing campaign in 2007.
  - Algeria stops destinations clauses in Europe contracts.
  - Holland insists on UIOLI at Rotterdam and Eemshaven LNG

**DESPERATE TO PROVE MARKET CREDENTIALS?**

## TEST CASE: GERMANY

- **5 Years ago**
  - **Gas:** A new entrant had to negotiate access individually, had little view of local tariffs, had significant problems over storage and quality ... a nightmare.
  - **Electricity:** The killing of 'yellow stom' in 2001 signalled the big players intent ... retail competition stopped well below 5%.
- **Today**
  - **Gas**
    - New entry – exits rules:- movement of gas is possible.
    - Destination clauses struck out of Ruhrgas/Gazprom contracts.
    - FCO banned L/T contracts above limits.
    - New gas trading hubs and platforms.
    - New entrants.
  - **Electricity**
    - New incentive based regulation on 'T' networks introduced.
    - Retail competition starts – E.ON's ("E' as in Easy" Campaign)
    - New entrants

**GERMANY'S STARTING POINT VERY DIFFERENT FROM UK**

## **GOING DOWN UNBUNDLED ROUTE**

- Joined up presentations!!

**SEE D. NEWBERY'S PRESENTATION**

## **KROES AND PIELBAGS SET THE NEW PARADIGM – JANUARY 2007**

- There is concentration in wholesale markets.
- Barriers to entry in retail exits.
- A lack of cross border trading or competition.
- Inability to enjoy gas transit.
- Paucity of information

**PARAMETERS FOR CHANGE**

## KROES – WITH THE FIST

- **THE CHARGES**

1. Hoarding – GdF and RWE
2. Access to networks – ENI ... follows last years case against ENI.
3. Raising rivals costs – RWE.
4. Market sharing – E.ON, GdF.
5. Long term contracts – Distrigas already charged with 27.4 notice in April 2007.

- **FIRST BLOOD TO KROES**

1. Literally 'broke down doors' in May 2006 dawn raids.
2. Tariff fixed – charges against Spain and France brought in 2007.
3. Forced unbundling – E.ON/MOL ... and probably GdF/Suez.
4. Settlement with Distrigas
5. 19 September industry announcement on unbundling.

**KROES MUST LAND BLOWS**

## KROES – COMMENTS TO NOTE

**Jan 10<sup>th</sup>: 2007** “Companies will face legal action for damaging consumers and business through anti competitive behaviour... this report will make uncomfortable reading for many energy companies”.

**On Networks:** “The current level of unbundling of network and supply interest has negative repercussions on the market functioning. This constitutes a major obstacle to new entry and also threatens security of supply”

**3rd Directive:** “Ownership unbundling ... is the simplest and cleanest way to achieve effective unbundling”.

**Microsoft:** “It could be reasonable to draw the conclusion that behavioural remedies are ineffective and that a structural remedy is warranted”

**KROES IS SERIOUS**

## PIELBAGS – WITH THE GLOVE

### **THE ADVANCES: 19 SEPTEMBER**

1. Improved information – 3<sup>rd</sup> Directive.
2. Unbundling to be enforced.
3. Independent regulation – supported (in concept).
4. Common standards – agreed.

**GENERALLY GOOD NEWS**

## **DANGERS REMAIN**

1. Who holds the pen?
2. Will the jail keys get thrown to the prisoners?
3. Independence not institutionally protected.
4. Devil will be in detail – who controls devil?
5. Delay is the incumbents friend!

**A BIG CHANCE FOR SUCCESS ... BUT PLENTY OF RISKS**

The background of the slide is a composite image. On the left, there are rows of solar panels under a bright sun. On the right, a hand is shown holding a white document. At the bottom, a water tap is visible, with water spraying out. The overall theme is clean energy and consumer choice.

*ofgem*

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