

ENERGY REGULATION AND CONSUMERS' INTERESTS

FINAL REPORT

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Introduction

This report is the final product of a two-years research project funded by the European Commission, DG Sanco, on the protection of energy consumers.

More specifically, the Commission asked the applicants to:

- List the competencies of National Regulatory Authorities regarding issues related to consumption in a general sense; make a comparison among Member States (Are consumers considered homogeneously by NRAs? Have consumers associations a specific role?);
- Evaluate and compare quality and added value of the NRAs' intervention to consumer's benefits; collect concrete/practical examples; identify good practices and as well as shortcomings;
- Clearly illustrate useful recommendations, in order to have the NRAs consider consumers issues thoroughly.

To accomplish these objectives, we proceeded as follows:

- a) Firstly, we collected national laws and regulations implementing the first and second electricity and gas directives;
- b) Secondly, we sent a questionnaire to each of the eight partners in this project and asked them to describe the main characteristics of their national energy systems, with a special emphasis on the measures aimed at protecting residential electricity and gas consumers in the new environment created by the liberalization process;
- c) Thirdly, we used the information collected to evaluate the effects of the liberalization process on the welfare of residential consumers and to advance some recommendations.

The research project was conducted between July 2005 and June 2007. The first phase of the project was devoted to data collection. Three main channels were used: the first was a six-parts questionnaire with 42 questions on the most important aspects of regulation of retail energy markets. It was sent to partner consumer associations in October 2005 and returned by most of them in the Spring of the following year. The text of the questionnaire is reproduced in Annex A, while the partners' answers are available on the website of the project, also activated in the first phase (www.energyandconsumers.net). The second channel for data collection was information contained in the official publications of international, European and national institutions, as well as in academic studies on retail energy markets. The third channel was information on energy consumers' complaints requested to the regulators of partner countries.

In the second phase of the project a methodology for interpreting the data collected was developed. Building on the insights of Law and Economics and Comparative Law, we tried to identify the main issues in the transition from monopoly to competition in residential markets. The solutions experimented in national regulatory systems were subsequently evaluated according to such theoretical framework. An interim report with preliminary results was discussed with the partners in the meeting held at Bolzano, Italy in September 2006.

In the third phase of the project the data on residential energy markets were further updated and the observations received by the partners were included in the Final Report. Whenever possible, we tried to make all information accurate as of July 1st, 2007. In this last phase the partners also conducted interviews with national regulators to collect additional information on the problems of retail markets and to get their impressions on the accuracy of the report. The transcripts of the interviews are available on the website of the project. The research team presented the Final Report to the European Commission in Brussels in May 2007.

Executive summary

The object of this report is the regulation of residential electricity and gas markets according to the rules laid down in the second electricity and gas directives. 1st July 2007, the date by which all European consumers must be free to choose their supplier, is a watershed for the European energy market, but nobody could believe it is the ending point of the liberalization process. Much work remains to be done before something resembling competition shows up in energy markets. The research presented here tries to assess whether Member States were able to design a legal and economic framework that fosters the twin goals of efficiency and protection of domestic consumers.

We now succinctly describe the contents of each chapter. Then we summarize the main findings of the project.

Contents of the chapters

The first chapter describes the methodology employed to analyse residential energy markets. It highlights the incentive structure of legal rules and the need to assess the relevance of regulatory institutions according to the legal tradition of each country.

The second chapter describes the main problems regulators shall tackle in residential energy markets. While they are not exclusive to such markets, it is suggested that they could be more difficult to solve than in other settings.

The third chapter lists the national energy laws and regulations implementing the second electricity and gas directives in the 27 Member States.

The fourth chapter describes the experiences of those countries that liberalized residential energy markets earlier than the European deadline. Problems encountered and solutions experimented could be very interesting for all countries that open their residential markets by 1st July 2007.

The fifth chapter describes the regulatory systems in partner countries, with specific reference to the institutions of consumers representation and the distribution of regulatory powers.

The sixth chapter discusses the evolution of retail energy prices in partner countries since the beginning of liberalization and its distributive impact on different categories of consumers.

The seventh chapter describes the main terms of residential energy contracts and the type of control on their contents.

The eighth chapter describes quality regulation, with special emphasis on its impact on consumers' welfare.

The ninth chapter describes energy consumers' complaints and alternative dispute resolution procedures

The tenth chapter describes the role of consumers associations in energy markets.

The eleventh chapter contains final recommendations addressed to the European Commission, to ERGEG and to national regulators.

The methodology of Comparative Law and Economics

The project emphasizes two methodological premises: the relationship between Law and Economics on one hand; the need to adopt a comparative approach to the analysis of national regulatory frameworks on the other.

Law and Economics is one of the most successful interdisciplinary approaches to the study of markets and institutions. In the last forty years it has been developing a consequentialist approach to legal rules. Its main insight is that rules have incentive effects and can be employed to alter people's behaviour. To discover the structure of incentives built in each rule or system of rules, the most important tool is a theory of behaviour, which Law and Economics borrows from economic analysis. While microeconomics studies how consumers and firms react to prices, Law and Economics studies how legal rules fix the 'price' for their addressees. Analogizing markets to institutional contexts, it is possible to make predictions on the likely impact of different legal rules.

Focusing on incentives provided for by legal rules helps to avoid the mistake of believing that liberalization will automatically increase total welfare. Instead, markets are artificial phenomena shaped by the rules that govern them. Therefore, it is of paramount importance to get incentives right.

The need for a comparative approach is prompted by the observation that in Europe coexist many different legal traditions. Although it is the aim of the European directives to harmonize the regulatory framework in the Internal Energy Market, it should be recognized that complete uniformity is very difficult to attain and, probably, not desirable at all. We shall see that the countries represented in our project display considerable variation in the institutional solutions they chose on such topics as protection of vulnerable consumers, regulation of contracts and dispute resolution procedures. What we should try to do is to assess the efficiency and efficaciousness of each different answer to the same problem. The starting point, however, is that there are many ways to do the same thing.

The problems of retail energy markets

The report is organized around four problems. Before commenting on each of them, it is useful to make some preliminary observations on the relationship between competition and consumer protection. While competitive markets are usually the best means to increase consumers' welfare, we cannot exclude that sometimes fostering competition and increasing consumers' welfare go in opposite directions. For example, increasing the number of suppliers adds to the complexity of consumers' choices. They now face costs that would not exist but for the opening of residential markets to competition. Because of such costs (and the cognitive problems to be discussed in a moment), we cannot be sure that an higher number of suppliers warrants lower prices and better quality. Therefore, consumers need help by regulators and consumer associations to make better choices and reap the fruits of liberalization.

Now suppose that liberalization policies succeed in creating reasonably competitive markets. Should we conclude that we can forgo the regulation of residential consumers' contracts? The answer is no. The problems discussed below do not disappear even in competitive markets. Therefore, the question is not whether we need consumer protection measures, but what kind of measures are better able to protect consumers without hampering competition.

We turn now to a brief discussion of the main problems of retail energy markets. It is clear that competition means enhanced ability to make choices. Unfortunately, the choices residential consumers make are often quite poor. They do not have enough information to locate the supplier who offers cheaper prices and better quality. Moreover, they try to economize on their cognitive efforts by means of simplified decision-making processes called heuristics. These mental shortcuts allow people to make choices without considering all information that would be needed to make the optimal choice. They intentionally eschew a large part of such information and focus on those cues which can guide them in the appropriate direction. This type of behaviour is what the economic literature calls bounded rationality.

Many consequences follow from these observations. Residential consumers will face search costs when trying to assess whether alternative suppliers are available. Moreover, they will incur switching costs, sometimes due to the psychological cost to leave a long-time supplier, sometimes artificially created by firms in subtle and difficult to detect ways. If search and switching costs are high, consumers will pay more and competition will be reduced.

Another consequence of asymmetric information and bounded rationality is the presence of unfair terms in the standard contracts drafted by energy firms. They have every incentive to exploit consumers' lack of information and bounded rationality by hiding onerous terms and making more

difficult to appraise their cost. By so doing they earn supra-competitive profits that would not be possible had all consumers been able to read and understand contracts.

There is also a direct link between contracting strategies and the competitive structure of markets. Firms can use complex standard forms not only because they want to exploit consumers' bounded rationality, but also because such standard forms make it easier to raise prices. If consumers find it difficult to compare offers, each supplier can use harsh terms or rise his prices without fearing the loss of too many customers. As a result, we could have supra-competitive prices even absent collusion. Moreover, complexity of contracts can also serve as a barrier to entry of new firms into the market. Consumers will find it difficult to understand that the new entrant is offering a better deal. Therefore, less consumers will switch and entry will be less profitable.

Asymmetric information is also relevant for the regulation of quality of supply. In this case, neither consumers nor the regulators have enough information to choose the optimal level of quality. Therefore, it is crucial to set incentive systems and mandatory refunds that prevent energy firms from economizing too much on quality. This is probably one of the fields in which the differences among the partner countries are more striking.

Finally, the design of energy markets should be completed with suitable dispute resolution procedures. From a Law and Economics perspective, alternative dispute resolution mechanisms can be conceived of as cost-avoiding solutions for small claims litigation. However, a number of institutional choices have to be made if they are to work effectively. First of all, it should be decided if energy consumers are better represented by the sectoral regulator, by an independent but specialized body, by a generalist consumer body or by self-regulatory industry ombudsman schemes. Pros and cons can be detected for all available options. Many of the above mentioned designs are employed in the partner countries. The most difficult task, however, is to assess their effectiveness.

The level of competition in retail energy markets

The description of the experiences of some pioneer countries shows that, when retail markets were opened to residential consumers, the needed institutional infrastructure was not put in place. With the exception of the Flemish region, the low levels of active participation on the demand side and the high levels of concentration on the supply side can be traced back to the lack of regulatory measures that reduce search costs, switching costs and entry barriers.

As far as search and switching costs are concerned, relying on general consumer law does not seem to be a fruitful strategy. Numerous factors foster consumers' inertia. Therefore, their active participation depends on more specific measures aimed at reducing the cognitive efforts they must face in the new competitive scenario. Moreover, we noted in chapter one that energy

companies are interested in raising search costs and making it difficult for consumers to compare alternative offers. ERGEG best practice propositions and Eurelectric Guidelines for Customer Switching are first steps toward the harmonisation of the different systems adopted in Member Countries. However, it is submitted that more attention should be paid to the heuristics residential consumers employ when comparing alternative offers. From this point of view, the way information is communicated by firms and regulators, as well as the contractual terms concerning the beginning and the end of the commercial relationship with the supplier, carry more weight than is generally supposed.

Entry barriers are the other side of the coin. Economics literature is increasingly supporting legal unbundling of distribution and retailing as the only measure able to stop cross-subsidies and difficult to detect strategic behaviour against new entrants. Besides structural measures, it is clear that successful retail markets presuppose efficient solutions for information exchange and switching procedures. Timing, too, is of fundamental importance. It is useless to anticipate opening if the institutional infrastructure is not ready to work.

The regulatory systems in partner countries

This chapter addresses two issues: firstly, how roles and competencies in the field of energy consumers protection are distributed among public and private institutions; secondly, which regulatory powers such institutions can use to discharge their duties.

Energy laws of all partner countries include consumers protection among the objectives of the regulatory framework. However, significant differences can be detected in the institutional solutions aimed at its implementation. Partner countries employed four models of consumers representation:

- 1) The powers are shared among NRAs and Government authorities
- 2) All the powers are attributed to the NRA
- 3) Some or all the powers are attributed to a specialized consumer body
- 4) Some or all the powers are attributed to a general consumer body

To assess advantages and shortcomings of each solution we need a more detailed description of the powers granted to the various institutions. For expositional clarity we distinguish four categories of regulatory powers:

- a) advisory powers: the institution can only make proposals to other authorities
- b) rule-making power: the institution can independently enact binding rules for energy firms
- c) enforcement powers: the institution can independently detect violations and decide the appropriate injunctive or punitive measures (usually subject to judicial review)
- d) dispute resolution powers: the institution can settle disputes between energy firms or between energy firms and their customers

Only in Belgium, Bulgaria and Greece sector regulators can exercise advisory powers, while formal rule-making powers were given to the competent Ministry. However, in Bulgaria it is suggested that the political authority usually accepts without significant modifications the proposals submitted by SEWRC. Because of the technical knowledge required to intervene in energy markets, we can safely assume that in other countries too the final decisions of the political authorities attach great weight to the opinions of the sector regulators.

The fact that in most partner countries NRAs and governmental authorities share rule-making powers leaves space to at least two interpretations. On one hand, it could be suggested that the direct involvement of political institutions warrants careful consideration of consumers' interests. On the other hand, it is equally plausible that governmental authorities give precedence to other interests, for example the maximization of the profits of energy firms under the control of the State.

The uncertainty on the consequences of direct governmental interventions in energy markets suggests that more attention should be devoted to an institutional solution adopted in a few partner countries, that is the appointment of an independent body charged with the exclusive task of representing consumers' interests. Its main advantage is the enhanced probability that energy regulation will be more favourable to consumers.

As we mentioned in chapter one, this solution too suffers of its own shortcomings. A consumer body would need access to relevant information, strong technical competencies and adequate resources. Moreover, means of coordinating its activities with those of NRA and other institutions should be provided. There is also a serious danger that the consumer body employs its powers to oppose competition and forestall any reform proposals.

So far, available evidence does not permit to establish the superiority of one institutional solution over anyone else. There are trade-offs involved that require careful consideration of the

national legal and economic environment. What can be said beyond any doubt is that an excessive fragmentation of competencies among many authorities is a source of unnecessary costs. It enhances the probability of conflicts and raises the complexities of the regulatory process. Above all, the fragmentation of competencies increases information costs for consumers, who must search for the competent authority to address in case of complaints against suppliers. Moreover, it increases the risk of inadequate funding. From this point of view, there seems to be room for improvement in the Finnish, Greek and Lithuanian regulatory frameworks.

Econometric analysis of residential markets regulation

Energy markets data in partner countries are used to identify, through the deployment of econometric and statistical techniques, the effects of relevant variables on the outcome of the liberalization process, and namely on prices.

Liberalization is a recent phenomenon, *a fortiori* in the subset of partner countries. This may make inference from available data weak. In spite of that, some quantitative assessments emerge quite clearly.

First, liberalization has generated advantages for the categories of customers that have been affected by it. Residential customers have indeed been advantaged by the full retail market opening, where this has already been implemented.

Second, residential customers are particularly disadvantaged when the market is open only for industrial customers. In this case, while industrial customers enjoy the benefits of liberalization, residential customers are worse off than without any openness. In other words, openness limited to industrial customers fosters a transfer from residential to industrial customers.

Third, concentration or State ownership in the upstream market reduces, according to our sample, the effectiveness of the liberalization process.

Fourth, the characteristics of the retail energy markets, in terms of both market structure (number of retailers and their concentration), and market design (in particular, rules on switching costs and on barriers to entry) are a significant determinant of the outcome. The presence of many players with a low degree of concentration entail lower price. The same happens with low switching costs and barriers to entry.

Energy consumers' contracts

Most partner countries supplement general contract and consumer law with more specific protective measures. Of course, such measures can partly be explained by the lack of competition in those countries that did not complete the liberalization of residential markets. However, we can also uncover additional reasons why general contract and consumer law risks being inadequate to protect energy consumers. Its rules usually employ vague formulas aimed at catching many different unfair practices. Therefore, they leave to the judge the task to interpret their meaning ex post. Such a control strategy inevitably produces a state of uncertainty until enough cases are litigated and dominant interpretations become settled. It is suggested that newly born residential energy markets can not tolerate any uncertainty as to the fairness of the most important contractual terms.

The inquiry in the CLAB database highlights an additional problem. Differences in the interpretation of unfair terms statutes by national courts lead to diverging assessments of the most common terms in energy contracts. It cannot be excluded that such differences hamper the development of competition on a continental level. A European standard contract could be the answer, but its drafting is far from easy.

Another and more fundamental reason for regulatory interventions on contract terms is the difference between protecting consumers and fostering competition. While the two objectives frequently overlap, it is by no means clear that it is always so. Take, for example, consumers' termination rights in energy supply contracts. Allowing the consumer to exit from the contract at any moment frees her from the constraints of unfair terms, but could hamper those suppliers who would like to offer fixed term, fixed price contracts. Because of the possible conflict between competition and consumer protection, it would be preferable to give NRAs the power to regulate ex-ante the most important terms. Relying exclusively on the ex-post assessment of generalist courts without a detailed knowledge of energy markets could result in less balanced outcomes.

A more focused analysis was conducted with regard to three important types of contract terms:

- a) termination of contract by the consumer
- b) termination of contract by the supplier
- c) modification of contract terms

As far as consumers' termination rights are concerned, behavioral biases, search and switching costs all push in the direction of too much inertia. At least in the first period after complete opening of the residential markets it would be preferable to forbid any constraint on termination. There is no reason to suppose that, because of such measure, suppliers will not be able to tailor their offers to customers' preferences. No one will terminate a long term contract that shields from price volatility, provided it does not deviate too much from wholesale prices. Of course, suppliers will bear some additional market risk, but they are in the best position to cover against it through financial instruments.

Disconnections procedures are strongly intertwined with the presence of a supplier of last resort and with measures aimed at protecting vulnerable customers. While forbidding disconnection would impose too much risk on suppliers, it would be useful to draw some guidelines as to the procedure to be followed for those consumers who cannot afford to pay their bills. Useful examples are the guidelines for preventing debt and disconnection published by Ofgem in January 2003 and the industry-wide safety net procedure for vulnerable consumers developed by the British Energy Retail association in 2004.

Finally, unilateral modifications could be uniformly regulated across Europe. The main points of such regulation are the cases in which modification should be allowed and the timing and contents of the communication sent to the customer.

Quality of supply

This chapter discusses the regulation of continuity of supply and commercial quality in partner countries. We first describe the main characteristics of quality regulation in each country, then try to assess its impact on consumers' welfare. Finally, we describe the measure and type of compensation paid to energy consumers when quality standards are not met.

Our research highlights the many differences among the partner countries in the field of quality regulation. While most of them have been introducing new regulations in the last few years, their contents, extent and effectiveness are far from uniform. Moreover, only a few countries provide adequate compensation to consumers in case of blackouts.

The reference to the right of household customers to enjoy the supply of electricity of specified quality at reasonable prices, inserted in art. 3 second electricity directive, is too vague to be of much help in building a regulatory system for quality of supply. Both CEER and ERGEG are trying to foster awareness of best practices in the European context and to suggest the course of action that promises to improve the performance of energy companies as quickly as possible.

Tough, we argue that various kinds of official initiatives at European Union level could ease the convergence toward common models. Our proposals are threefold:

- a) insert quality regulation among the powers to be attributed to each NRA
- b) provide that continuity of supply be fostered through incentive systems
- c) provide for mandatory automatic refunds to consumers in case of quality failures.

Energy consumers' complaints and dispute resolution procedures

This chapter discusses the procedures that partner countries adopted for resolving disputes between energy companies and residential customers. According to Annex A second electricity and gas directives these procedures should be transparent, simple and not burdensome. They should provide fair and fast resolutions of the disputes and mechanisms of redress for consumers. Their structure should reflect the principles laid down in the Commission recommendation 257/98/CE.

This survey shows that various problems must be solved to enhance the effectiveness of dispute resolution procedures in the energy markets. While in most cases NRAs are able to exert pressure on the firms to settle the controversy, there isn't any proof that residential consumers are adequately informed about these procedures. Moreover, the experiences of Finland and Lithuania, that rely on general consumer body without direct knowledge of energy markets, advise against this solution.

The role of consumer associations

This chapter discusses the role of consumer associations and the opportunities for direct participation of consumers to regulatory proceedings in partner countries. Existing evidence attests both to the benefits and the hurdles of consumers' participation and representation in the energy sector. On the benefits side, enhanced involvement of consumers in regulatory decisions could increase their quality, reduce conflicts among the different categories of energy users, strengthen the democratic legitimacy of the choices made by appointed experts, reduce the influence of business and industrial interest groups. On the other hand, almost nowhere does consumers' participation, directly or through their representative organizations, reaches adequate levels. The technical complexity of the energy markets is the most important factor hampering a larger involvement of people lacking the needed expertise in the regulatory process. Moreover, it is suggested that both NRA and governments rarely support the active participation of consumers

in all aspects of regulation. This is because of elitist or technocratic traditions that tend to discard the contribution from the general public and to give almost exclusive priority to technocratic judgements.

While enhancing consumers' participation in the energy sector could improve the regulatory process, it must not be forgotten that consumer associations have their own agendas. They could pursue short-term interests that do not coincide with the collective interests of their constituency, for example because in so doing they can get more funding from public or private contributors. Consumer associations can also become entrenched in the political culture of their country and develop strong linkages with political parties that influence their action. Finally, consumer associations sometimes represent only a fraction of consumers and not the majority of them. For all these reasons, adequate mechanisms should be introduced that warrant responsiveness of consumer associations to the public's long-term interests.

Various models of consumer participation can be devised, ranging from the submission of written observations in regulatory proceedings to the creation of a consumer advocate funded by the State. We provide a detailed description of the forms of consumer participation in the regulatory process of partner countries. This theme is strongly connected to the power of consumer associations to file legal actions against energy companies, discussed in the chapter on the regulation of contract terms.

Final recommendations

The general conclusion of the report is that, with few exceptions, most partner countries were not ready to take up the challenges stemming from the liberalization of retail energy markets. Faced with the pressing needs to protect residential consumers, they tried to preserve the controls on prices and on other aspects of the supplier-customer relationship. However, they did not pave the way for a smooth transition to competition. On the contrary, some protective measures were ineffective or hindered the entry of new suppliers.

We suggest that much work has to be done to put in place the institutional infrastructure that will allow the benefits of liberalization to be fairly distributed to all categories of final customers. For each problem discussed in this report we now propose a few recommendations aimed at improving the workings of retail markets. Depending on the type of problem, the institution better positioned to find effective solutions can be located at the national or the European level. Therefore, our recommendations can be addressed to the European Commission, to supranational organizations like ERGEG and CEER or to the NRAs. We also suggest that an ample variety of

regulatory tools be employed, including mandatory rules, default rules, soft law and self-regulation schemes.

Search costs and switching costs

The reduction of both types of costs is perhaps the most important task European and national regulators should focus on. The low switching rates documented in most partner countries show that consumers find difficulties in exercising their power to choose. At the same time, energy companies try to make it more costly for consumers to compare alternative offers. To provide effective answers to such issues, we make the following recommendations:

- Recommendation 1

NRAs should adopt a code of commercial practice dealing with the pre-contractual phase. The code should enhance the comparability of offers and discourage energy companies from creating unnecessary complexity in their offers. Belgium and Italy provide useful examples of such codes.

- Recommendation 2

NRAs should sponsor a voluntary code of practice for advertising and marketing activities. It should specify the general principles laid down in the unfair commercial practice directive. Its main objective would be to help NRAs monitoring the behaviour of energy companies.

- Recommendation 3

The European Commission or ERGEG should draft guidelines on the legitimacy of practices widely used in the energy sector like fidelity programs, rebates and tying clauses. Because the validity of such clauses depends on complex assessments that must balance various factors, it could be useful to set up a uniform legal framework at the European level. This measure could be justified on two counts: first, it avoids replicating the same assessment in each national regulatory system; second, it avoids the risk of contrasting judgements at national level that could hinder the development of the Internal Energy Market.

Econometric analysis of residential markets regulation

Econometric evidence tends to confirm that residential customers reaped the benefits of liberalization in those countries where full market opening has already been achieved. On the

other hand, partial liberalization tends to thwart residential consumers, both in relative terms (with respect to the industrial customers located in the same country), and in absolute terms (with respect to the residential customers of the countries in which residential and industrial customers receive the same treatment).

Although the full market opening of 2007 should induce a homogenization between industrial and residential customers and mitigate the bias against residential customers, a number of persistent problems must be addressed.

- Recommendation 4

High concentration levels in the upstream and downstream markets soften the price-reduction effects of the liberalization process. Therefore, more aggressive actions should be taken in order to enhance competition in electricity and gas markets. In particular, a strong supervision (either by sectoral Authorities or Antitrust authorities) on anticompetitive conducts, predatory pricing, and collusive behaviour by the key players in the retail market is strongly recommended.

- Recommendation 5

The retail market design significantly shapes outcomes. Countries in which consumers are more informed and in which switching is easier have on average lower prices than those that do not display these features. Ensuring more information to consumers and a simpler and cheap switching procedure is crucial for an effective liberalization process.

- Recommendation 6

Policy measures aimed at favouring industrial customers, such as, for example, a bilateral contract market and/or merchant lines accessible only to industrial customers, damage residential customers. It is likely that, under such circumstances, the supply side in the electricity market shifts its revenue from the industrial to the residential customers, thus damaging the latter. It is crucial to understand that industrial policy measures tend to thwart residential customers. On the policy side, this trade-off has to be evaluated, and a complete welfare analysis, which includes also customers, has to be performed prior to any industrial policy decisions.

Energy consumers' contracts

Regulation of contractual terms in residential energy markets should balance the need to protect consumers with that of fostering competition. It is submitted that, at least for the most

important aspects of the contractual relationship, ex-ante regulation is to be preferred to the ex-post judicial control provided by the unfair terms directive. We make the following recommendations:

- Recommendation 7

It would be useful to develop a model standard contract for electricity and gas supply at the European level. Industry associations could be charged with this task under the supervision of the European Commission or ERGEG. Alternatively, the model contract could be inserted in the forthcoming Charter of electricity and gas customers' rights. The model contract could be applied on a voluntary basis in Member States, but it could also become the reference point for regulators and judges. To encourage its adoption, the model contract should escape additional public scrutiny at the national level.

- Recommendation 8

Residential consumers should have the right to terminate the contract at any moment. Allowing energy companies to apply restrictive conditions to consumers' withdrawal risks increasing switching costs. Moreover, there isn't any convincing evidence that energy companies are not able to bear the risk of early termination.

- Recommendation 9

NRAs should draw guidelines about the procedures to be followed for the disconnection of those consumers who cannot afford to pay their bills. The most detailed provisions on this topic are provided by the Belgian and Finnish statutory rules. Useful examples are also provided by the guidelines for preventing debt and disconnection published by Ofgem in January 2003 and the industry-wide safety net procedure for vulnerable consumers developed by the British Energy Retail association in 2004.

- Recommendation 10

As far as unilateral modifications by energy companies are concerned, two principles should apply. Firstly, deviations from the general rule that requires the consent of both parties to change the terms of the contract should be allowed only when justified by the peculiarities of energy supply contracts. Secondly, enough information should be given to the consumer to enable him to understand the reasons of the change and decide whether to search for better offers.

Quality of supply

The report shows that quality regulation in partner countries is far from uniform. Different quality standards and measurement protocols make it difficult to assess whether liberalization pushed energy companies to improve their performance or had negative effects on quality. We suggest that the following three recommendations could ease the convergence toward common models:

- Recommendation 11

The European Commission should employ the power included in art. 28 second electricity and gas directives with reference to high levels of public service and submit to the European Parliament and the Council a proposal aimed at extending the competencies of NRA to quality regulation.

- Recommendation 12

The implementation of incentive systems for improving continuity of supply should be encouraged. CEER and ERGEG should draft more detailed proposals aimed at harmonizing the measurement protocols and at developing common indicators for incentive schemes. Moreover, the forthcoming Charter on the rights of electricity and gas consumers should include specific reference to the duty to adopt incentive schemes that promote optimal levels of quality.

- Recommendation 13

Automatic refunds to consumers in case of quality failures should be mandatory. We suggest that the Charter lists the main continuity and commercial quality standards whose breach gives the customer a right to compensation. The amount of compensation could be left to the discretion of NRAs, but it should be high enough to stimulate firms to comply with quality standards.

Dispute resolution

The report points out various problems with alternative dispute resolution procedures in the energy markets. Consumers seldom have adequate knowledge of their mechanisms. Often there isn't the possibility to obtain financial redress without filing an action in court. Moreover, general consumer bodies lack the financial resources and the expertise needed to adequately assist energy consumers. Therefore, we make the following recommendations:

- Recommendation 14

A specialized consumer body should be created through public or self-regulatory schemes to assist energy consumers in their controversies with energy suppliers. It should have the power to award financial compensation.

- Recommendation 15

NRAs should have the task to spread information on the competencies of the dispute resolution body and make access by complaining consumers as easy as possible

Consumer representation

Various initiatives could be promoted to enhance consumer representation in regulatory proceedings. We make the following recommendations:

- Recommendation 16

Consumer representation should be guaranteed through advisory organisms or directly in the board of the NRAs. The Czech Republic and Belgium are examples of such solutions.

- Recommendation 17

The participation of consumer representatives should be enhanced both through periodic public hearings and the implementation of electronic consultation procedures.

- Recommendation 18

E-learning training programmes should be organized by NRAs to ensure consumer representatives have the skills needed to assist energy consumers and to actively participate in regulatory proceedings.