

POSITION PAPER
CRITERIA FOR A WELL-FUNCTIONING RETAIL MARKET

1. Introduction

Both regulators and gas suppliers are committed to ensuring a well-functioning, competitive market for gas. Successful implementation of the internal energy market will provide customer choice and encourage innovation as suppliers compete to meet the needs of customers; it will at the same time contribute to security of supply, by helping incentivise necessary investment in securing and transporting supplies to help meet the requirements of Europe's gas markets.

Good functioning of the competitive energy market has both a wholesale and retail dimension. At the wholesale level, it requires interconnection and transit arrangements to meet the needs of infrastructure users, capacity allocation and congestion management processes to ensure the best possible use of available capacity, and appropriate market instruments for secondary trade of capacity and commodity to ensure a liquid market. Increasingly these are being considered on a regional basis.

At the retail level, pre-requisites include the customer's ability to make an effective and informed choice between a range of competing offers, the provision of a smooth switching experience and special measures to safeguard the interests of vulnerable customers.

At both wholesale and retail levels, a well-functioning market needs fair and non-discriminatory third party access to infrastructure backed by effective unbundling, together with elimination of market distortions and action against anti-competitive behaviour, which would otherwise constrain the provision of competitive energy services to customers.

Ensuring these criteria are met is key to successful creation of well-functioning competitive markets, but while competition is the best safeguard of the customer interest, there are areas in the retail market where further measures should be considered.

This paper reviews what customers want from the competitive market, considers where additional measures in the retail market may be appropriate, and identifies the criteria for a well-functioning retail market which meets customers' interests and expectations.

2. Retail market

The definition of 'wholesale' (2003/55/EC Art. 2.29) refers to customers 'who purchase natural gas for the purpose of resale'. Thus the wholesale sector includes the supply of energy to local distribution/supply companies for subsequent resale to final consumers.

There is no definition of 'retail', but this definition of 'wholesale' suggests that 'retail' means supply to any final user - industrial consumers, commercial and municipal users, SMEs and domestic households.

Within this paper, we consider 'retail' primarily in the context of the supply of energy to domestic (household) customers, although certain of the more general comments also apply to other parts of the market.

3. What customers want from the competitive market

While attempts have been made to use quantitative indicators such as switching rates to measure retail competition, the variety of national situations and market structures makes it

difficult to rely on such indicators solely or universally. Eurogas therefore believes it is helpful to consider competition from the customer perspective.

On this basis, a national or local market can be said to be well-functioning if:

- customers are well-informed about the structure and operation of the competitive market, and are aware of their right to choose;
- there are a number of suppliers from which the customer can choose; to encourage this, there should be no barriers to suppliers wishing to enter (or exit) the market;
- all suppliers have fair and non-discriminatory access to capacity and can make competitive offers;
- suppliers can source competitively;
- suppliers have equal access to the industry information needed to construct their offers;
- customers can access clear price and other information which enables them to select from the services in the marketplace;
- customers are not deterred from exercising their right to choose by the switching process itself, which must operate reliably, smoothly, efficiently and with minimal errors/exceptions;
- retail prices derive from market drivers and the operation of competitive pressures, rather than being imposed without regard to such fundamentals; and
- the normal operation of the market is not distorted by the behaviour of any individual player(s).

To ensure a well-functioning market, any barriers to effective competition should be taken up by the regulatory or competition authorities according to their competencies. Removal of these barriers may not be straightforward, particularly if it entails modifications to existing industry processes.

Ultimately however, suppliers also have an interest in ensuring that competition functions well, since not only are their customers more satisfied with the competitive market and the role of the industry players involved, but also industry costs are reduced.

4. Meeting the customer interest

Provided the above conditions (and general requirements for consumer protection) are met, the operation of the competitive market is normally sufficient to ensure the differing needs of retail customers are met and to encourage responsible behaviour by market participants.

Thus, in relation to bills, for example, bill design does not need to be specified through ex ante rules on suppliers; suppliers already have every incentive to present clear bills, which minimise customer confusion and resulting queries. It should be accepted that in a competitive market the design of bills will vary, reflecting an individual supplier's brand identity and approach, bill design serves to differentiate one supplier from another, and it may be a source of competitive advantage.

Similarly in relation to contracts, characteristics such as price structure, price indexation (if any), duration etc. are aspects of competition and suppliers should be free to innovate in this area, competing with the offerings of other suppliers to provide attractive packages to meet consumer needs.

In determining their retail propositions, gas suppliers are very aware of their social responsibilities, and will wish to pursue customer-friendly policies which do not expose them to public criticism.

5. How best to safeguard the customer interest

A fully competitive market should normally also be sufficient to ensure the interests of customers in the domestic or household sector are met.

It is however recognised that the social considerations applicable to the supply of energy to the household sector make it appropriate for Member States to introduce specific measures for this sector beyond ordinary consumer protection legislation, consistent with the provisions of the Gas Directive in this area and the normal operation of the competitive market.

Sector-specific consumer protection is of two kinds – the designation of certain minimum standards applicable to the whole market, and special measures which are justified by the particular needs of certain customer groups e.g. socially disadvantaged or vulnerable customers. In addition initiatives can be introduced in a variety of ways - through formal ex ante regulation or legislation, through industry rules, agreements or codes of practice, or through other self- or co-regulatory measures.

In all cases, Eurogas agrees with the underlying principle of the current directives - that measures in this area are primarily for Member States to determine at an individual level, consistent with their needs, traditions and market structures.

6. Competition and safeguarding the consumer interest

Whatever measures may be adopted, they do not come free. Careful consideration should therefore be given to any interventions in the market, to ensure they are necessarily, reasonable, proportionate and could not be met by normal competitive forces.

In addition, the desire to ensure high standards of customer service must not undermine competition itself, and the cost of particular consumer obligations must not become an obstacle which deters market entry. Indeed, minimising barriers to entry is important to stimulating the good functioning of the competitive market.

Eurogas therefore believes the following principles should be followed in considering how best to safeguard the interests of energy consumers:

- wherever possible, competition and ordinary consumer law should be relied upon to ensure consumer welfare;
- sector-specific regulation should be considered only in areas where customers are not being well served by the competitive market and where it is clear that the operation of competitive forces or the use of self-regulatory initiatives would be insufficient;
- any sector-specific measures must be designed in such a way that they allow suppliers maximum room to innovate and compete in the way they meet the objective;
- such measures should minimise cross-subsidies and avoid creating distortions which hinder the efficient operation of the competitive market;
- measures intended to help disadvantaged or vulnerable customers should be carefully targeted;
- measures should not create an excessive administrative burden (and therefore cost) on suppliers or their customers.

From a customer perspective, Eurogas would also highlight the importance of the following to ensuring consumer welfare in a competitive market:

- domestic customers must have confidence that in the competitive market suppliers and other industry players will follow certain minimum standards of behaviour;
- the particular needs of vulnerable customers must be met;
- in this context, suppliers should be aware of their social and environmental responsibilities and act responsibly, in conjunction with other bodies; and

- domestic customers should have clear information about how they should pursue complaints and resolve disputes with their supplier.

In response to these considerations, Member States often determine

- what steps should be followed when dealing with customers who do not pay their bills on time and arrangements for the recovery of debt;
- what standards suppliers should adopt when marketing to customers;
- who 'vulnerable customers' are, for example those with a particular disability, or those for whom disconnection would have life-threatening consequences;
- what special protection vulnerable customers should be entitled to, taking into account climate, national social protection arrangements and other local circumstances; and
- accessible schemes for dispute resolution.

7. Criteria for a well-functioning market - summary

While attempts have been made to identify quantitative measures of competition, the variety of national situations and market structures make it difficult to apply these universally. From a customer perspective therefore, the following are essential if a competitive market is to be considered to be well-functioning:

- **customers are well-informed about the structure and operation of the competitive market, and are aware of their right to choose;**
- **customers have a number of suppliers from which they can choose; to encourage this, there should be low barriers to suppliers wishing to enter (or exit) the market;**
- **all suppliers have fair and non-discriminatory access to capacity and can make competitive offers;**
- **suppliers have equal access to the industry information needed to construct their offers;**
- **customers can access clear price and other information which enables them to select from the services in the marketplace;**
- **customers are not deterred from exercising their right to choose by the switching process itself, which must operate reliably, smoothly, efficiently and with minimal errors/exceptions;**
- **retail prices derive from market drivers and the operation of competitive pressures, rather than being imposed without regard to such fundamentals;**
- **the normal operation of the market is not distorted by the behaviour of any individual player(s);**
- **domestic customers have confidence that suppliers and other industry players will follow certain minimum standards of behaviour;**
- **the particular needs of vulnerable customers are met;**
- **suppliers are aware of their social and environmental responsibilities and act responsibly, in conjunction with other bodies; and**
- **domestic customers have clear information about how they should pursue complaints and resolve disputes with their supplier.**