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Why is the decrease in wholesale energy prices not reflected in retail prices?

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Despite a general decrease in wholesale energy prices[1], gas and electricity retail prices continued to grow in 2013, although at a slower pace than in previous years. On average, the electricity bill for households increased by 4.4% while gas prices rose by 2.7%. The latest Market Monitoring Report[2] presented today by the EU Agency for the Cooperation of Energy Regulators (ACER) and the Council of European Energy Regulators (CEER) identifies a vicious circle in many Member States wherein a lack of competition results in low switching rates, which is sometimes used to justify regulated tariffs which, in turn, can hamper competition.

In order to break that trend, **Alberto Pototschnig** ACER Director advocated "*the removal of barriers to entry into retail markets by fully implementing the Third Energy Legislative Package, adopting the network codes and phasing out regulated prices for non-vulnerable customers as soon as possible*".

Wholesale market integration improving, but more flexibility required

At the wholesale level, both for gas and electricity, market integration continues to progress. In 2013, the efficiency level in the use of electricity interconnectors continued to increase, due to market coupling, reaching a level of 77%[3]. However, this has not always resulted in an increase in price convergence[4]. This is mainly due to the challenge posed by the penetration of renewables. Going forward, a larger share of variable and non-programmable renewable-based generation in the electricity system will require more flexible-response resources, including from demand response.

Regulators foresee a transition by 2025 to a low-carbon society, where flexible and responsive markets will change the way consumers engage with energy (and which will require enhanced regard for consumers' protection and rights). Pointing to the concrete actions outlined by regulators in the Bridge to 2025 proposals[5] to better engage small consumers in the market, **Lord Mogg,** Chair of ACER's Board of Regulators and CEER President highlighted "*the need for an appropriate framework to include demand-response in the market".*

In the gas sector, the main challenge identified is the need to promote the liquidity of gas trading and ensure that all unused capacity, whether or not strategically acquired, can be easily returned to the market so that other shippers can use it if short-term trading opportunities arise.

What is hampering retail competition?

The lack of product and price differentiation provides few incentives for household consumers to switch supplier. This lack of switching and weak retail competition is often used to justify maintaining regulated prices, which in itself may hamper competition (especially if regulated prices are set below costs levels). But, there has been some progress. In 2013, the number of Member States with regulated prices has fallen, for example in electricity from 18 to 15, compared to the previous year[6]. Also hampering retail competition is the fact that the energy component on which retailers can compete is relatively small[7].

Despite this effect, opportunities for consumers to get a better deal by switching are available, yet switching rates remain low in most Member States. The report notes that in some cases, it could be due to loyalty or risk aversion, but ACER and CEER also make a call for raising awareness of switching opportunities through, among other initiatives, the development of transparent and reliable online price comparison tools as well as transparent energy prices.

ENDS (See Notes for Editors below)

Notes for Editors

(1) The report identifies a decrease in wholesale energy prices due to higher penetration of renewables and cheap coal from 2011 onwards. Prices on the Nordic market show a different pattern, due to the fact that this market has a large share of hydro-based generation. Enhanced competition in EU wholesale gas markets has reduced gas prices. Nonetheless, EU gas wholesale prices remain over twice as high as US prices, while Asian and Latin American LNG markets still sustain price levels which considerably exceed those of the EU.

(2) The *Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets* presented on 22 October 2014 fulfils the Agency's mandate established by Article 11 of Regulation (EC) No 713/2009. It covers retail prices for electricity and natural gas, access to networks (including network access by electricity produced from renewable energy sources), and compliance with the consumer rights laid down in Directive 2009/72/EC and Directive 2009/73/EC. By producing a joint report, ACER and CEER aim to provide as complete an assessment as possible of progress towards the implementation of the Third Energy Legislative Package, focusing on the remaining barriers for the completion of well-functioning electricity and gas markets in 2014. In parallel, the 2013 National Country Reports by each National Regulatory Authority are now available on the CEER website www.ceer.eu

(3) This refers to the level of efficiency in the use of the electricity interconnectors in the day-ahead timeframe, which is measured as the share of cross-border capacity used in the economic direction, that is to say from the lower to higher-price areas.

(4) In 2013, the Central-West Europe (CWE) region recorded the most significant decrease in price convergence (down by 32% compared with 2012). This is explained by several factors such as the fact that penetration of renewable-based generation and cheap coal in the international markets drove German prices down more than elsewhere in the region, due to the relatively high proportion of renewable-based and coal-fired generation in Germany.

(5) Regulators' Bridge to 2025 proposals, published 23 September 2014, present a set of concrete actions for collective action by regulators, the EU institutions, Members States and stakeholders to fully implement EU legislation, including the network codes as well as the Gas and Electricity Target Models, to help establish and maintain liquid, competitive and integrated wholesale energy markets. The Bridge to 2025 provides a vision for the next decade, and is intended as a guide to policy makers and the energy sector alike. Cross-cutting proposals address the full range of energy policy - from electricity and gas, to retail and consumer to distribution networks and the overall governance for European level energy cooperation. The findings in the MMR coincide with and reinforce the analysis and proposals set out in the Bridge.

(6) 15 out of 28 EU Member States in electricity and 15 out of 26 Member States in gas (there is no natural gas supply in Cyprus and Malta) are still applying regulated prices to household consumers. In some of these countries, market prices (when available) tend to cluster around the regulated price. In order to continue promoting market entry, retail price regulation should be removed as soon as possible, with their used limited to protect vulnerable consumers.

(7) Network charges, taxes and other administratively set charges (including those to cover the costs of renewables support schemes) account for a large share of final consumers' energy bills (sometimes exceeding 50%). Hence the energy component on which retailers can compete is relatively small.

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