



## EUROPEAN COMMISSION 2005 REPORT ON THE FUNCTIONING OF THE ELECTRICITY AND GAS DIRECTIVES

# Comments of UEAPME regarding the the effects of energy market opening on SMEs

It is a well-known fact that 99.8 % of all European enterprises are SMEs. 93.4 % of all enterprises are even micro-businesses employing less than 10 staff.

The opening of energy markets has often been described as significant opportunity for SMEs and small business associations have unanimously welcomed this development. Still, large companies and consumer associations showed a much stronger interest than the small business sector. A study by UNIZO, the Flemish UEAPME member, showed that only 6.5 out of the 33,000 SMEs have switched to a new supplier since market opening. This relative restraint is due to a number of reasons:

### 1. Small share of energy costs in total costs

Most of the 22 million SMEs are offering services rather than production. However, for a typical small service provider, the energy bill amounts to only 0.55 % of turnover. These businesses are not particularly motivated to swap their energy supplier.

### 2. Small cost savings potential due to low bargaining power

Even SMEs with more significant expenses for energy benefit only marginally from market opening. The bargaining power even of energy intensive SMEs is usually too low to obtain significant cuts in tariffs. The following table shows that small consumers usually pay a two times higher price for electricity than large companies.

Electricity prices in Euro per 100 kWh in 2003 (all taxes included)<sup>1</sup>

	Industry	Small consumers
Austria	5.65	12.95
Finland	5.65	8.36
Germany	7.02	15.65
Spain	5.00	9.76
Sweden	6.20	12.38
UK	4.60	9.16

While this situation has to be accepted as a natural consequence of market opening, it leads undoubtedly to a weakening of the SMEs' competitive position.

<sup>1</sup> EU Energy and transport in figures – statistical pocketbook 2004, part 2, chapters 2.3 and 2.5

One solution is the pooling together of several small enterprises in joint purchasing structures, which would increase the volume of energy and, thus, increase the bargaining power. This strategy is promoted by small business associations. The fact that the number of such energy pools is still low may be due to the legal and organisations problems involved.

### 3. Price reductions after market opening have disappeared

While market opening has usually led to sinking tariffs in the short term, prices are back to “pre-liberalisation” levels in most countries.

**Current electricity prices for households in Euro per kW/h (all taxes included)<sup>2</sup>**

	<b>1995</b>	<b>2000</b>	<b>2003</b>
<b>Austria</b>	12.73 (1999)	12.35	12.95
<b>Finland</b>	7.35	7.48	8.36
<b>Germany</b>	14.69	14.04	15.65
<b>Spain</b>	11.25	10.01	9.76
<b>Sweden</b>	9.28 (1999)	9.52	12.38

Three obvious reasons contributed to this development:

- a) Introduction of “eco-taxes” on energy products such as gas and electricity;
- b) Increasing prices for petrol and gas on world markets;
- c) Lack of competition on energy markets.

While it is true that state-controlled monopolistic utilities disappear with the implementation of the relevant EU directives, they are, in many cases, transformed into privately run quasi monopolies or oligopolies. This increases the entrance barriers for new energy suppliers and makes it difficult for small businesses to find a serious alternative. In addition, speedy market consolidation leads to a further reduction of important competitors. Hence, the period of harsh competition immediately after market opening has come to an end. Today, competitive pressure is much lower and profit margins of the major suppliers are rapidly increasing.

The Commission report on network industries<sup>3</sup> confirms this trend and states that “M&A activities have mainly involved companies active in the same domestic market”. Furthermore, “despite entry, most markets are still dominated by incumbents, indicating that new entrants have been so far unsuccessful in challenging them.”

**Belgium:**

Electrabel and its satellite SPE control 95 % of electricity production. New suppliers have the buy electricity from the quasi monopoly or import it. The latter option is not realistic due to high transmission tariffs and low cross-border capacities.

**Germany:**

The “big 4” (Eon, RWE, Vattenfall Europe and EnBW) officially control 80 % of the market. As they are the successors of former regional monopolies, their real market share at regional level is significantly higher.

### 4. Lack of transparency in price offers

Market opening led to a multiplication of price offers. They differ not only in the tariff applied, but also in duration, possibilities to increase tariffs, minimum / maximum consumption etc. Small enterprises usually do not have the time to figure out which out of the dozens of different formulas suits them best. Consequently, they stay with their traditional supplier.

<sup>2</sup> EU Energy and transport in figures – statistical pocketbook 2004, part 2, chapter 2.5.6

<sup>3</sup> Commission Staff working Paper “Horizontal Evaluation of the Performance of Network Industries Providing Services on General Economic Interest SEC(2004) 866 (2004 report) (pages 23 and 25)

## 5. Complicated procedures

In several countries there seems to have been a poor transfer from the old system to the new. For example, in Ireland, very little communication from the Electricity Supply Board (ESB) regarding changes in procedures has been forthcoming.

- There has been a loss of accountability, whereby all applications for connections must be processed through a central office. It is very difficult to get any direct contact with a technician or scheduler to discuss the application. SME are left talking to telephone administrators who are completely oblivious to the needs of SME seeking connections.
- Developers have great difficulty with regards to the issuing addresses to the ESB prior to construction of the development. This means that if any changes occur during the construction, the developer is liable for the costs involved in changing the addresses from the original submission.

## Negative side effects of market opening

While most SMEs welcome market opening, others, such as specialist engineering contractors (electrical, HVAC, sanitary), energy advisers and auditors and small ESCOs have to face new, financially strong competitors and often complain of unfair competition.

Many energy suppliers have developed services downstream the supply chain including installation, inspection and maintenance of energy-using building equipment (heating, lighting etc.). To do this, they either take over specialist private companies or they establish energy service division using staff that has become redundant in the restructuring process. As energy suppliers dispose of address lists of all their clients, they can easily and efficiently promote additional services linked to energy sales. Small independent service providers have to buy address lists or contact potential clients individually.

While the downstream integration itself has to be accepted by independent energy efficiency specialists, a number of questions remain as to the way this is done.

### 1. The issue of cross-subsidies

The legislation<sup>4</sup> on the opening of energy markets includes clear provisions on the unbundling of energy-related services (transmission, sales, related services) also from an accountancy point of view. Cross subsidies are not allowed in this new system. However, many small service providers feel that energy suppliers allocating financial aid directly or indirectly to their energy service units (financing of advertising campaigns, billing, integrating service prices in tariffs etc.).

It was therefore somewhat astonishing to see that Art. 10 (b) of the Commission proposal for a Directive on the Energy End-use Efficiency and Energy Services (COM(2003) 739

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<sup>4</sup> Directive 54/2003/EC (Art. 19 (3): "Electricity undertakings shall, in their internal accounting, keep separate accounts for each of their transmission and distribution activities as they would be required to do if the activities in question were carried out by separate undertakings, with a view to avoiding discrimination, cross subsidisation and distortion of competition. They shall also keep accounts, which may be consolidated, for other electricity activities not relating to transmission or distribution."

Directive 55/2003/EC (Art. 17 (3): "Natural gas undertakings shall, in their internal accounting, keep separate accounts for each of their transmission, distribution, LNG and storage activities as they would be required to do if the activities in question were carried out by separate undertakings, with a view to avoiding discrimination, cross-subsidisation and distortion of competition. They shall also keep accounts, which may be consolidated, for other gas activities not relating to transmission, distribution, LNG and storage."

final) foresaw the possibility of “costs for investments made on the energy end-use side by distribution companies by including them in their distribution tariffs, where appropriate,

having due regard for the need to ensure equal competition and a level playing field for other providers of energy services”.

It is to be welcomed that the European Parliament removed this clause in their first reading position. Member States also seem to be in favour of a removal.

## **2. Obligation to offer energy services**

Article 6 (a) of the directive on the Energy End-use Efficiency and Energy Services (COM(2003) 739 final) wants to oblige energy distributors and/or retail energy sales companies to “offer and actively promote energy services as an integral part of the distribution and/or sales of energy to customers, either directly or through other energy service providers”. Such a practice seems rather strange in an open market environment. In addition, it ignores the fact that tenths of thousands of specialised enterprises are already active across Europe in this market, for which energy efficiency services have increasingly become a part of their core business. They include technical contractors, energy service companies, engineers etc. For the reasons outlined above, these independent businesses find it difficult to live up against the competitive pressure from large energy suppliers.

## **3. The issue public guarantees**

A number of energy suppliers are still (partially) owned by public authorities. This led to complaints of unfair competition in particular in the case of German municipal power plants. Many of them are very active in the field of installation and maintenance of technical building equipment. Due to their public ownership, they cannot go bankrupt and enjoy refinancing costs, which are significantly lower than those of private businesses. Many specialist engineering contractors say that this practice leads to distortions in market prices.

## **4. In-house contracts**

Questions also arise from municipal power plants which are entirely owned by a local authority and which offers installation and maintenance services to municipal buildings (schools, town hall etc.). Municipalities may feel tempted to give this works contract directly to its municipal power plant without a public procurement procedure, as the Stadt Halle Jurisprudence (C-26/03) of the ECJ would not apply in this case.

Would the Teckal-Jurisprudence (C-107/98) exclude such practice?

# **Conclusions**

Most SMEs do not really feel concerned by energy market opening as they do not see themselves as beneficiaries. On the other hand, while there is a certain disappointment with the effect of market opening, most SMEs do not see major problems neither.

UEAPME invites ERGEG and the European Commission to look into the following issues:

## **1. Increasing the transparency of price structures**

While energy suppliers should be free to develop innovative formulas responding to the needs of specific user groups, they should be committed to full transparency in their offers. Energy regulators should examine the effects of complicated offers on consumer choices. At the same time, energy regulators should encourage the European Commission to work towards harmonisation of the structure of price offers with the aim of achieving full transparency in terms of

- Tariffs and additional charges
- Duration of contracts
- Possibilities to increase tariffs
- Minimum / maximum consumption etc. etc.

This could be part of a CEN standard mandated by the European Commission.

## **2. Energy services – an issue of real unbundling**

National regulators have mainly been busy with examining the unbundling between energy transmission and sales. There was little attention relating to downstream services such as energy advice, energy audits, installation, maintenance, performance contracts etc. The energy regulators should also examine the risk of cross-subsidies at this end of the market. A particular focus should be placed on the following issues:

- Internal financing of energy services (advice, installation, maintenance etc.) in energy supplying companies including, marketing campaigns, billing and price structure.
- Regulators' view on the obligation on energy suppliers to offer and actively promote energy services. Is this compatible with the freedom of decision of private companies? Is this obligation acceptable even if it goes to the detriment of other market players.
- What are the repercussions of ECJ rulings on state guarantees for banks on the status of municipal power plants?
- How should in-house contracts be defined in the case of municipal power plants?

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