Managing the liberalization of Italy’s retail electricity market: A policy proposal

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Outline

• Italy’s electricity retail market: a long awaited reform
• Structure-Conduct-Performance
• Challenges ahead
• A policy proposal: asymmetric regulation and opt-out collective switching
• Conclusion
Italy’s retail electricity market design

• July 1\textsuperscript{st}, 2007: all customers are free to choose...

• ...but if they don’t they are covered by the Maggior Tutela [Greater Protection] service:
  • They will be supplied by the local DSO...
  • ...at a price that reflects the procurement costs of the Single Buyer [Acquirente Unico];
  • The Maggior Tutela is a temporary regime that will be phased out by July 1\textsuperscript{st}, 2019;

• Issues with the Maggior Tutela:
  • May work as a focal point;
  • May nudge customers into the regulated regime, thereby discouraging engagement;
  • Prevents commercial innovation.
Research question

• How to manage the phasing out of the Maggior Tutela?

• No conclusive evidence on retail competition’s effect on prices, depending on: i) actual competition; ii) customer engagement (Newbery and Pollitt 1997, Polo and Airoldi 2017, Fernandez-Gutierrez et al. 2017);

• Competition successful in creating better opportunities for consumers, but they often fail to catch it (Waddams and Zhu 2016, CMA 2016);

• Larger consensus on the nexus between retail competition and innovation (Eakin and Faruqui 2000, Littlechild 2002, Rassenti et al. 2002, Cooke 2011, Stagnaro 2017);

• Growing (behavioral) literature on how to make customers more active (CEER 2016, Crampes and Waddams 2017);

• No “textbook” architecture to rely on for the transition (Joskow 2008).
Structure-Conduct-Performance

• **Structure:**
  • Customers under the Maggior Tutela declined from 79% in 2012 to 66% in 2016 but
  • Extremely concentrated market **by design**: largest retailer 73% (slightly declining over time);
  • High number of operators: low entry barriers;

• **Conduct:**
  • Switching rate (8.7%) slightly above EU average but high number of non-switchers (circa 90%), high rate of internal switching (circa 60%);
  • Increasing number of offers;

• **Performance:**
  • Price dispersion as expected (converging energy-only tariffs, diverging if other services are bundled);
  • Markup around the EU average.
Challenges ahead

• **Market concentration**
  • Reducing the incumbent’s market share...
  • ...while creating the conditions for competitors to grow

• **Customer engagement**
  • Promoting switching activity;
  • Discriminate the “truly” disengaged customers from those who do not switch because they are just happy;

• **Customer protection**
  • Protecting vulnerable consumers *via* targeted measures (energy poverty)
A policy proposal

• Target: reducing market concentration while promoting customer engagement;

• Three pillars scheme: graduality, asymmetric regulation, opt-out collective switching:
  1. Graduality allows competitors to grow and consumers to get accustomed with the new rules;
  2. Asymmetric regulation lowers the incumbent’s market share;
  3. Opt-out collective switching turns inertia into a convenient feature.
Three pillars: graduality and asymmetric regulation

• **Graduality:** 3 years transitional period when:
  • Former regulated customers are still supplied by the (brand unbundled) incumbent i) under standardized terms & conditions; ii) price variations should be approved by the regulator;
  • The incumbent cannot win formerly regulated customers neither can it win them back as they switch but it can compete for other customers;

• **Asymmetric regulation:**
  • A transitional, decreasing antitrust ceiling is introduced under which the incumbent market share (73% in 2016) shall decrease to:
    
    less than 60% in 2019, < 50% in 2020, < 40% in 2021
Three pillars: opt-out collective switching

• If the incumbent’s market share is above the ceiling, the exceeding share of its customers is enrolled in a collective switching exercise:
  • The customer basis is (randomly) picked from the formerly regulated ones;
  • Customers **retain an opt-out option**: if they are happy, they can stay with their supplier, otherwise inertia will lead them to a more convenient supplier;

• Auction design:
  • Either reference price – one-off discount, or spot price + head-on;

• By the end of the transitional period:
  • **Final opt-out collective switching** with all the former regulated customers who have never switched.
2019
- Phasing out starts
- Clients in MT to PLACET

Late 2019
- Check % former MT
- Auction for Δ(%MT-60%)/2

Early 2020
- Auction for Δ(%MT-50%)/2

Late 2020
- Auction for Δ(%MT-50%)/2

Early 2021
- Auction for Δ(%MT-40%)/2

Late 2021
- Auction for Δ(%MT-40%)/2

Early 2022
- Auction for residuals

Mid 2022
- Final auction

Ceiling:
- 60%
- 50%
- 40%
Conclusion

• Retail competition may create opportunities for customers and innovation but it needs a careful design;
• No “textbook” solution;
• Italy’s challenges: market concentration and customer disengagement;
• A solution “as plain as the nose on your face”: instead of nudging customers into the regulated tariff, nudge them into the most convenient offer!
  • Transitional period, asymmetric regulation, opt-out collective switching;
• No easy solution, but a comprehensive process.
Thank you for your attention

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