Topics in UK Utility Retail

by

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Topics in UK utility retail – Agenda

• Industry overview
• Key features of UK competitive market
• Market review
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Key stats on UK system

- Total system capacity of 80,000 MW and peak demand of 57,000 MW
- 29 million total customers consuming 365,000 GWh of electricity
- Natural gas makes up largest share of electricity supplied at around 35-40%
- Office of Gas and Electricity Markets (Ofgem) regulates industry by granting licenses
- Monopoly businesses of T&D are regulated through price controls (reset every 4-5 years)
- Generation and retail supply have been deregulated and operate in fully competitive markets
Today’s electric industry structure

Electricity structure in GB

Trader → Supplier
Trader → Distribution
Trader → Consumer
Supplier → Distribution
Supplier → Consumer
Distribution → Consumer
Generation / interconnection → Transmission
Generation / interconnection → Distributed generation
Transmission → Distribution
Transmission → Consumer
Consumer → Metering services
Distributed generation → Directly connected customers
Physical Flows
Financial Flows

Source: Ofgem
Timeline to supply competition

**GB Supply Competition Timeline**

- **1990**: Privatization of GB electricity market
- **1991**: Partial privatization of Nuclear Power to British Energy
- **1993**: Competition begins in generation and into the >1MW supply market
- **1994**: Competition introduced in the 100kW to 1MW supply market
- **1995**: Remaining Magnox nuclear generators privatized and absorbed by BNFL
- **1996**: Competition introduced in the <100kW supply market
- **1997**: Completion of electricity market deregulation
- **1998**: All forms of direct price regulation removed
- **1999**: Utilities Act 2000 removes distinction between 1st and 2nd tier licensees

Source: Datamonitor
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What obligations do electricity suppliers have to serve customers?

• Any company holding electricity supply license can sell electricity

• Suppliers are obligated to meet Standard License Conditions:
  - There is no duty to supply, but licensees have a duty to offer terms on request
  - Cross-subsidies of any kind are prohibited
  - Suppliers can offer different contractual terms across customer types or areas

• T&D companies are also obliged to meet Standard License Conditions:
  - Provide access to system & certain ancillary services on a non-discriminatory basis
  - Distributors are required to maintain full managerial and operational independence from any of their affiliates and related undertakings

• Suppliers can supply customers nationwide using another company’s distribution network and paying them for use of the system

• Suppliers who are authorized to supply customers must meet all “reasonable” demands made by customers
How is electricity procured?

- New Energy Trading Arrangements (NETA) replaced the Pool in 03/01
- Most of the UK's power is traded through bilateral contracts ahead of time
- Power is also traded on forward and futures markets and through PXs
- NGC operates a Balancing Mechanism (BM) to ensure system security
  - about 2% of power goes through the BM
  - generators out of balance if cannot provide contracted power or generate too much
  - suppliers out of balance if they consume more than contracted or consume too little
- Due to NETA (among other factors) baseload prices have fallen by 19% and peak prices by 27%

![Diagram showing traded markets under NETA](source: Ofgem)
How are tariffs set in the UK?

- All forms of direct electricity and gas retail price regulation removed in 2002
- Two-tier pattern of prices has emerged in residential market, where incumbents:
  - maintain prices to existing customers
  - lower prices to attract new customers
- No lock-in period with residential customers
- Suppliers are beginning to offer more innovative tariffs
- I&C customer rates tend to reflect characteristics of the business

<table>
<thead>
<tr>
<th>Tariff innovation</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lifestyle tariffs</td>
<td>BG offering energy at entirely variable rates &amp; no standing charge</td>
</tr>
<tr>
<td>Social tariffs</td>
<td>Powergen’s “staywarm” tariff targeting those over 60 years of age</td>
</tr>
<tr>
<td>Green tariffs</td>
<td>Examples include npower’s “Juice” tariff with Greenpeace</td>
</tr>
<tr>
<td>Price caps</td>
<td>SP offering capped tariffs to all first tier (in-area) customers</td>
</tr>
<tr>
<td>Added features</td>
<td>BG provides free bill payment cover in case of accidental death</td>
</tr>
<tr>
<td>Payment options</td>
<td>Most suppliers offer standard credit, direct debit and prepayment options</td>
</tr>
</tbody>
</table>

Source: Datamonior
## What does Ofgem do to assist disadvantaged customers?

<table>
<thead>
<tr>
<th>Action</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy efficiency advice</td>
<td>Working with industry participants to develop best practice guidelines for the industry on money-saving energy efficiency advice.</td>
</tr>
<tr>
<td>Encourage older people to switch</td>
<td>Ofgem and Age Concern are working on a joint campaign to encourage more older people to switch to more competitive suppliers.</td>
</tr>
<tr>
<td>Help prepayment meter customers</td>
<td>Working with industry participants and energywatch to improve the information suppliers give to customers about meters and ability to pay.</td>
</tr>
<tr>
<td>Improve debt prevention and management</td>
<td>Working with energywatch to identify and promote good practice in debt prevention.</td>
</tr>
<tr>
<td>Promote competition</td>
<td>Working to ensure that people whose first language is not English are aware of the benefits of competition.</td>
</tr>
</tbody>
</table>

Source: Ofgem
What are key competitive issues in the UK electricity market?

- Delivering a single electricity market across the whole of GB
- Introducing competition into the metering & connections markets
- Delivering environmental policy compatible with competitive energy markets
- Sustaining competitive retail supply
  - Consolidation in the retail energy market
  - Misselling / erroneous transfers of customers to new suppliers

![ Consolidation of Retail Supply Market Diagram ]

Source: E&Y
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Market review topics

Switching

Prices

Sales channels

Strategies
Customer switching

- Over 80% of customers with a demand of 1 MW are being served by a non-local supplier
- More than half of all customers with a demand of 100 kW to 1 MW are supplied by non-local supplier
- Around half of residential customers have switched suppliers at least once
- Non-incumbent new entrants have yet to gain a foot hold in serving residential customers (with less than 5% of the total market)
Retail prices

- Average annual residential prices have fallen 14% over the last five years in real terms.
- Average annual industrial prices have fallen 31% over the last five years in real terms.
- Difference in price paid by largest and smallest I&C consumers is narrowing:
  - Largest I&C users have seen real terms price falls of 29% over the last ten years.
  - Smallest I&C users have seen real terms price falls of 38% over the last ten years.

![Real decline in average annual electricity prices over past 5 years](chart.png)

Source: DTI
Customer acquisition channels

• Residential customer acquisition channels:
  - Doorstepping is consistently the primary point of contact
  - Doorstepping also has the best conversion rate of contact to contract
  - Contacted about 1.7 times per year on average to switch suppliers

• I&C customers typically acquired through a formal tendering process

% type of sales contact in UK, 2000-02

<table>
<thead>
<tr>
<th>% type of sales contact in UK, 2000-02</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doorstep salesperson</td>
<td>62%</td>
<td>61%</td>
<td>61%</td>
</tr>
<tr>
<td>Leaflet through the door</td>
<td>39%</td>
<td>33%</td>
<td>34%</td>
</tr>
<tr>
<td>Telesales</td>
<td>22%</td>
<td>25%</td>
<td>27%</td>
</tr>
<tr>
<td>TV advert</td>
<td>28%</td>
<td>25%</td>
<td>24%</td>
</tr>
<tr>
<td>Street /shopping centre</td>
<td>14%</td>
<td>18%</td>
<td>20%</td>
</tr>
<tr>
<td>Contacted retailer</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>None</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: Datamonitor
Mass market retail strategies

Current supplier product and geographic market positioning

- **National players emphasizing a wider product offering**
  - Powergen
  - npower
  - BG

- **Regional players emphasizing energy-centric offering**
  - SP
  - EdF Group
  - SSE

Geographic positioning

- National
- Regional

Product positioning

- Energy only
- Energy plus...
- Multi product