

Issues concerning electricity market and competition policy (Summary)

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Fair Trade Commission

Electric power is a lifeline that is needed for national life and one of the important industry infrastructures which is the basis of the economic activities. In Japan, regulatory reform toward more efficient electricity market has been made step by step, but competition is not enough. The Ministry of Economy, Trade and Industry (METI) which is in charge of designing regulatory framework in the electricity market, established Subcommittee for Evaluation on Regulatory Framework under the Advisory Committee in Natural Resources and Energy that is council of advisers to the METI. The subcommittee evaluated the effectiveness of the institutional reform up to the present in preparation for the discussion as to the full opening of the retail markets. The discussion is to be started in FY 2007. It is one of the important responsibilities of Japan Fair Trade Commission (JFTC) as the competition authority to survey the current competition in the electricity market and discuss the upcoming issues.

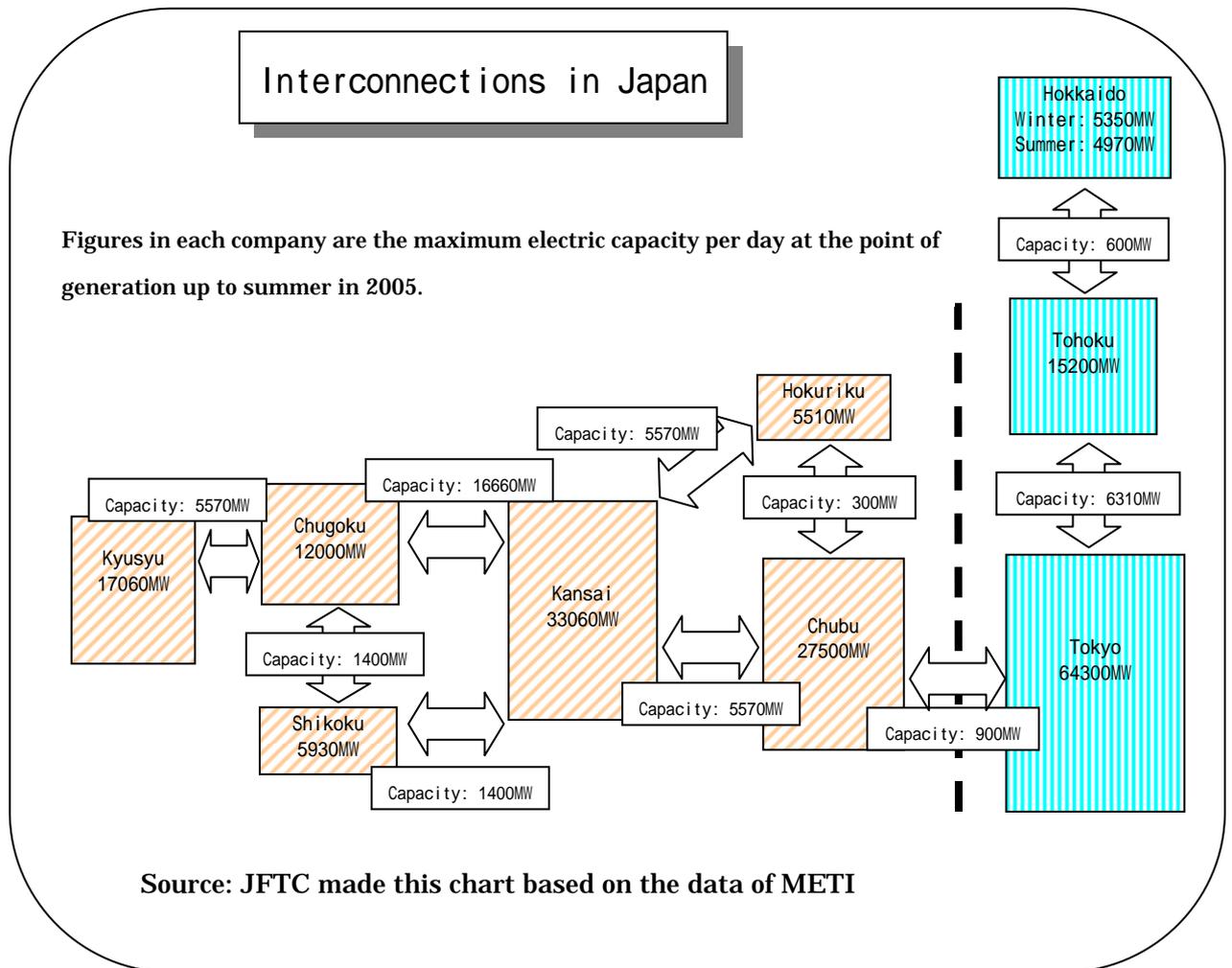
In this report, firstly, we evaluated the competition in the electricity market. Here, we showed our view how to define electricity retail market and evaluated matters related to rates and services in the market. Secondly, we discussed seven issues which must be improved to enhance competition in the electricity market.

Competition and evaluation in the electricity retail market

1. Definition of the electricity retail market

We define each of nine supply areas of incumbent utility companies as a geographic market and each of four demand-categories of products for special high-voltage for industry use, special high-voltage for business use, high-voltage for industry use, high-voltage for business use as a product market. In this report, we took into account the historical background of institutional reform in the electricity supply business and the special feature of electricity.

Chart1 Interconnections in Japan



2. Situation of new entry and change of market structure

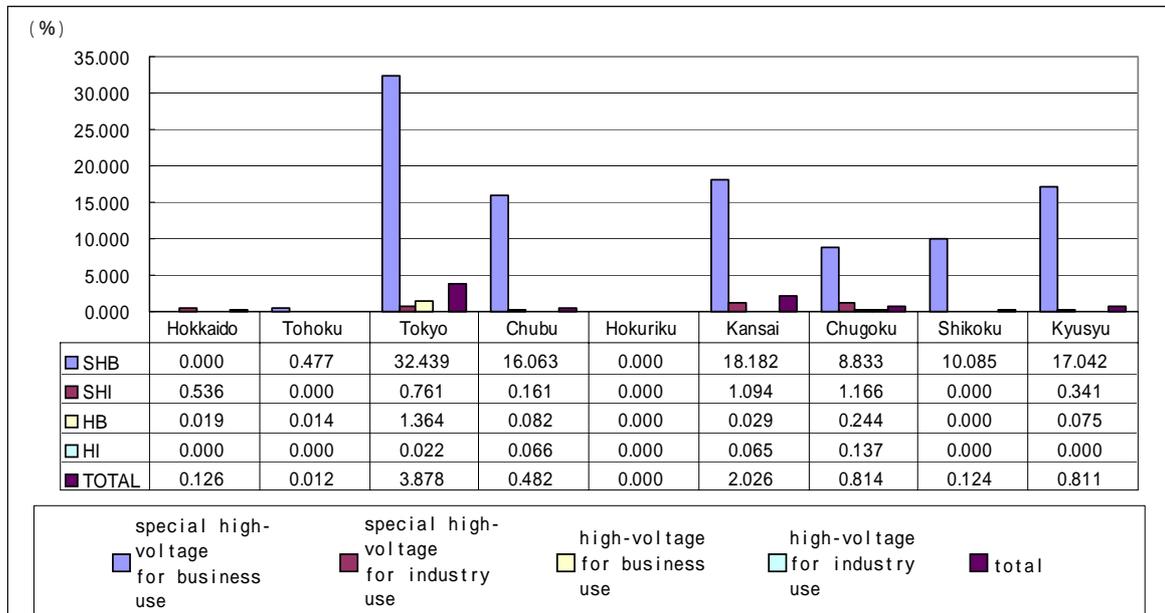
According to the trend of the number of new entrants to each supply area of incumbent utility company, relatively many PPSs¹ entered markets where sales amount of electricity to large-lot customers in the liberalized part is large, however, PPSs have not yet entered the other markets.

With regard to the PPSs' share, it increases in the market for special high-voltage business in the supply areas such as Tokyo Electric Power Co, Kansai Electric Power Co, and Kyusyu Electric Power Co. However, the proportion of sales amount for special high-voltage for business use is only six percent in the liberalized part in total sales amount, and PPSs' share is

¹ PPS means Power Producer and Supplier. Basically PPS is a new entrant of the electricity retail market.

less than 1 percent in the total markets.

Figure2 PPSs ' share in each electric supply area of general electric utility company based on voltage and its purpose of use



Source: JFTC ' s questionnaire held in March 2006

According to results of the questionnaire survey on customers, the percentage of users who has changed supplier is over ten percent in gas and telecommunications market. However it is only two percent in the electricity market. Sales promotion by suppliers is passive. Customers have less opportunity to choose suppliers in the electricity market than in other markets. As a general trend, the opportunity for customers to choose electricity suppliers has not been expanded as yet.

3. Trends of Electricity rates

According to the trend of electricity rates, the rates have declined from FY2000 when the liberalization of retailing began. The range of decline differs in each market. The rates of product for special high-voltage for business use in FY2004 declined 24.3% from FY2000, because of the market competition. However, the decline of rates for special high-voltage for industry use of which the market was liberalized but not yet competitive is only 9.3% from FY2000, and the decline of rates in regulated area is 8.1%. The difference in rates among incumbent utility companies is still large even

though the gap was slightly narrowed to 9.0% in FY2006 from 10.0% in FY2000. If incumbents compete with each other on nationwide scale, the difference in rates among them would become smaller.

In international comparison of rates from 1995 to 2004, rates in Japan are still more than double of those in the U.S., even though the difference has become smaller. More than 50% of customers in the electricity market think the rates are high or relatively high and this percentage is higher than that in other markets.

4. Evaluation on the quality of service

According to the evaluation on the quality of service, the degree of satisfaction of customers in the liberalized area is three times higher than those in the regulated area. With regard to variety of tariff, less than one-third of the number of customers in the regulated part compared with those in the liberalized market answer that there are many or relatively sufficient choices. The level of explanation in terms of rates shows similar trend.

5. Management index of incumbent utilities

According to the trend of cost and profit of incumbent companies, the cost per unit of amount of electricity had declined by ¥1.83/kwh from FY2000 when partial liberalization started to FY2004. Items which had largely declined in the cost are interest expense, depreciation expense and repairs expense. The recurring profit ratio of incumbent companies remains at high level. That is 4.2 times as large as the average profit ratio of all industry and 5.2 times as large as that of non-manufacturer.

Issues on competition in the electricity market

1. Issues related to securing sufficient amount of supply

(1) The JEPX (Japan Electric Power Exchange)

To enhance competition between incumbent companies and PPSs, the JEPX is expected to function as an effective tool of PPSs for wholesale procurement of electricity. PPSs need to promote sufficient amount of electricity stably through wholesale channels. To activate transaction through JEPX, the following are important; (a) increasing the amount of electricity offered to the JEPX; (b) enhancing monitoring functions by the

JEPX: (c) expanding the scope of disclosure of information held by the JEPX.

(2) Fulltime backup support

It is necessary to maintain the basic idea that it may possibly violate the Antimonopoly Act (refusal to deal, discriminatory treatment) to refuse fulltime backup support to PPSs by incumbents, just because the JEPX was established. Furthermore, if necessary, we will clarify trade practices that may violate the Antimonopoly Act in the guideline, as the amount and pattern of transactions related to fulltime backup support has changed, and the JEPX was established.

2. Constraint of interconnection capacity

When the market is divided due to constraint of interconnection capacity, the JEPX executes contracts by settlement of trade account within each segmented market. Gap in rates between the markets is regarded as income of the JEPX. As the income is a kind of congestion fee, it should be used to expand the capacity of congested interconnection, which will contribute to wider transaction of electricity trade. In addition, it is necessary to evaluate regulatory implementations including earlier release of margin kept in each interconnection for security of supply, and to take additional measures if necessary.

3. The issue of transmission tariff

Many PPSs doubt whether transmission tariff is properly calculated. It should be reviewed whether the prior notification system² functions effectively, and this system should be changed if it does not function properly.

Additionally, in order to enhance confidence in proper setting of consignment supply fee, the adoption of approval system and third party verification system to check that the rates are properly calculated based on the cost should be on the agenda. The JFTC will strictly enforce the Antimonopoly Act to behaviors which exclude competitors, for example, by unjustly raising the amount of transmission tariff.

² In this system, the incumbents which possess transmission system have to notify the tariff to the Minister of Economy, Trade and Industry in advance. The minister reserves the right to order change in case it damages public interest, for example.

4. The issues of rule of keeping supply and demand balance and imbalance tariff

It is appropriate to review present rule of keeping supply and demand balance and imbalance tariff so as to make them reasonable in accomplishing security of transmission and competition in electricity market. The solution would be, for example, to loosen the balance level to small size companies or to introduce a new balancing system in which imbalance is calculated on the basis of notified amount from PPSs, instead of their actual amount of demand.

5. The issues corresponding to CO₂-reduction

It is necessary to consider how to change the institution to secure equal footing between incumbent companies and PPSs in competition of CO₂ emission factor. In calculating the amount of greenhouse gas discharge based on the system of calculation, report and publication regulated in the current Law for the Promotion of Measures to Tackle Global Warming, the amount of discharge is to be calculated in relation to the use of electricity supplied by electricity companies. The system should be changed to take the amount of green house gas reduction credits into consideration when calculating the amount of discharge. In addition, the fact that nuclear power generation and hydraulic power generation which have no CO₂ emission is vested rights of incumbent companies should be taken into consideration in order to secure equal footing between incumbents and PPSs.

6. The issues of promoting competition between incumbent companies

For promoting competition on a national scale, it is necessary to expand the capacity of interconnection and to change the imbalance tariff in order to reduce the risk of utility companies when they supply outside their each supply area. Activating the transactions in the JEPX is also very important so as to promote competition between incumbent companies indirectly, because incumbents are extremely negative in supplying directly outside their supply areas. Through transactions in the JEPX, electricity can be provided at lower rate by using more efficient electric utilities, which will contribute to reducing the electricity cost in Japan as a whole.

7. The matter to be considered in discussing the full retail market opening.

Discussion of the full opening of the electricity market will be started in FY2007. From the viewpoint of competition policy, customer's benefit and equal footing between competitors are particularly important, and should be considered in the discussion.