



## **Seventh US-EU Energy Regulators Roundtable**

SESSION II – Market Monitoring, Oversight and Abuse

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# Overview

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1. **Some lessons from history**
2. **Are energy markets different?**
3. **Lessons from the past**
  - **Structure v conduct**
  - **Conduct v market rules**
4. **Is competition law (anti-trust) an effective tool for policing wholesale energy markets?**
5. **Liquidity**
6. **EU markets**
7. **Conclusions**

## Lessons from history

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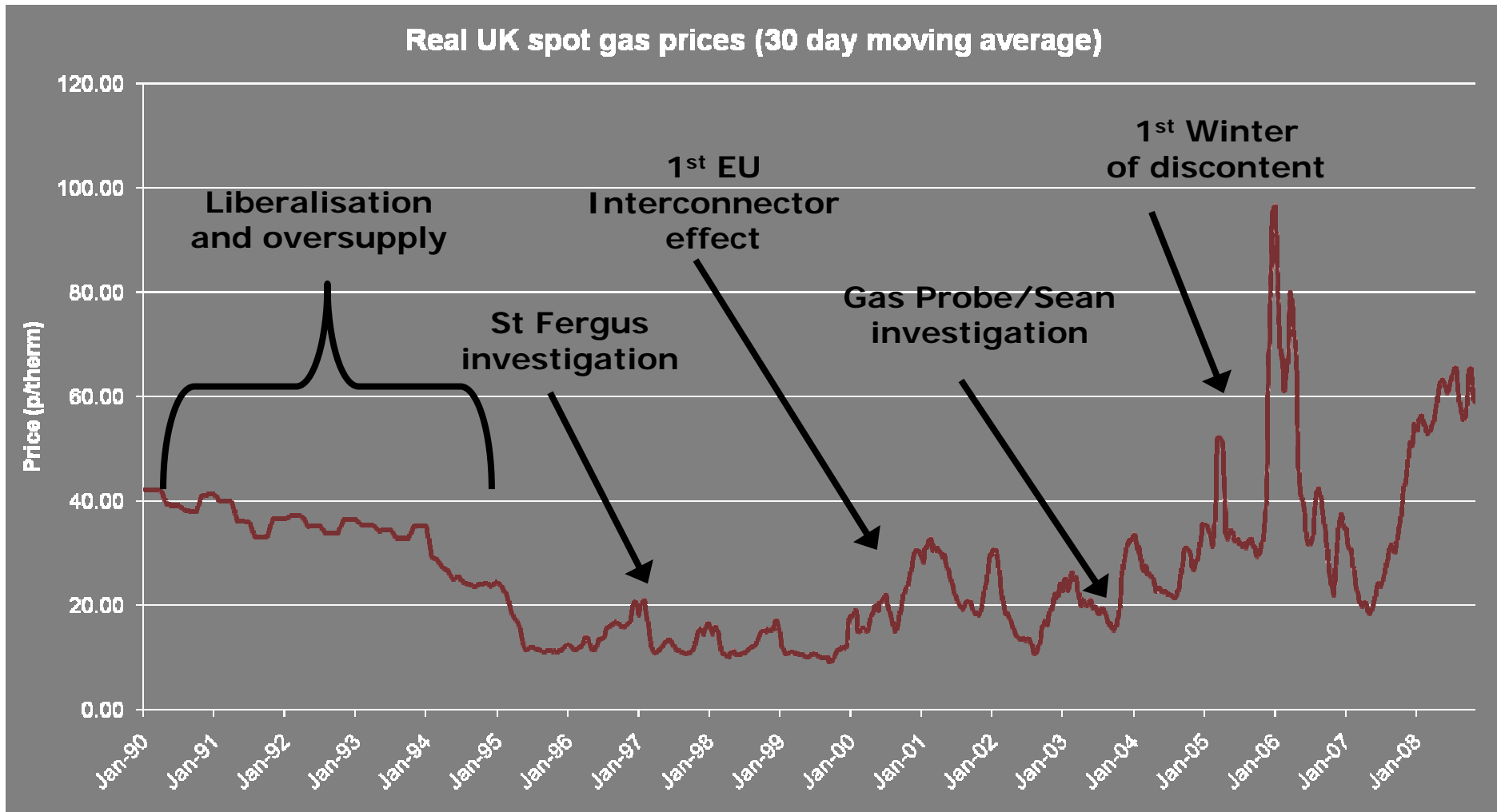
**Mixture of cases and concerns over the years and many pre-date new UK anti trust laws (Competition Act 1998)**

- **Wholesale price concerns**
  - Numerous pool price investigations
  - Gas probe
- **Capacity constraint costs concerns**
  - 1991 Pool Price investigation
  - St Fergus investigation
  - Scottish constraints (ongoing)

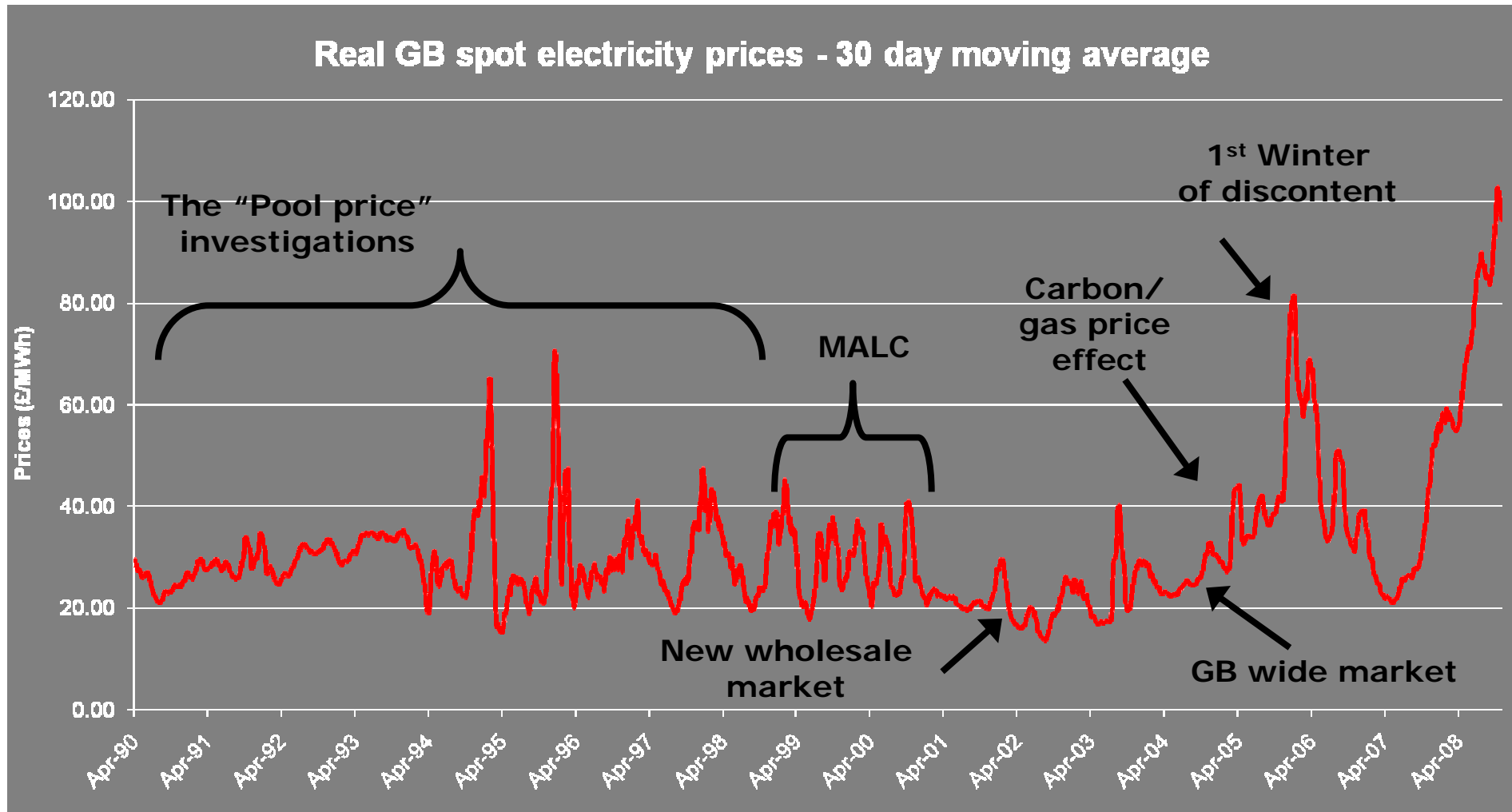
*Range of remedies/policy measures deployed: structural, conduct, market rules, role of system operator and incentives*

***2001 Ofgem proposals for additional powers – Market Abuse Licence Condition rejected***

# A brief history of UK time – gas



# A brief history of UK time - power



# Are wholesale energy markets different?

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## Special features of wholesale energy markets

- Highly inelastic demand close to real time
- Supply relatively inelastic in short term
- Need to keep network in balance second by second
- System Operator must clear the market in short run – not fully exposed to costs of actions



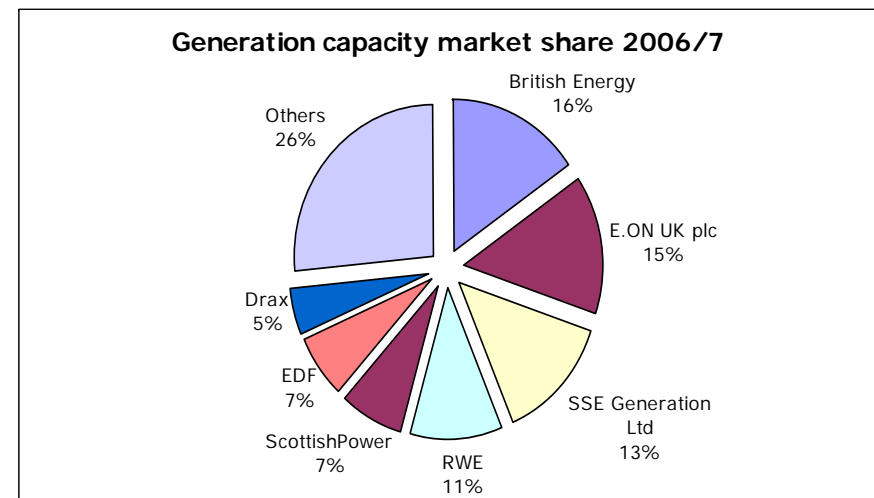
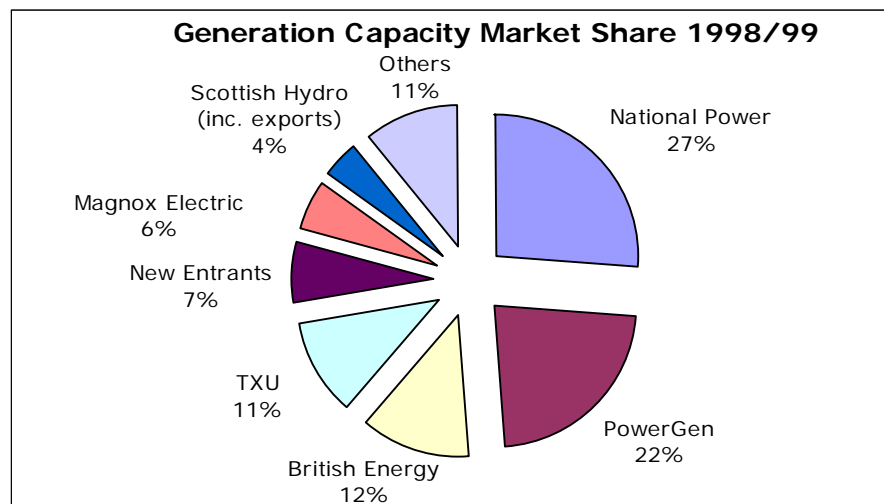
*Companies with relatively low market shares (<10%) by typical competition law metrics may have significant market power*

***Impact on competition and customers:***

***Competitors see immediate effect through imbalance prices  
I&C customers increasingly exposed directly to wholesale prices***

**Combination of features make energy markets more prone than other markets to abuse and significant and immediate impact on competitors and customers**

## Lessons from the past: Structure v conduct



## Change in market structure driven by combination of factors

- Forced divestment
- Creation of GB market
- New entry/corporate activity

**Right market structure necessary but not sufficient for competitive wholesale energy markets**

## Lessons from the past: conduct v market rules

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### Market rules and regulatory framework matter

- Pool arrangements made tacit collusion easier (litany remains persuasive)
- Significant reduction in number of investigations post change in market rules (New Electricity Trading Arrangements)
- Role of System Operator and incentives/regulatory obligations also important (and often overlooked)

### Governance of market rules governance is also very important

- Market rules need to change and evolve over time (technology e.g. smart metering and renewables)
- Need governance that allows all participants (inc. small players/customers) to propose change and prevent incumbents blocking change – regulator takes final decision
- Checks and balances – appeal of Ofgem decisions a positive step?



## Anti-trust law v energy specific law

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### Competition law still largely untested at GB or European level

- Some transmission constraint cases in Spain/EU Sector Inquiry cases

### Concerns stem from *principle...*

- *Lack of EU case law on excessive pricing?*
- *Establishing dominance with low market shares?*
- *Establishing narrow locational markets to deal with transmission constraints*

### And *process...*

- *Typical case under CA98 takes 18-48 months to complete if appealed – too slow given size and impact of customer/competitor harm?*

### ***BUT...***

*Competition law not yet tested – including use of interim orders  
Sectoral investigations can be lengthy and no appeal on merits (only process)*

*“The CC’s decision not to support the introduction of the MALC in 2001 seems well-justified by subsequent market developments in Great Britain. Equally, however, Ofgem’s view that such powers can be necessary in some circumstances also seems to be supported by subsequent developments overseas.”* **UK Competition Commission, January 2008**

# Liquidity

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- **In late 1990s expectation was that gas/electricity markets would develop in same way as capital and other commodities (oil, coal etc)**
  - *Deep, liquid, traded spot and forward markets in energy and capacity*
  - *Physical and non-physical players – better risk management, facilitate new entry in supply and generation*
  - *Easier market surveillance – transparent reference prices that can be reconciled to supply and demand*
- **Collapse of Enron, withdrawal of US trading houses and increased vertical integration lead to significant fall in liquidity**
- **Some signs of recovery but likely to be reversed by credit crunch (Investment banks were filling gap left by exit of US traders)**
- **Raises a range of issues for wholesale energy market surveillance**
  - *Are liquid wholesale markets necessary or sufficient for competition **and/or** effective surveillance by regulators and authorities?*
  - *Is vertical integration an efficient capital market response to nature/risks in energy production – should regulator's be concerned?*

**Jury still out but liquid wholesale markets *does not equal* competitive energy markets**

# EU Energy Markets

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## 1. New legislation – the 3<sup>rd</sup> package

- Institutional reform – power and scope of energy regulators and European regulator?
- Unbundling of transmission from supply/production?
- Transparency

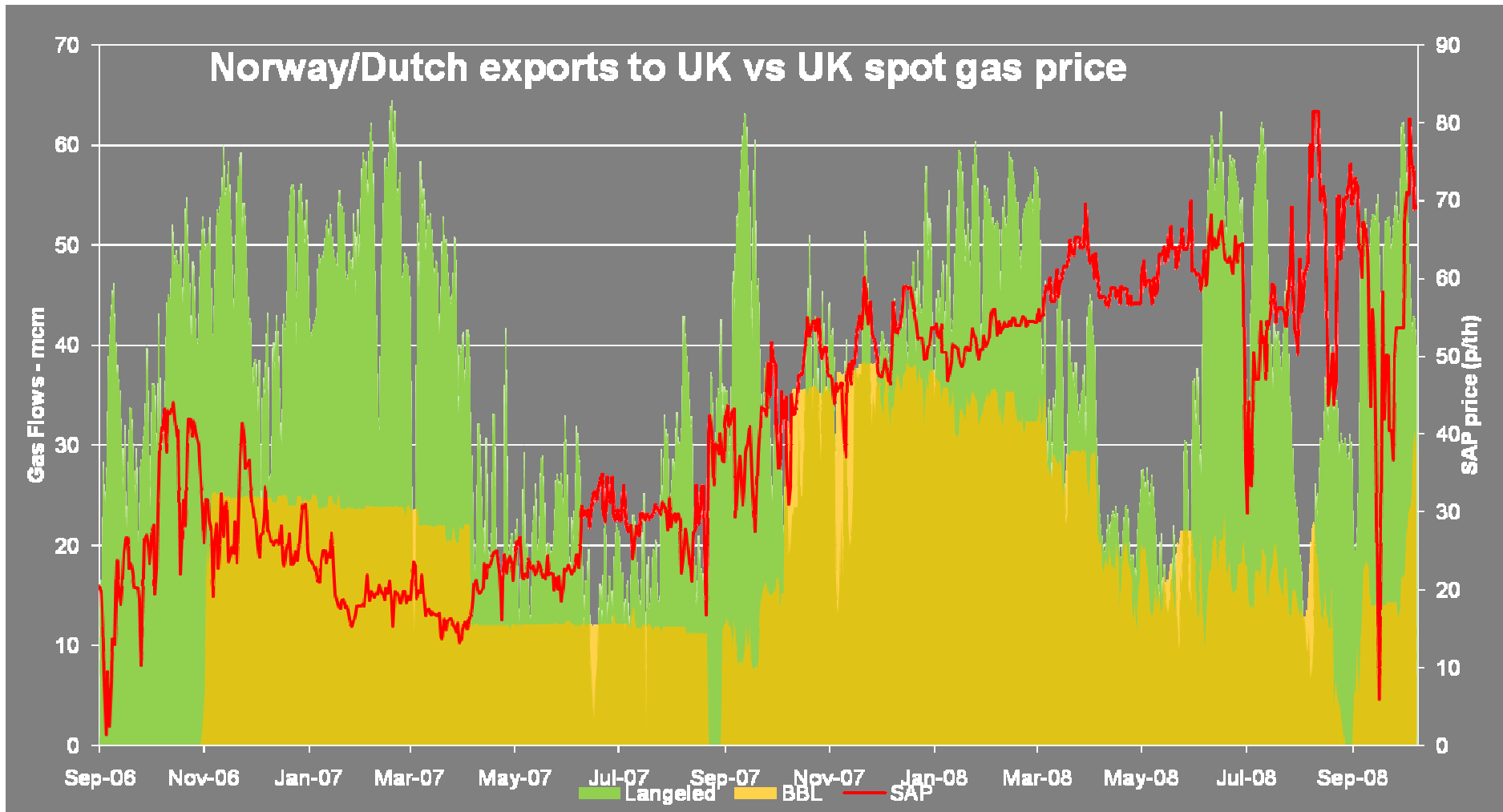
## 2. Anti-trust action

- Current DG Competition c13 cases covering Belgium, France, Germany, Italy
- Recent case with EON – sale of generation assets and transmission network

## 3. Regulatory action

- Regional initiatives – create regional markets as stepping stone to creation of European market
- Transparency initiatives

# Dysfunctional European gas markets?



## Conclusions and outlook

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To create effective, competitive wholesale energy markets requires action on

- Market structure
- Market rules, governance and role of system operators
- Effective market surveillance and regulation

Major challenges to create functioning EU market

- Commission currently has c13 open anti-trust cases
- Third package of legislation

Even if we get there – is competition law an effective tool given special features of wholesale energy markets?

*Technology to the rescue? Real time metering – more active customer participation  
Global gas markets through LNG: import competition from the US gas market?  
Will emergence of European power market reduce concerns about structure within  
Member States?*

***Huge task ahead for Commission and national regulators to create competitive European markets and to police them...***