

# Public Service Obligations in a Competitive Electricity Market:

A study of how the British regulatory framework currently deals with public policy objectives and how this might change after 1998

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## **1. PREFACE**

This paper is the product of a series of interviews with people working in and around the Scottish electricity industry carried out by the author in July and August 1996 while he was on a six week secondment from Scotland Europa to ScottishPower. I would like to thank all the people who gave so generously of their time in helping me write this paper. Particular thanks are due to Alex Brennan, Peter McDonald and Ken Vowles of ScottishPower for their support and guidance during my secondment and to Susan Drennan, Elaine Fell, Joanne Nimmo and Liz Patrick for putting up with the extra work that my presence generated.

While many of the factual passages in this Paper are based on things said to me during interviews the analysis contained in the Paper is entirely my own. It does not necessarily reflect the views of any of the parties I interviewed, and should not be read as doing so.

### **1.1 Abstract Of Paper**

This Paper describes the British electricity industry<sup>1</sup>, the manner in which competition has been introduced into it and the way in which the regulatory framework for the industry reconciles competition with other public policy objectives. It highlights the ambiguous attitude the *Electricity Act 1989* takes towards social policy objectives and speculates as to whether the introduction of competition in the under 0.1 MW supply market after April 1998 will put British policy makers under greater pressure to clarify the social obligations of electricity utilities.

The Paper concludes that the British experience to date tends to suggest that it is possible to pursue public policy objectives in areas such as security of supply, environmental protection and consumer protection at the same time as opening parts of the electricity industry to competition. While the 1998 liberalisation will present much greater problems than previous market openings and may force a rethink of the mechanisms for protecting disadvantaged groups of customers, it should still be possible to resolve these problems within the context of a competitive market.

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<sup>1</sup>I am using the term electricity industry instead of the more standard Electricity Supply Industry (ESI) because the word "supply" has taken on a very specific meaning in the context of the British industry and the term ESI may therefore cause confusion amongst readers who do not have a background in electricity. Because this Paper touches very little on the situation of the electricity industry in Northern Ireland it might have been more accurate to use the term "mainland British" or "Great British" electricity industry, but for the sake of simplicity I have not.

## 2. INTRODUCTION

In the debate surrounding the European Commission's attempts to open up the European Union electricity market to cross-border competition one of the most effective arguments deployed by those opposing liberalisation is that competition undermines the ability of electricity utilities to pursue wider goals beyond making a return on their capital. In a competitive market, the argument goes, electricity utilities will be less able to plan for security of supply, energy efficiency and environmental protection and less able to deliver a high quality, affordable service to all citizens regardless of location or social status.

Similar arguments are put forward to justify the continuation of monopolies in the provision of gas, water, telecommunications and postal services. The fact that many politicians and members of the public in Europe view the introduction of competition into the utilities sector with such trepidation should be a matter of concern to those who would like to see the emergence of European single markets for the various utility services. Scotland and the UK have a contribution to make to this debate in that they have introduced competition, to varying degrees, into some aspects of the provision of gas, electricity, telecommunications and water services.

This paper examines the extent to which the introduction of competition in the British electricity sector has been reconciled with other public policy objectives, how this might change with the full scale liberalisation of the market in 1998 and whether competition and social obligations are as incompatible as the opponents of liberalisation believe.

### **2.1 The EU Debate on Utilities, Liberalisation and Public Service**

Though market opening and competition have been central objectives of the European Community ever since it was founded, public utilities have always been regarded as a special case. Article 90(2) of the EC Treaty exempts public utilities from the rigours of EC competition law to the extent that such exemption is needed in order for them to perform "the particular tasks [of general economic interest] assigned to them", while Article 222 of the EC Treaty explicitly forbids the European Commission from taking a view on the merits, or demerits, of public ownership.

Until the 1980s the prevailing wisdom amongst EC Member States was that public utilities were outside the scope of EC law<sup>2</sup>. The Commission successfully challenged this view with a campaign of court cases and Directives to open up the telecommunications equipment, services and leased lines markets and had its right to do this was upheld by the European Court of

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<sup>2</sup> Case 155/73 Sacchi was thought to be authority for this proposition.

Justice<sup>3</sup>. Flush with success in the telecommunications sector, in 1988 the Commission turned its attention to the energy.

The Commission began its campaign to liberalise the energy sector by inaugurating formal consultations with industry and Member State governments on what competitive markets for electricity and gas should look like. These consultations produced a number of reports<sup>4</sup> but no consensus. In February 1992 the Commission decided to press ahead regardless and presented proposals to restructure the European gas and electricity markets along lines similar to the current UK arrangements with a separation of energy supply and infrastructure businesses and a right of Third Party Access (TPA) to networks<sup>5</sup>. These proposals got precisely nowhere.

In retrospect the Commission's 1992 gas and electricity proposals can be seen as the high water mark of the late 1980's free marketeering ascendancy in Europe. That the Commission could even think of presenting proposals which, viewed from most EU countries, were so radical is a measure of its confidence in the heady days of the early 1990's. What happened next is that the EU suffered a huge loss of political momentum following the Danish "no" vote in the Maastricht Referendum, a loss from which it still has not yet fully recovered, and the forces opposing liberalisation managed to organise a successful counter attack.

During 4 years of trench warfare in the Council of Ministers and European Parliament opponents of the Commission's proposal on electricity managed first to block all progress and then to limit severely the scope of the final deal on market opening<sup>6</sup>. More than this, however, they were successful in launching a wider debate on the delivery of public services in Europe.

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<sup>3</sup> see C-41/83 Italy v Commission and C-202/88 France v Commission

<sup>4</sup>See the reports of the Professional Consultative Committee on Electricity (PCCE) and the Comité Consultatif Etats Membres Electricité (CCEME) published by the European Commission in *Reports of the Consultative Committees on Third Party Access to Electricity Networks* May 1991.

<sup>5</sup>COM(91) 548 *Proposal for a Council Directive concerning common rules for the Internal Market in electricity* and COM(91) 548 *Proposal for a Council Directive concerning common rules for the Internal Market in natural gas* both published in Official Journal C65 of 14 March 1992

<sup>6</sup>The draft Directive on Electricity still has to go for second reading in the European Parliament and Council of Ministers so the terms of the deal could still change, but essentially Member States agree to phase in competition for customers using over 9 GWh per year by the year 2003. Third Party Access to the networks is no longer as of right but must be agreed with the owner of the infrastructure: the principle of negotiated Third Party Access had already been conceded by the Commission since 1994 when it amended its proposals in response to comments from the European Parliament: see COM(93) 643 published in Official Journal C123 of 4 May 1994 and also Report of Claude Desama MEP on the electricity Directive (adopted by Parliament on 17 November 1993).

The Initiative for Public Utilities in Europe (ISUPE), a platform grouping traditional state owned utilities, was born out of the fight against the Electricity Directive but has turned its attention to wider issues. It is lobbying for the inclusion in the EC Treaty of the provision of high quality public services for all citizens as an objective of equal status to the free movement of goods, services, persons and capital. In this it has received significant support from the Socialist Group in the European Parliament and the, mainly southern European, Member States who take the view that liberalisation in the EU has gone far enough.

The underlying assumptions of the utilities and the politicians who are opposed to liberalisation is that introducing competition into their monopoly markets will cost jobs and endanger their ability to achieve a number of public policy objectives. From the evidence of the UK experience the first of these assumptions is probably true<sup>7</sup>, at least in regard to the incumbent utility - though these losses will be matched by new jobs in new entrants and elsewhere in the economy. For the second of these assumptions the evidence is less clear cut. It is the purpose of this paper to examine the extent to which electricity utilities can fulfil public policy objectives in a competitive market.

### **3. UNIVERSAL SERVICE, PUBLIC SERVICE AND SOCIAL OBLIGATIONS<sup>8</sup>**

The provision of electricity, in common with the provision of gas, water, telecommunication, and postal services, is a business which was for many years regarded as qualitatively different from ordinary economic activities. Not only have these activities, which can be loosely termed utilities<sup>9</sup>, been regarded as "natural monopolies" exempt from the usual laws of competition, they have also been seen in most European countries as activities in which the State has a vital strategic interest. For these reasons utilities in all European countries have long been subject to some degree of State control, if not outright State ownership. While utilities were shielded from competition and enjoyed a cosy relationship with the public authorities they had no overwhelming need to analyse the extent to which they were acting as businesses and the extent to which they were acting as tools of public policy. It is only since the 1980 and the attempts to open utilities and public services to competition that there has been much demand for clarity about these things: it is still often difficult to tell with some utilities which of their actions are inspired by business considerations and which by public policy.

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<sup>7</sup>For example in March 1990, about a year before the introduction of competition, ScottishPower had 9263 employees. In March 1995 it was down to 8040 employees.

<sup>8</sup>For a more in depth analysis of the concepts of Universal Service and Public Service Obligations see *Towards a Single Market in Utilities* Centre for European Policy Studies (CEPS) Working Party Report No. 14, July 1996

<sup>9</sup>For a more in depth analysis of the concept of a utility see *ibid.*

Notwithstanding the above, the types of public policy objectives utilities are commonly asked to fulfil can be divided into two main categories:

- objectives to do with geographical and social availability of a service;
- objectives relating to strategic national policy objectives

In the post and telecommunications sector this first category of policy objectives have tended to be referred to as the utilities' Universal Service Obligation while in the energy and transport sectors the tendency has been to refer to them as the utilities' Public Service Obligation. There is no hard and fast definition of these terms and they are sometimes used as if they are interchangeable. In general, though, Public Service Obligation is a wider concept than Universal Service Obligation and can encompass the achievement of strategic national policy objectives - e.g. security of supply and environmental protection - as well as the provision of a uniform basic service.

The essential characteristics of a Universal Service Obligation are that the utility is mandated to provide a basic service which is:

- *available throughout the territory* served by the utility;
- of a *uniform minimum quality* throughout the territory;
- *affordable* to all citizens.

In the telecommunications sector the basic service covered by the Universal Service Obligation is voice telephony. The equivalent basic service for the electricity sector would probably be ordinary domestic supply of electricity (this is discussed in greater detail below).

The best definition of Public Service Obligation I have found is the imposition of obligations which the utility "would not assume if it were solely considering its commercial interest"<sup>10</sup>. This would encompass the obligations concerning security of supply, fuel mix and energy efficiency typically placed on energy utilities, as well as the obligation to provide a uniform basic service. In the telecommunications sector this might encompass obligations to build out new services rather faster than demand would dictate.

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<sup>10</sup>This definition is taken from Council Regulation (EEC) No 2408/92 on access for Community air carriers to intra-Community air routes. See in particular Article 2.

## 4. THE BRITISH ELECTRICITY SECTOR

The development of the British electricity industry up until the late 1980's followed a pattern similar to that of its counterparts in most other European countries: the industry emerged towards the end of the last century, it developed in its early years as a patchwork of local monopolies and these were latter consolidated into a national monopoly. There are differences in the dates and the manner in which these developments happened in different countries and many other States - for example Belgium, the Netherlands, Germany and Sweden - still have local authority involvement in electricity supply and distribution, but these are minor details. The point of divergence was 1989 after which the British industry was in short succession restructured, privatised and opened up to competition.

Amongst other innovations introduced by the restructuring of the British industry were the creation of a spot market for electricity in England and Wales and systems under which rival companies could compete to supply customers using the distribution infrastructure of the incumbent utility. Though similar systems are now being used or considered in various countries in Europe and around the world, it is worth remembering that even as recently as 1983 the separation of electricity supply from distribution and transmission was being pronounced unachievable by competition policy theorists<sup>11</sup>. The 1989 restructuring was very much a leap into the unknown and it is only fairly recently that anyone outside the British industry has been willing to declare it a success. Britain is still in the position of being a pioneer of the competitive electricity market and is therefore in a position to make a unique contribution to the European debate on how such a market can be reconciled with other public policy objectives.

This chapter gives a brief history of electricity supply in Britain, describes how the competitive market works and looks at some of the main ways in which its regulatory framework balances competition with other public policy objectives.

### 4.1 The British Electricity Industry from Birth to Privatisation<sup>12</sup>

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<sup>11</sup>P.L. Joskow and R. Schmalensee saw that it was theoretically possible to replace the command and control relationships within an integrated electricity utility with contractual relationships between separate generation, transmission, distribution and supply businesses. Nonetheless they concluded that the transaction costs of negotiating, executing and litigating the necessary contracts would be so high as to make such a structure impracticable - see *Markets for Power, an Analysis of Utility Deregulation* MIT Press (1983).

<sup>12</sup>This section gives a very brief history of the development of the British electricity industry. For a much more complete history of the industry up to and beyond nationalisation see *Electricity Before Nationalisation and Engineers, Managers and Politicians* both by Leslie Hannah and both available from the Electricity Association.

The British electricity industry began its existence towards the end of the last century as a mixture of small scale private and municipal schemes supplying electricity, mostly for the purpose of street lighting. Demand for electricity grew rapidly, especially from the transport sector with the arrival of electric trams in the 1890s and then later from industry and households. By the turn of the century many municipalities around Britain were awarding monopoly contracts for the supply of electricity in their area and investing in generating plant. Even in these early years the development of the industry was seen as a matter of public interest and various pieces of legislation were enacted<sup>13</sup> giving the promoters of electrification schemes the necessary powers to dig up streets and to require land owners to allow pylons to be placed on their property.

Britain's experiences in the First World War highlighted the importance of electricity for a modern economy and exposed the weakness of a fragmented system of local monopolies and local technical standards. Following the recommendations of the Williamson Report, Parliament passed the *Electricity Supply Act 1919* which established the Electricity Commissioners with a remit of creating a more efficient, better co-ordinated electricity industry. The Commissioners lacked the necessary powers to make much of an impact on the industry and following another investigation into the industry, this time by Lord Weir, Parliament passed the *Electricity Supply Act 1926*. This Act created the Central Electricity Board (CEB) which was tasked with co-ordinating the generation and transmission of bulk supplies of electricity. The CEB began a campaign of interconnecting the different local networks and building a national backbone grid to facilitate bulk transfers of electricity. It also rationalised electricity generation via a system of Selected Stations allowed to supply the national grid and implemented harmonised technical standards. By the 1930s Great Britain had a publicly owned national grid stretching from the south of England to Dundee in Scotland, however ownership of much of the rest of the industry was still in private hands.

In 1947 the Labour Government passed an Act of Parliament<sup>14</sup> which was to take the entire British electricity industry into public ownership. This fulfilled a pledge made at the 1945 election to take the "towering heights" of the British economy into public ownership, however, the move was probably based as much on the belief that this was the best way of getting the industry on its feet again following the War as it was on ideology. The British Electricity Authority took over ownership of all major generating station in Great Britain except those owned by the North of Scotland Hydro- Electric Board, a statutory body which had been created in 1943 under the wartime Government with the dual mission of exploiting the hydro-electric potential of the Scottish Highlands and developing the economy of that area. The British Electricity Authority also took over the assets and functions of the CBE in running the national

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<sup>13</sup>See for example the Electric Lighting (Clauses) Act 1899

<sup>14</sup>The Electricity Act 1947

grid and setting technical standards. Ownership of the regional electricity distribution networks was passed to 14 Area Boards, which also had the responsibility of supplying customers in their region.

The independence of the North of Scotland Hydro-Electric Board from the British Electricity Authority and the Area Boards was an anomaly most keenly felt in the South of Scotland. This anomaly was resolved by the *Electricity Act 1954* which transferred ownership of the BEA's generating station and grid in Scotland to a new "super-board" covering the old South East and South West Scotland Areas. Thus was born the South of Scotland Electricity Board. The diminished BEA became the Central Electricity Generating Board (CEGB) and the Electricity Council was created as a central forum for the whole of the British industry. While the industry in Scotland operated separately from the industry in England and Wales it is important to note that their grids remained interconnected, they exchanged electricity and to some extent co-ordinated their activities.

The 1988 White Paper and the Electricity Act 1989 laid the foundations for the most recent restructuring of the electricity industry. The industry in England and Wales was privatised in 1990, the Scottish industry was privatised in 1991 and the industry in Northern Ireland in 1993<sup>15</sup>. The Area Boards in England and Wales became Regional Electricity Companies. The CEGB's generation capacity was divided between National Power and PowerGen (both of which were sold off) and Nuclear Electric (which was not) while the National Grid became an independent company. In Scotland NSHEB and SSEB were sold off as the vertically integrated companies Scottish Hydro-Electric and ScottishPower respectively. Their nuclear capacity, which as in England the private sector was unwilling to buy into, became Scottish Nuclear Ltd. and a series of complex legal agreements were put in place to reflect the fact that though they owned separate assets NSHEB, SSEB and Scottish Nuclear Ltd had in fact co-ordinated their generation activities prior to privatisation.

#### **4.2 The Competitive Electricity Market**

Competition has been introduced in the British electricity industry by separating the natural monopoly infrastructure businesses of transmission - the transportation of electricity over the high voltage national grids in Scotland and England - and distribution - the transportation of electricity over the low voltage local and regional networks - from electricity generation and supply. Transmission and distribution are heavily regulated, subject to price control and non-discrimination obligations and must be operated as separate businesses from generation and supply when they are performed by part of an integrated company. Regional Electricity Companies, for example, must establish separate distribution and supply business, publish tariffs

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<sup>15</sup>The Northern Irish electricity system is not interconnected with the systems in Great Britain. The industry there is structured very differently to the industry in Scotland and England and is not dealt with further in this paper.

for their respective services and be prepared to distribute electricity to customers of rival supply companies on the same terms as they offers their own supply business.

Electricity supply pure and simple covers customer service, billing and revenue collection. These are important services and new entrants can find ways of delivering them in more efficient and more customer oriented ways, but they constitute only a small percentage of the average electricity bill. Competition in the generation market is what has the most significant impact on prices.

The show piece of the competitive electricity market in Britain is the spot market for electricity created on the England and Wales National Grid<sup>16</sup>. Instead of being scheduled to run on the basis of a merit order determined by the CEGB, generating stations must now place bids to run with the Pool which matches up predicted demand with available supply in each 24 hour period on the basis of the least cost bids. The Pool price has become a key determinant in deciding the going rate for the wholesale purchase of electricity throughout Great Britain: though there is no Pool in Scotland the maximum price ScottishPower and Scottish Hydro-Electric generation businesses can charge Second Tier (i.e. rival) suppliers for wholesale electricity is linked to Pool prices.

Competition in the generation and supply markets interact. Though all sales of electricity in England and Wales must go via the Pool<sup>17</sup> it is standard practice for suppliers to back up their supply contracts with Contracts for Differences (CFDs) with a generator to guard against the volatility of Pool prices. A CFD allows both parties to simulate the effect of a fixed price contract for wholesale electricity. It establishes a target, or "strike" price for the wholesale electricity: if Pool prices go below the strike price the supply company pays the generator the difference, while if Pool prices go above the strike price the generator pays the supplier. While in theory all supply companies are buying wholesale electricity on the same conditions from the same spot market, competitive advantage can in fact be gained by negotiating a CFD with a lower strike price than one's competitors.

### **4.3 Public Service Obligations in the Privatised British Electricity Industry**

Though Public Service Obligation is not a term used in the Electricity Act 1989, the Act and licences issued under it undoubtedly force companies to operate in ways they would not do if they were solely considering their commercial interests. In some instances there are clear obligations placed on electricity utilities, or explicit market distortions created, which can be

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<sup>16</sup>For a fuller and much more expert account of competition in the generation market see *Electricity Generation in England and Wales - a Competitive Market?* Gill Brodie, MBA Thesis Strathclyde University 1995.

<sup>17</sup>There are limited exceptions to this, for example customers generating for their own consumption.

easily pointed out as Public Service Obligations. Most of the time, however, Public Service Obligations come dressed in the language of competition law or consumer protection and are difficult to recognise as such.

It is also worth distinguishing at this stage between the law and the way it has been applied. The Electricity Act 1989 gives the Government extensive powers to intervene in the electricity industry and impose Public Service Obligations, however, up until now these powers have been used very sparingly. The reasons for this are partly to do with need (there have been no major crises in the industry) and partly to do with ideology but there would be little to prevent a future Government regulating the industry in a more interventionist way.

#### **4.4 Public Service Obligation and the Electricity Act 1989**

The most obvious Public Service Obligation contained in the Electricity Act is the "Duty to supply on request" placed on Public Electricity Suppliers (PESs)<sup>18</sup> by Section 16. This section requires a PES to meet any reasonable request for a supply of electricity to a premises in its area. The PES can recover the cost of any infrastructure which it needs to build in order to connect the premises to its electricity distribution system (see Section 19 of the Act), and in the case of isolated premises a long way away from the PES's network the connection fees quoted to customers could be prohibitive<sup>19</sup>, but there are very few circumstances in which a PES could flatly refuse to supply electricity<sup>20</sup>. Certainly the creditworthiness, or lack of it, of a potential customer or the fact that they are likely to have a low load factor would not be valid reasons, bar perhaps the most exceptional cases.

Sections 32 to 38 of the Act give the relevant Secretaries of State in England and Scotland the power to impose Public Service Obligations on electricity utilities in terms of fuel mix, security of supply and the environment. These powers have been exercised to require a higher proportion of nuclear and renewables in the generation mix than market forces would dictate, via the Non-Fossil Fuel Obligation in England and Wales, the Scottish Renewables Order in Scotland and the

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<sup>18</sup>The Public Electricity Suppliers are the incumbent utilities serving the various regions into which the British market is divided. Up until 1 April 1998 they retain a monopoly on the supply of electricity to customers with a maximum demand below 0.1 MW (i.e. households and most small businesses).

<sup>19</sup>Most connections are done for a standard fee of around £250 but in cases involving the connection of isolated farm houses fees as high as £18,955 and £7,891 have been held to be reasonable by the Regulator: see OFFER Determinations S23/R/011(B) and S23/R/054/B respectively.

<sup>20</sup>examples of "unreasonable" requests for supply might be an ordinary domestic customer asking for a 1 MW connection even though there is no likelihood of him ever having such a load factor, or an industrial customer demanding an exceptionally large supply in a location which would unbalance the entire network. In reality such "unreasonable request" are virtually never received.

Fossil Fuel Levy applied to fossil fuel generation throughout Britain (though NB support for nuclear generation has been curtailed following the privatisation of British Energy in July this year).

However, the majority of the Public Service Obligations covering the British electricity utilities come out of the system of regulation imposed on the industry by the Director General for Electricity Supply rather than directly from the Act.

#### **4.5 Public Service Obligation, Electricity Licences and the Regulator**

The Electricity Act 1989 is essentially enabling legislation. Reading the Act does not do much to enlighten one as to how the UK industry is structured or the rules under which it operates. The three main things it does are:

1. it creates a system of licences for companies participating in the industry;
2. it creates a Regulator - the Director General for Electricity Supply (DGES) backed up by an Office for Electricity Regulation (OFFER) to police these licences;
3. it gives the Government the necessary powers to privatise the industry.

It is from the licences and their enforcement that most of the Public Service Obligations imposed on British electricity utilities flow.

Licences are needed for the generation, transmission and supply of electricity (see Section 4 of the Act). While in England and Wales these activities are carried out by separate companies, and are therefore the subject of separate licences, in Scotland both ScottishPower and Scottish Hydro-Electric are vertically integrated companies and hold combined generation/transmission/supply licences. Another point of difference is that licences in England and Wales are issued under the authority of the President of the Board of Trade whereas in Scotland they are issued under the authority of the Secretary of State for Scotland. There are differences between the licences issued in Scotland and those issued in England and Wales which reflect the different structure of the industries<sup>21</sup>, but generally most of the principles are the same. The main divergence is between the licences issued to incumbent businesses, which contain a lot of what could be regarded as Public Service Obligations and those issued to new entrants which do not.

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<sup>21</sup>For example the Scottish licences contain a non-discrimination clause relating to the price at which the generation businesses of ScottishPower and ScottishHydro can sell electricity, reflecting the fact that the two companies are vertically integrated.

Up until now the only "Public Service Obligation" placed on new entrants to the supply market has been to refrain from supplying customers below a certain size<sup>22</sup>. While this is a limitation that few suppliers would place on their business if they were only thinking of their own commercial interest, it is a moot point as to whether this constitutes a "Public Service Obligation"<sup>23</sup>.

In contrast, the incumbent electricity utilities have a large number of conditions in their licence which might be termed Public Service Obligations. Holders of Public Electricity Supply Licences<sup>24</sup> are obliged to agree standards of service and codes of practice with OFFER relating to such matters as late payment of bills, special services for the elderly and the disabled, energy efficiency and customer complaints<sup>25</sup>. It is just about arguable that some electricity utilities could see it as in their commercial interest to set and achieve targets in all of these areas as part of their approach to quality and customer service. It is equally arguable, though, that not all utilities would set and achieve high standards of performance in all these areas all the time if only considering their own interest, and to this extent they could be termed Public Service Obligations. It has also tended to be the case that British electricity utilities have either not sought to or not been allowed to recover the full cost of providing some of the special services they provide to the elderly and the disabled - for example, specially adapted meters and other equipment.

The most onerous burden which incumbent utilities have placed upon them via their licences, however, is the duty to observe price controls in relation to their monopoly activities - transmission and distribution of electricity and, up until 1 April 1998, supply to customers with a maximum demand of less than 0.1 MW. The entire reason for these price controls is the fear that a commercial company in a monopoly situation will seek to maximise its profits at the expense of its customers. While an efficient private company will always look to drive down its costs, if it is not faced with competition it has little incentive to pass on these cost savings to its customers. Price control has undoubtedly made life less lucrative than it would have been for

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<sup>22</sup>Up until 1 April 1994 the limit was customers with a maximum demand of less than 1 MW. Up until 1 April 1998 the limit is a maximum demand of less than 0.1 MW. See Condition 2 of the Scottish Private Electricity Supply ("Second-Tier") Licence.

<sup>23</sup>I think it probably is in that the companies are refraining from doing something in order to further a public policy goal (that competition be phased in gradually to allow time for restructuring of the electricity industry), thereby doing a public service. Nonetheless, the term Public Service Obligation usually carries with it the notion of doing something extra for the public good.

<sup>24</sup>The English and Welsh Regional Electricity Companies and the supply businesses of Scottish Hydro-Electric and ScottishPower.

<sup>25</sup> see Conditions 12 and 13, 14, 16 and 17 respectively of the ScottishPower Public Electricity Supply Licence.

British electricity utilities and benefited their customers: again, in this sense it could be regarded as a Public Service Obligation.

It might also be worth noting that an informal price cap has been applied to the supposedly competitive generation market in England and Wales via an agreement between PowerGen, National Power and the Regulator<sup>26</sup>. On the same principles as mentioned above this could also be regarded as the imposition of a Public Service Obligation.

#### **4.6 Conclusions**

When the creation of a competitive electricity market was being planned in the late 1980's no one knew for sure how the restructured industry would work. Even if the Government of the day did not believe the worst predictions of the opponents of the new structure as to its impact on energy security, prices or services for disadvantaged customers, it could not afford to ignore them. The Act that it negotiated through Parliament left the Government with substantial powers to intervene in the electricity industry and competition was introduced at a cautious pace.

Thus far liberalisation has proved a success in as much as tariffs for all groups of customers have come down<sup>27</sup>, standards of service have either been maintained or improved<sup>28</sup> and no major problems have arisen over security of supply. Electricity is an industry which typically operates in 10 and even 20 year or more timescales, so in relative terms the new structure of the British industry is still in its infancy. While problems may yet arise, it would be fair to say that the present competitive market has not had the dramatic adverse effects which some of its critics feared it would have.

It would be tempting to conclude from this that the final opening of the British electricity supply market after April 1998 will have no adverse effects. This misses the point that all the most problematic groups of customers are in the under 0.1 MW supply market - i.e. the one about to be opened. The fact that these customers have not lost out thus far has had, arguably, more to do with regulation than it has with market forces.

The next chapter examines the strains that the 1998 liberalisation may put upon the regulatory framework within which the industry operates. In particular, it looks at whether a new definition of the electricity industry's social obligations will be needed.

## **5. SOCIAL POLICY AND THE BRITISH ELECTRICITY SECTOR AFTER 1998**

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<sup>26</sup>See statement by Professor S.C. Littlechild, Director General of Electricity Supply *Pool Pricing and the Undertaking on Pricing Given by National Power and PowerGen*, 26 January 1995.

<sup>27</sup>For figures on this see OFFER Annual Report 1995, Chapters 2 and 4

<sup>28</sup>*ibid.*, Chapter 6

When opponents of electricity liberalisation talk about its adverse social consequences they are generally referring to one of two scenarios: job losses in the incumbent electricity utility forced by a more competitive environment and higher prices for smaller customers or special needs customers as the market participants scramble after the larger, more lucrative customers<sup>29</sup>. The incumbent utilities in Britain have all shed jobs since liberalisation<sup>30</sup>, but the British Government has always taken the view that these losses are acceptable in view of the benefits that a more efficient electricity industry brings to other sectors of the economy. The possibility of price rises, or poorer services, for disadvantaged groups of customers, in contrast, has been a much more sensitive issue in Britain and policy makers have gone to considerable lengths to prevent this scenario being fulfilled.

### **5.1 Social Obligations and the Electricity Act 1989**

The explicit social obligation placed on Public Electricity Suppliers (PESs) by the Act itself is the "duty to supply" (discussed in section 4.4 above), while their licences oblige PESs to provide special services for the elderly and the disabled (see section 4.5 above). PESs have a duty to charge their customers on the basis of published tariffs<sup>31</sup> and Section 18 (4) of the Act prohibits them from "unduly discriminating" against any individual or class of customers<sup>32</sup>. At the same time, though, Section 18 (1) of the Electricity Act 1989 explicitly foresees that a PES's could have different tariff charges relating to different "areas, cases and circumstances" provided the PES can make a cogent economic case for its tariff structure<sup>33</sup>.

Just where the balance lies between the principle of cost reflective pricing contained in Section 18 (1) and (2) and the principle of non-discrimination contained in Section 18 (4) is unclear. The short answer is probably that it very much depends on the view taken by the Regulator or the Secretary of State of the day

With the introduction of competition in the over 1 MW and over 0.1 MW markets in 1990 and 1994 respectively PESs have been obliged to offer lower tariffs to customers in these markets and to negotiate individual contracts with their largest customers. In many ways, though, this is

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<sup>29</sup>see for example the story ELECTRICITY RULING WILL 'FORCE UP BILLS AND HIT JOBS' Sunday Times (Republic of Ireland edition) 23 June 1996

<sup>30</sup>As noted already, ScottishPower went from 9263 employees in March 1990 to 8040 employees in March 1995.

<sup>31</sup>see Section 18 of the Electricity Act 1989

<sup>32</sup>see *ibid.*, subsection 4

<sup>33</sup>see *ibid.* subsection 2

not much different to practice before liberalisation or practice in other European countries: large industrial customers have always been offered cheap electricity, all that has changed in Britain is that the threshold at which customers have bargaining power has been lowered. What is perhaps more remarkable is how little use the PESs have made of their right to charge differential tariffs to franchise customers.

The factors which explain why all the PESs have chosen to apply a uniform tariff to domestic and other under 0.1 MW customers<sup>34</sup> are various. Chief amongst them, probably, is that up until now there has been little incentive to do otherwise. The anger of whichever group of customers was charged a higher tariff would more than outweigh the gratitude of those customers subject to a lower tariff. Given that there are well defined channels for turning such anger into political pressure via the Customers' Committees established by Section 2 of the *Electricity Act 1989*, given that as regulated businesses the PESs are vulnerable to political pressure and given that all the under 0.1 MW customers have to buy from the PES in any case, differentiation is more trouble than it was worth. The equation changes, however, when this market is opened up to competition on 1 April 1998.

## **5.2 The Economics of Electricity Supply after 1 April 1998**

Electricity supply is the customer service, billing and marketing component of the delivery of electricity to customers. It is this component which is being opened to competition in 1998: transmission and distribution will remain regulated monopoly businesses while generation has already been opened to competition since 1990. Even assuming that significant efficiency gains can be made in the supply business these savings will not lead to big reductions in the average household's electricity bill since supply costs account a very small percentage of the average bill. Add to this the fact that multi-million pound investment programmes are underway in both Scotland and England to establish the necessary infrastructure to make the new market work, costs which will in the end be passed on to the customer, and that whatever savings are made in customer service and billing, marketing costs are likely to increase in the competitive market and it is possible that new costs could cancel out any efficiency gains made. Regardless of this, however, new entrants to the domestic electricity supply market will have to offer significant benefits to customers if they are to persuade them to change supplier.

The electricity which new entrants will be selling will be exactly the same as the electricity offered by the local PES. Innovative payment methods or enhanced customer care might attract some households, but most people will be looking for a price discount in order to persuade them to switch suppliers. The two ways in which a new entrant to the under 0.1 MW electricity supply market can compete on price are either to find a source of generation which is cheaper

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<sup>34</sup>No PES has yet differentiated its price per unit between high use and low use customers although some PESs, such as ScottishPower, apply an equipment rental charge to customers using prepayment meters and give discounts to customers paying by direct debit.

than the generation used by the local PES, or to differentiate the customer base in such a way as to target high usage customers.

There are conflicting views within the industry on the scope for increased supply competition to drive down prices in the generation market.<sup>35</sup> Assuming this source of competitive advantage is available, however, it will be more easily accessible to existing utilities, which already have a large customer base and are attacking the franchise markets of other PESs, than to completely new entrants to the market.

Few industry analysts dispute that there is scope for new entrants to gain competitive advantage by attacking the cross subsidies which exist to a greater or lesser extent in all PESs under 0.1 MW tariffs. Most analysts agree that high usage customers are paying too much and low usage customers too little and that, particularly within the PES domestic tariff, there are groups of customers which are disproportionately expensive to service. It should be not too difficult for new entrants to devise tariffs which cut the bill for the larger, more lucrative under 0.1 MW customers at the same time as avoiding the more costly customers. The problem with this approach is that if the customers which currently provide the cross subsidies are "cherry picked" by new entrants the tariff for the remaining PES customers may eventually have to be increased.

### **5.3 Anatomy of the Tariff Cross-subsidies**

Any tariff will contain some element of cross subsidy within the group of customers it covers in as much as is it based on the characteristics of the average customer. Individual customers within the group will be "winners" or "losers" to the extent to which they differ from the characteristics of the average customer. The likelihood is that the bigger the group covered by a tariff the bigger the scope is for individual customers to depart from the norm and either be "winners" or "losers".

The typical PES domestic tariff will cover upwards of a million customers. Very few of these customers will have exactly the same characteristics of the "average customer" on which the tariff is based, though many may be there or thereabouts. It is likely that all sorts of cross-subsidies are in operation within the domestic tariff to the extent that customers differ widely in:

- their demand profile;
- the demands they place on customer service;
- their creditworthiness.

It may be that it will take a number of years of a competitive market for the significance of some of these cross-subsidies to become apparent. Some of the cross-subsidies may never be

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<sup>35</sup> For an analysis of the constraints on price competition in the generation market see *Electricity Generation in England and Wales - a Competitive Market?* Gill Brodie, MBA Thesis Strathclyde University 1995.

quantified - for example, unless and until the domestic market moves to half-hourly metering customers who cook their dinner at 8pm, after the height of the evening demand peak, will continue to subsidise customers who cook their dinner at 6pm. However, there are two major cross-subsidies which are already apparent and which are fairly easy to quantify. High consumption customers are cross-subsidising low consumption customers and customers who settle their bills by direct debit are cross-subsidising customers who use other, more expensive, payment means.

#### **5.4 "Cherry Picking" and Social Obligations after 1 April 1998**

Within the domestic tariff the customers who are relatively more costly to supply are households with low usage who pay their bills by more administratively burdensome means of payment such as cash, cheques, the various budgeting schemes (e.g. electricity stamps) offered by some PESs or prepayment meters. The customers which tend to be providing the cross-subsidy are households which use large amounts of electricity and which pay their bills by direct debit. It is unwise to generalise too much about the demographics of these different groups, but the first groups of customers will tend to contain more disadvantaged and low income households and the second group will tend to contain more high income households<sup>36</sup>.

Two possible scenarios post-1998 are that competition will force a rebalancing of domestic tariffs in favour of high usage, low maintenance customers, or that incumbent PESs will be left with all the undesirable customers and a tariff structure which obliges them to loose money. Fuel poverty activists on some of the Consumers' Committees lose sleep at night worrying about the first of these scenarios while managers in some of the PESs lose sleep worrying about the second scenario. The questions which arise are, to what extent will the Regulator allow new entrants to cherry pick? And what will it mean for the PESs if they do?

The position taken by the DGES is that he needs to strike a balance between making the regulatory environment sufficiently attractive to new entrants and protecting smaller customers<sup>37</sup>. While recognising that a Second Tier supplier targeting domestic customers should be obliged to offer terms to customers throughout the PES area it is targeting, it looks as if the Regulator will stop short of requiring that they should all be offered electricity on the same terms. Though Second Tier suppliers entering the domestic market will probably be obliged to offer a range of means of payments to customers, they will not have to offer them at the same

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<sup>36</sup>The situation is far from simple. For example, the lowest usage, and therefore most heavily cross-subsidised, type of household are those used as second homes, a preserve of the relatively affluent. There are also many low income families amongst the category of large users of electricity as their homes are more likely to be installed with electric central heating (which is cheaper to install, though more expensive to run, than gas central heating).

<sup>37</sup>See *The Competitive Electricity Market from 1998: Customer Protection, Competition and Regulation* OFFER November 1995.

price. Although this might mean that a Direct Line Insurance style energy supplier obliged to offer prepayment meters as well as direct debit could offer meters at a price which would preclude anyone wanting to pay by prepayment meter signing up with them, the OFFER view seems to be to wait and see what competition brings.

Though not explicitly stated the attitude within OFFER seems to be that some degree of cherry picking is inevitable. It would be surprising if a competitive market did not favour some groups of customers more than others. Competition is about promoting choice and innovation, both of which imply differentiation. What matters is that better prices and services for some groups of customers do not lead to worse prices and services for other customers.

OFFER starts from the assumption that competition will benefit everyone. It is bullish about the prospects of the market delivering cheaper supply transaction costs, not just for direct debit customers but for all customers, including those on budget schemes and prepayment meters. Officials in OFFER also believe that the more competitive supply market after 1998 will lead to a more competitive generation market: players in the supply market will be motivated to shop around for ever better generation contracts. Accordingly, they anticipate that a significant margin of cost saving will be freed up to allow for price cutting in the under 0.1 MW market, and while not all customers will benefit to the same degree, no one is likely to see their bills go up as a result of competition.

There is a contrary view that says increased supply competition will have little impact on the generation market, the efficiency gains to be made in the supply business are very small and that discounts for one group of under 0.1 MW customer will eventually have to be funded by higher bills for other customers. OFFER refuses to speculate on how it would react if this scenario proves to be correct, but it is probably fair to speculate that, post-1998, if an incumbent PES were to propose a significant increase in its tariff for prepayment customers or low usage customers the first thing that OFFER would do would be to investigate whether the price hike was caused by market forces or by the PES abusing its market power. If, as seems likely, incumbent PESs retain 80% - 90% of the domestic customers in their area in the first few years of the new market OFFER is more likely to view such price hikes as the product of PESs abusing their power than the dictates of the market.

If OFFER decided that higher electricity bills for low usage, low income customers was indeed the natural outcome of a competitive market the DGES could possibly interpret his general duty under Section 3 of the Electricity Act 1989 to "ensure all reasonable demands for electricity are met" as giving him a mandate to set up some sort of cross subsidy scheme for these customers. In practice industry Regulators have tended to see the promotion of competition and economic

efficiency as their overriding aim and to view the pursuit of wider social aims as outside their remit <sup>38</sup>. It is unlikely that Professor Littlechild, the present DGES, would differ from this view.

The way the British system of electricity regulation works a political problem such as a threatened increase in bills for socially disadvantaged customers would have to be met by a political response. As discussed above the relevant Secretaries of State in Scotland and England retain wide ranging powers over the industry which they could no doubt use to impose a solution. Whether they were motivated to do so would depend on the level of political protest that higher bills for disadvantaged groups provoked: a small price hike in one PES area might pass unnoticed, large price hikes throughout Britain probably would not.

### **5.5 Regional Policy and the Electricity Industry After 1998**

The urban / rural divide has little bearing on the cost of electricity supply. Distance makes only a marginal difference to the cost of providing customer service, billing and marketing and a prosperous high usage rural householder who pays by direct debit is as attractive a proposition to an electricity supplier as his urban counterpart. The big differentiation between urban and rural customers is the cost of providing the infrastructure to deliver the electricity to them. Since use of system will remain a regulated monopoly, 1998 will have little or no impact on the cost of supplying electricity to rural areas.

As observed above Section 18 of the *Electricity Act 1989* explicitly foresees that a PES could differentiate its tariffs, including use of system charges, geographically. This is balanced by Article 3(4) of the Act which places a duty on the DGES to take account of the interest of rural customers when reviewing PES tariffs. Exactly what this means has never been determined as no PES has yet sought to differentiate its tariffs on a geographical basis. This is partly because the bad feeling generated in whichever area was put on a higher tariff would outweigh the gratitude of the customers charged a lower tariff and partly because the economics of use of system costs are a lot more complicated than just looking at the kilometres of cable per customer in a given area. Costs also depend on the sub-station infrastructure, which is often much lower cost in rural areas and the cost of maintenance of power lines. This later cost can be higher in urban areas than in some rural areas as urban power lines tend to be buried.

The area of Britain where the case for charging remote customers higher use of system charges is most clear cut is the Scottish Hydro Electric area. It is probably no coincidence that Scottish

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<sup>38</sup>See for example the evidence of Professor B. Carsberg, then Director General of the Office of Telecommunications, to the House of Commons Energy Committee hearing on the gas industry, 12 December 1985 especially Memorandum 18, Supplementary Note by Professor Carsberg.

Hydro Electric is the only PES specifically precluded by its licence from differentiating tariffs on the basis of location. It is interesting to note that the Regulator is proposing to extend this licence condition to Second Tier Suppliers wishing to target the domestic market in the Scottish Hydro-Electric area<sup>39</sup>.

## **5.6 Conclusions on Social Obligations after 1998**

Though the *Electricity Act 1989* contains warm words for elderly customers, disabled customers and customers in rural areas it gives no cast iron guarantees that they will be supplied electricity at an affordable price. Thus far a mixture of the Regulator's price control, the Consumers' Committees' political pressure and the industry's desire for a quiet life have ensured that all groups of customers have received a reasonably equitable deal. Whether this proves adequate post-1998 will depend on a number of factors, including the attitude taken by new entrants and the intensity of the competition which develops in the under 0,1 MW market. The chief factor which will determine whether or not social obligations become a major issue, though, is what happens to the price of wholesale electricity.

If the price of wholesale electricity decreases over the coming years it may be possible to rebalance tariffs for under 0.1 MW customers without producing any "losers". This is already happening to some extent: for example, ScottishPower this year rebalanced its tariff between under 0.1 MW business customers and domestic customers in the context of price cuts for both (the domestic tariff was reduced by 5%, the business tariff by 15%). Nonetheless, as someone with but a few weeks experience of the generation market it is difficult for me to expound with great confidence as to where prices are likely to go over the coming years<sup>40</sup>. Prices have been on a downward trend recently and new entrants are beginning to build power stations but the market is noted for its volatility and the big two English generators are noted for their market power - witness for example their informal price control agreement with the Regulator<sup>41</sup>. Wholesale prices may well be continued on their downward path by increased competition in the supply market but there is no guarantee of this.

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<sup>39</sup>See *The Competitive Electricity Market from 1998: Customer Protection, Competition and Regulation OFFER* November 1995

<sup>40</sup>For a fuller and much more expert account of competition in the generation market see *Electricity Generation in England and Wales - a Competitive Market?* Gill Brodie, MBA Thesis Strathclyde University 1995.

<sup>41</sup>See the statement by Professor S.C. Littlechild, Director General of Electricity Supply *Pool Pricing and the Undertaking on Pricing Given by National Power and PowerGen*, 26 January 1995.

If tariffs for some groups of customers are forced up by competition this will not necessarily make electricity unaffordable to those groups nor will it necessarily become a political issue if the increases are small and phased in gradually.

The worst case scenario is that fierce competition from day 1 of the new market mean that some groups see a sudden jump in their electricity bills. The increase would not be huge in absolute terms but may be significant enough for some customers to provoke a political storm. British policy makers might be forced to devise some sort of subsidy mechanism or market distortion to help these customers, but this would not be an insurmountable difficulty. Such schemes already exist to ensure that the competitive generation market includes some renewables in its fuel mix<sup>42</sup> and one could easily imagine various types of schemes aimed at social obligations.

## **6. THE BRITISH CONTRIBUTION TO THE EU PUBLIC SERVICES DEBATE**

Given the long time horizons which the electricity industry operates to Britain's competitive electricity market is still, in relative terms, in its infancy. It is also a market which is still evolving. With the opening of the under 0.1 MW supply market in 1998 Britain will go from having a competitive market covering several thousand medium to large business customers to a market covering some 22 million households and every business in the land. With these two provisos in mind, and particularly in view of the quantum leap the competitive market will take in 1998, it is difficult to draw too many firm conclusions about whether competition in general is a good or bad thing, though I will make a few observations. It is, however, rather easier to edge towards the conclusion that a partial opening of the electricity supply market can be managed in such a way as to avoid any dramatic adverse consequences. Since a partial opening of their supply market is exactly what many EU Member States are faced with when the Electricity Directive is finally passed, this conclusion is a very relevant one.

### **6.1 Lessons for Partial Opening of the Electricity Supply Market in other Countries**

The British experience shows that a partial opening of the electricity supply market allowing competition for larger customers need not prejudice the interests of smaller customers. Since such a partial opening is exactly what is being proposed in the draft EU Electricity Directive<sup>43</sup>, the British experience should be of interest to Governments and consumers groups in other EU Member States.

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<sup>42</sup>the Non-Fossil Fuel Obligation in England and Wales and the Scottish Renewables Orders in Scotland

<sup>43</sup> For a description of the "Common Position" text of the Directive see the digest of it in *Agence Europe* of 10 July 1996.

Britain's success in holding down, and even decreasing, tariffs for smaller customers can be put down to two main factors:

- the system of price control on the incumbent utilities' monopoly businesses;
- the fact that even after the opening up of competition in the over 0.1 MW supply market, the size of the incumbent utilities' supply monopoly was still large enough to support cross-subsidies

Exposure of the whole electricity supply market to competition after April 1998 when this monopoly ends could end up meaning that some groups of customers will see their electricity bills increase. As discussed in the previous chapter, whether or not this happens will depend on the type of competition faced by incumbent utilities, where the price of wholesale electricity goes in the coming years and the extent to which the market is left to find its own prices free from political interference. Nevertheless, Britain currently manages to hold down prices for smaller customers and disadvantaged groups at the same time as having a higher level of competition in the electricity supply market than that foreseen in the draft Directive. Thresholds for competition will, of course, have different impacts in different countries according to the mix of customers in their markets, but even allowing for this the current level of market opening in the Britain is so far in advance of that proposed in the draft Directive<sup>44</sup> that the British experience must be of relevance to other Member States.

The British experience of liberalisation shows that competition at the top end of the market can be managed in such a way as to avoid price increases at the lower end of the market. Indeed, it is fair to observe that if some form of price control is *not* imposed on the monopoly supply market then there will not be true competition in the liberalised part of the market: an incumbent utility able to make excessive revenues from its captive customers would have an unfair advantage over new entrants.

The British experience also shows that partial market opening need not have dramatic adverse consequences for other public policy objectives such as fuel security and environmental protection. Mechanisms have been found, for example, to reconcile competition in the generation market with the policy priority of retaining nuclear power and renewable energy in the fuel mix.<sup>45</sup> 6 years of liberalisation is perhaps not long enough to conclusively prove that

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<sup>44</sup>The draft Electricity Directive defines thresholds in terms of customers' total annual consumption of electricity (Gigawatt Hours - GWh) whereas the British thresholds are based on maximum demand capacity (Megawatts - MW). The maximum market opening the Directive requires is that by 2003 customers with an annual consumption greater than 9 GWh should be allowed to choose their supplier. Though the thresholds are not *directly* comparable, this is about 50% higher than the 1 MW threshold put on the competitive market when it was introduced in Britain in 1990. As of 1994 the threshold for competition in the British market has been 0.1 MW.

<sup>45</sup>see Chapter 4.4 above

there will always be ways and means of reconciling such policy priorities with the competitive market, but the British experience does give grounds for optimism.

## **6.2 Public Service, Social Justice and Competition**

Critics of liberalisation often appear to be starting from the assumption that State owned monopolies are very benign organisations with deep rooted social consciences. This certainly was not the case with the old Electricity Boards in Britain. During the 1970s they were disconnecting so many low income families and pensioners for non-payment of bills that the Government of the day commissioned research into why this was happening and how much hardship it was causing<sup>46</sup> In terms of the number of disconnections and the level of domestic tariffs<sup>47</sup> disadvantaged groups in Britain are getting a significantly better deal now than they were prior to privatisation. I have found no authoritative Europe wide data for disconnections, but conversations with people in different European utilities suggests that the British electricity industry is probably disconnecting fewer customers than most of its counterparts. Domestic tariffs in Britain also compare favourably to those in other European countries<sup>48</sup>.

It would be an interesting piece of research to compare how electricity industries in different European countries behave towards their more disadvantaged customers. Due to time constraints I have been able to do no more than gather anecdotal evidence, but my impression is that the performance of the British industry is not out of line with the performance of the industries in other European countries. It is certainly no worse than that of the old Electricity Boards.

In the debate over Public Services in Europe it is worth separating the question of what should be happening from the analysis of what actually is happening. When discussing social obligations the views of the managers of State owned monopolies and those of managers in the British industry are remarkably similar, and could be paraphrased as follows. The job of the electricity industry is to provide a high quality service at a reasonable price. If some citizens are

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<sup>46</sup>*Fuel Debts and Hardship: A Review of the Electricity and Gas Industries' Code of Practice*, Richard Berthoud, Policy Studies Institute report no. 601, November 1981

<sup>47</sup>detailed figures for these and other service indicators can be found in the OFFER Annual Report 1995, but to take an example ScottishPower disconnected 10 customers in 1995 compared to [100,000] in 1990.

<sup>48</sup>see *UK Electricity '95*, the Electricity Association. In 1995 UK domestic customers typically paid 9.23 pence per kWh compared to 13.74 pence per kWh in Germany 11.93 pence per kWh in France and 10.84 pence per kWh in Italy. A small note of caution should be sounded in that these prices include VAT and VAT on electricity in the UK at 8.5% is amongst the lowest in Europe. This notwithstanding it is clear that prices paid by British householders are not excessive

so poor that they have problems paying their electricity bills this is a matter for the Social Security system, not the electricity industry.

The British experience shows that the performance of a partially liberalised electricity industry towards socially disadvantaged customers can be made at least as good as that of a State owned monopoly. Whether this continues to be the case when the whole of the electricity supply market is open to competition remains to be seen.

The only substantive ground for attacking the social performance of the British electricity industry to date is that the incumbent utilities have shed a lot of jobs since privatisation<sup>49</sup>. Whether or not keeping the electricity industry as a total monopoly is a cost effective means by which to maintain levels of employment would be an interesting subject for further analysis.

## **GLOSSARY OF ACRONYMS AND TECHNICAL TERMS**

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BEA	British Electricity Authority
CEB	Central Electricity Board
CEGB	Central Electricity Generating Board
CFD	Contract for Differences
DGES	Director General for Electricity Supply
EC	European Community
EU	European Union
GWh	Gigawatt hour
MW	Megawatt
NSHEB	North of Scotland Hydro-Electric Board
OFFER	Office for Electricity Regulation
PES	Public Electricity Supplier
SSEB	South of Scotland Electricity Board
TPA	Third Party Access (to infrastructure)

Generation generation of bulk supplies of electricity

Transmission movement of electricity over the national high voltage network

Distribution movement of electricity over local and regional networks

Supply retailing of electricity to the final customer

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<sup>49</sup> see Chapter 5 above

The Franchise the PESs monopoly supply market  
National Grid the England and Wales Transmission Grid  
The Pool the National Grid spot market for electricity  
The Regulator the Director General for Electricity Supply  
Second Tier Supplier a supplier other than the local PES  
Incumbent Utility the local PES

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