UK's Distribution Utilities Not Ready For Competition

By Fereidoon P. Sioshansi*

Everybody knew that preparing for competition was going to be complicated and expensive - particularly the systems required to keep track of customer accounts and billing. Now with the remaining 23 million customers in England and Wales expected to get a chance to pick their supplier over a 6 month period between April to September, 1998, new concerns have surfaced that suggest the task will be more complicated and far more expensive than originally estimated.

A few months ago, the Office of Electricity Regulation (OFFER) figured that the billing and accounting systems required to handle competition will cost some £154 million (approximately $230 million) for the 12 regional electricity companies (RECs) and the two Scottish suppliers, Scottish Power and Hydro-Electric (Table 1). OFFER figured that this modest cost could be recovered through an annual per-customer charge of £1 (approx. $1.50) collected over 5 years. Given the fact that the average (residential) customer's bills considered negligible.

Table 1
Cost of Competition
Millions of Pounds*

<table>
<thead>
<tr>
<th>Public Electricity Supplier (PES)</th>
<th>Original OFFER Estimate</th>
<th>Revised OFFER Estimate</th>
<th>Revised PES Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eastern</td>
<td>15.00</td>
<td>26.25 - 29.45</td>
<td>43.10</td>
</tr>
<tr>
<td>East Midlands</td>
<td>12.00</td>
<td>20.69 - 23.61</td>
<td>80.18</td>
</tr>
<tr>
<td>London</td>
<td>11.50</td>
<td>18.91 - 30.40</td>
<td>55.17</td>
</tr>
<tr>
<td>Manweb</td>
<td>9.50</td>
<td>15.04 - 23.44</td>
<td>55.62</td>
</tr>
<tr>
<td>Midlands</td>
<td>12.00</td>
<td>20.58 - 33.41</td>
<td>67.45</td>
</tr>
<tr>
<td>Northern</td>
<td>9.50</td>
<td>15.11 - 23.57</td>
<td>31.43</td>
</tr>
<tr>
<td>NORWEB</td>
<td>12.00</td>
<td>19.93 - 32.25</td>
<td>118.53</td>
</tr>
<tr>
<td>SEEBOARD</td>
<td>11.50</td>
<td>19.26 - 29.76</td>
<td>77.24</td>
</tr>
<tr>
<td>Southern</td>
<td>13.50</td>
<td>23.35 - 30.44</td>
<td>41.62</td>
</tr>
<tr>
<td>SWALEC</td>
<td>8.00</td>
<td>12.19 - 18.30</td>
<td>67.52</td>
</tr>
<tr>
<td>South Western</td>
<td>9.50</td>
<td>15.18 - 22.17</td>
<td>34.96</td>
</tr>
<tr>
<td>Yorkshire</td>
<td>11.00</td>
<td>18.61 - 23.87</td>
<td>57.52</td>
</tr>
<tr>
<td>Scottish Power</td>
<td>11.00</td>
<td>18.86 - 30.31</td>
<td>71.74</td>
</tr>
<tr>
<td>Hydro-Electric</td>
<td>7.50</td>
<td>11.57 - 16.02</td>
<td>51.58</td>
</tr>
<tr>
<td>Total</td>
<td>153.50</td>
<td>255.50 - 383.00</td>
<td>853.70</td>
</tr>
</tbody>
</table>

Source: Offer report: Opening the Market
* Each £ is approximated US$1.50

Now, with less than 7 months until April 1998, two new and significant issues have surfaced. First, it is generally acknowledged that only 3 of the 14 public electricity suppliers (PESs) will be ready for the last phase of open competition based on where they are today. Second, the cost of getting ready has ballooned to £854 million (approximately $1.28 billion) - at least as figured by the 14 PESs.

OFFER has scoffed at these estimates, but even OFFER acknowledges that its original estimate was far off-target. OFFER now figures the cost of gearing up the customer information systems (CISc) for competition to be somewhere between £256-383 million (approximately $380-575 million). That amounts to an annual per customer surcharge of £1.9-2.9 (approximately $2.80-4.35) for 5 years. If the numbers end up being closer to what the companies estimate, then who will make-up the difference? Another question: if the costs are anywhere as large as the PESs estimate, then will there be any residual savings from competition? Professor Stephen Littlechild, Director General of OFFER insists that the savings from competition would still outweigh these costs, even though electricity supply (i.e., retailing in U.S. jargon), the portion of the service which is being opened to competition, accounts for just 6 per cent of the bills. Distribution (i.e., poles & wires), which remains a monopoly, covers 29 per cent of the bills, with the balance covering generation and other costs. And that's not all. The Electricity Pool, the wholesale power market, is spending £50m (approximately $75m) to update its own computerized trading system.

One piece of the puzzle is the wide disparity in estimated cost of CIS upgrades among the PESs, e.g., Northern Electricity asking for £31m (approximately $47m) while Norweb is requesting spending of £118m (approximately $177m). Some of this may be due to size, density, customer diversity or other variables, but NORWEB's price tag stands out as an outlier no matter how you look at it (Table 1).

A more serious problem facing Professor Littlechild and John Battle, the new Minister of Energy, is that only Eastern, SEEBOARD, and Yorkshire appear to be anywhere ready to handle the competitive market come April 1998 based on system tests planned to begin in October 1997. The other 11 PESs are lagging anywhere from 3 to 4 months or more behind (Table 2).

Table 2
Who's Ready for Competition?
England and Wales Scotland
1997 October Eastern, SEEBOARD, Yorkshire, the Pool
1997 November SWALEC
1997 December Northern, NORWEB, South Western, Hydro-Electric
1998 January East Midlands, London Scottish Power
1998 February East Midlands, London Scottish Power
1998 March Southern Settlements


In an editorial in Energy Utilities (June 97), Dietel Helm of Oxford Economic Research Associates (OXERA) says, “Professor Stephen Littlechild, Director General of Electricity Supply, has finally recognized two facts about the 1998 project to liberalize the electricity market. The first is that the costs of competition are likely to be much higher than he expected. His latest estimate is £255m-£385m over five years. The second is that the timetable for his three-phase program is hopelessly optimistic. Only three companies are now expected to be ready for the first trials.” Helm goes further when he opines, “Nobody wants to admit publicly that the overall electricity project needs urgent surgery. Some slips in timetable and a bit more money may be OFFER’s solution. Nevertheless, the fundamental problems will not go away. It is too early to predict with much confidence which ‘event’ will trigger the next set of timetable and cost revisions.”

*Fereidoon P. Sioshansi edits and publishes the Energy Informer, a monthly newsletter focused on the North American electric power industry. This is an edited version of the article which appeared in the August 1977 issue.
has already begun selling its 53 million barrel inventory of government owned crude oil. The United States has assumed a leadership role within the International Energy Agency advocating that free markets be allowed to work even in an emergency and that the first response to a disruption should be the release of strategic reserves. Our credibility in maintaining that advocacy role is a factor that policy makers will also weigh in reaching a position on this issue.

On the other side of the issue is the question of money. The Federal Government has added massively to the national debt since 1980, and it is a clear priority of the Administration and the current Congress to eliminate the deficit no later than FY 2002. After the deficit is eliminated, the critical question within the big picture of Federal Government activities is in what proportion surpluses will be assigned to national debt reduction, further tax relief, or increases in discretionary spending. Since the funds to acquire oil for the Reserve fall in this last category, the issue of SPR size and the timing of fill will compete not simply against a break even cost benefit analysis but against a queue of other programs that are philosophically acceptable to the Government and the American people but which have been shrunk or eliminated by the unrelenting budget pressures associated with elimination of the deficit.

Conclusion
The Department of Energy and the Administration have a target date of the end of September to release the Statement of Policy. That document will provide the basis for further amendments of the Energy Policy and Conservation Act that the Department of Energy hopes to champion during the next session of Congress, and for future budgets that will determine the direction of the Reserve’s size and inventory.

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14-18 June 1998, National Energy Conference CNE’98: Energy for Tomorrow - Reconciliation of Efficiency and Competitiveness with the Sustainable Development. Neptun, Romania. Contact: Mrs. Eisa Ratcu, CNE’98 General Secretariat, 8 Energeticienilor Blvd., 79619 Bucharest 3, Romania. Phone: 401-321-4665. Fax: 401-321-1010. E-mail: sraei@mail.gsci.vasat.ro


19-21 November 1998, 7th International Energy Conference and Exhibition - ENERGEX ’98, Manama, Bahrain. Contact: Dr. W.E. Alnaser, Conference Secretariat, Dean, Scientific Research, University of Bahrain, PO Box 32038, Bahrain. Phone: 973-688381. Fax: 973-688396. E-mail: EAB07@isa.cc.uob.bh

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