SSE Response to the Draft Preliminary Report on Electricity and Gas Markets

Scottish and Southern Energy plc (SSE) welcome the opportunity to respond to the DG Competition preliminary report on the energy sector enquiry.

SSE is a FTSE-100 company, formed in 1998 from the merger of Scottish Hydro-Electric plc and Southern Electric plc. The core activities of SSE include the generation, transmission, distribution and supply of electricity throughout the UK. Other activities include the operations of a telecommunications network, gas storage, supply of gas, retail shops and utility contracting. The company has a market capitalisation of circa EUR14 billion and supplies around 6.5 million energy customers in the UK, from Shetland to the Isle of Wight. As part of a joint venture, we acquired two gas distribution networks from National Grid Transco in June 2005, one for the south of England and one for the whole of Scotland. All of our operations are currently focused solely in the UK

With regard to the draft report, we believe this provides a very thorough investigation of the current problems within the European energy markets. We note that the preliminary findings have confirmed the initial findings presented in the Issues Paper of November 2005. These indicate that there are five main barriers to a fully functioning internal energy market within the EU and these have been identified as: market concentration; vertical foreclosure; lack of market integration; lack of transparency; and price formation. The Commission has also made a number of preliminary remarks regarding potential structural, regulatory and competition law based remedies to overcome the perceived problems within the sector.

Overall we agree with the broad conclusions in the report and we comment in more detail below on the next steps for the investigation. Firstly, however, we would like to focus on the development of competition within the UK and our specific concerns with the lack of competition in other European Markets.

Competition is firmly established in the UK energy markets, with both the second gas and electricity Directives fully implemented. For example, the UK electricity market has undergone legal unbundling including creation of an independent GB System Operator (SO) with no supply or generation assets and this has helped to create a transparent, liquid market. Under this model, transmission assets continue to be owned and operated by transmission owners that are separate from the SO function.

In addition, the UK gas market has also undergone legal unbundling and in the preliminary report the NBP has been noted as providing transparency and liquidity in a fully competitive wholesale market.

Switching rates in the UK are high, averaging 350,000 and 300,000 per month in the domestic electricity and gas markets respectively.[1] These rates compare very favourably with other competitive markets in the UK. For example, the National Consumer Council noted in 2005 that 'a large number of consumers in the energy, fixed telephony and mortgage markets have understood the potential benefits of switching, as levels have risen considerably in these sectors [since 2000].'[2]

As part of the development of competitive markets, and to ensure full compliance with the second gas and electricity Directives, the UK energy regulator (Ofgem) is fully independent from both Government and the market. Furthermore, since the enactment of the Utilities Act 2001 the regulatory regime in the UK has been relatively stable allowing firms to compete in an open and transparent marketplace. In our view, if a national regulator has the requisite power to intervene and enforce the second gas and electricity Directives, as in the UK, then no further legislative action will be necessary to ensure effective competition.

Given the above, it is clear that competition has fully developed in the UK due to effective implementation of the European Directives requiring market opening and legal business separation. Furthermore, the preliminary report indicates that a few other markets, e.g. the Scandinavian 'Nordpool' have also developed effective, competitive markets through full implementation of the second electricity Directive.

However, it is clear that significant problems continue to exist in many European member states in both the gas and electricity markets where these Directives have not been fully implemented. For example, as noted in the preliminary report, regulated prices in France are seen as a barrier to switching in the electricity market and in Germany and Belgium access to capacity in the gas markets is noted as problematic due to complex processes, lack of information and stringent balancing rules. It is apparent to us that whilst UK energy companies compete with European 'national champions' (some still fully or partially owned by their respective governments) within the UK market, they are unable to access markets on the continent due to the failure to implement the market opening Directives.

Furthermore, Sir John Mogg wrote to Philip Lowe in November 2005 expressing serious concern over potential anti-competitive activity in the European gas market, in particular activity with regard to the Zeebrugge interconnector and changes to the Spanish market rules that may be causing LNG to be diverted from the UK.[3] This activity has resulted in a significant increase in gas bills for UK customers and should therefore be thoroughly investigated as a matter of urgency, with robust action taken against any company found to have been withholding gas from the UK market. More generally, however, the large adverse consequences for UK gas customers underlines the need for prompt action to implement the gas and electricity market opening Directives in continental markets.

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[1] Ofgem's Domestic Retail Market Report – September 2005. Ref: 23/06

[2] Switched on to switching? A survey of consumer behaviour and attitudes, 200-2005. National Consumers Council, November 2005

[3] European Gas Market, Reference: jfm/jd/05. Ofgem, 25th November 2005

In addition, we are becoming more and more concerned with what we see as increasingly prescriptive regulation where, we believe, enforcement of existing legislation is all that is required. For example, we believe that the gas storage guidelines recently published by ERGEG, whilst well meaning, will be prescriptive on Member States where competition is already well established. In the UK, storage systems are already market based with open access to all players, Any changes to these competitive arrangements would clearly be a step backwards and would not be of benefit to UK consumers. What is required, in our view, is direct action against those member states that have failed to implement existing legislation rather than more prescriptive and detailed regulation in areas where it is not required.

SSE therefore fully support the proposed action by the Commission to act on the most serious problem areas where competition law infringements are identified. In the first instance we would suggest that this should focus on individual companies who have abused their dominant position in the continental energy markets to foreclose such markets to competition. Such action would send a strong signal that anti-competitive practices in the European energy markets will not be tolerated. As noted above, we consider that the behaviour of continental companies trading across the Zeebrugge gas interconnector should be a particular focus for this work.

We would also urge the Commission to take action against particular member states that have failed to implement the spirit of the market opening Directives. In this regard, we welcome the recent enforcement proceedings by DG Tren against certain member states for non-compliance with these Directives.

However, we are concerned that the Commission's preliminary findings indicate that the market structure suffers from systematic conflicts of interest resulting from vertical integration. In our view, full structural unbundling is not necessary to ensure that effective competition is delivered across Europe. It is also clear that the requirement for full structural unbundling would create significant uncertainty and cost for many companies across Europe, even in markets where competition is established. Indeed, enforced structural unbundling could raise substantial legal issues in relation to Article 1 (Protection of Property) of the Human Rights Act 1998. Furthermore, it is clear that structural reform is not required to deliver effective competition, since some member states have achieved this by relying on legal unbundling alone (e.g. the UK and Scandinavian Nordpool markets).

For these reasons, we would be strongly against any further legislation to introduce more prescriptive rules. The existing Directives have been sufficient to ensure market opening in some member states. Therefore, we see no reason and considerable costs in the preliminary conclusion that more prescriptive regulation may be required across the entire EU by way of new legislation.

To conclude, the UK and other energy markets provide ample evidence that the second gas and electricity Directives' requirement for legal unbundling are sufficient to ensure effective competition. In our view, if there is a willingness to introduce competition at the national level, and national regulators are provided with sufficient powers to enforce these Directives, then legal unbundling will be effective and

achievable across all Member States. We therefore fully support the Commission's proposal to review on a Member State by Member State basis the implementation of the gas and electricity liberalisation Directives in 2006, and to take action in specific cases of non-compliance. We would, however, be firmly opposed to further legislation at this time.

If you would like to discuss this further, please call.

Yours sincerely

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