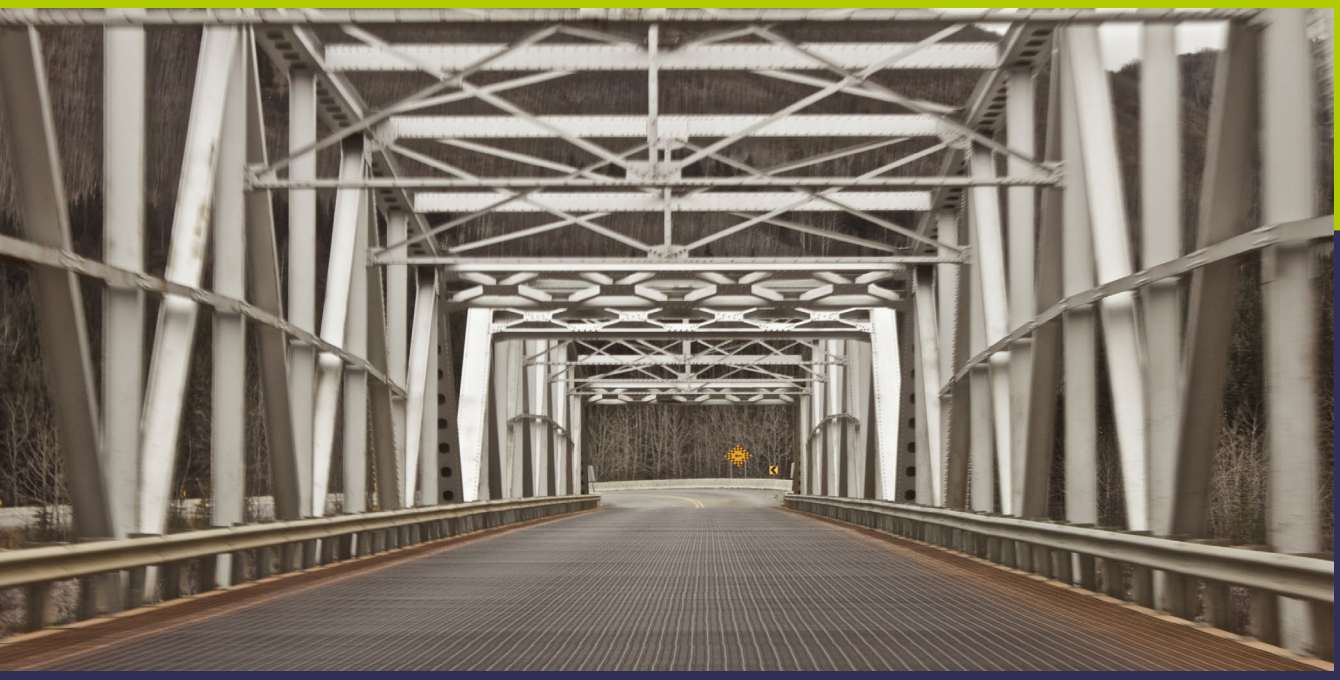
European Commission

# EUROPEAN BARRIERS IN RETAIL ENERGY MARKETS



# LATVIA
# Country Handbook

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*Energy*

# EUROPEAN BARRIERS IN RETAIL ENERGY MARKETS PROJECT: Latvia Country Handbook

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Please note that this and the other country handbooks form just part of the deliverables of the “European Barriers in Retail Energy Markets” project. For more detail on methodology, Europe-wide results and the Barriers Index, please refer to the following associated reports: “Final Report of the European Barriers in Retail Energy Markets Project”; “Report on the European Retail Energy Market Barriers Index”

# SUMMARY

## Project Outline

The following project outline describes the overall European Barriers in Retail Energy Markets Project. It relates to all the countries and markets which are the focus of the project.

### The Context

European retail energy market liberalization is now well into its third decade in the most mature markets. Customers of electricity and gas are now free to choose their electricity and gas suppliers in nearly all markets across the EU and in a number of other European markets. At the same time, the European Commission and national European regulators have created a basis for non-discriminatory market access for energy suppliers through a series of regulations and directives. In theory at least, the European retail energy market is a place where new suppliers and providers of retail services can enter the market and compete relatively freely and on equal terms for customers in the market; a place where formerly incumbent electricity suppliers can compete for gas customers and where gas suppliers can compete for electricity customers; a place where a supplier from one region or jurisdiction can compete in another, without facing unreasonable or excessive barriers; a place where a capacity aggregator or other innovative business model can compete to provide its services to retail energy customers.

### Objective

The European Barriers in Retail Energy Markets project was established to research the extent to which the theory is the case in practice; the extent to which energy suppliers across Europe face a variety of barriers to enter and compete in the market; to identify which barriers exist and to provide some suggested solutions to those barriers. The project thereby aims to support the European Commission and Member States in developing policy and implementing actions to reduce barriers.

This project has also designed and calculated a performance index that ranks different countries according to how easy it is to do business in the retail energy segment by combining a selection of measurements into a single score. The project is on the other hand, not intended as a measure or indicator of the ‘competitiveness’ of any given market, and it does not in this respect judge the effectiveness of regulatory authorities or governments, many of which have put great effort into developing their markets.

It is also important to note that all the markets included in this research are continuously evolving. Changes are being planned and improvements (and in some cases additional barriers) are possible as a result. While this project highlights and considers known future changes, it cannot make assumptions as to the effectiveness and outcomes of those changes. This project is therefore weighted in the present, based on the actual context in the market, whilst accepting that the present context may change, in some cases imminently.

### Competitor Perspective

What sets this project apart from previous Europe-wide projects looking at the issue of barriers is above-all that it primarily takes the perspective of the competitor rather than any objective view of regulators, economists or academics. This is an important distinction since it requires an acceptance that even if the existence of specific barriers may not seem logical or rational, and even if they are not permitted or legal, even if they were supposed to have been eradicated, those barriers are significant at least in the experience or expectations of competitors in the market.

Notwithstanding this however, the project does not simply accept whatever competitors claim. On the contrary, the researchers have gone to great lengths to ensure that claims are challenged and justified. Cooperation with regulatory authorities to understand the regulatory context of claims, along with survey and interview feedback from competitors (including incumbent suppliers) with alternative perspectives or points of view, have also been considered to ascertain a balanced evaluation of the barriers in any given market. This approach may therefore be of value to policy makers, and complementary to other studies addressing market outcomes.

In some cases, claims by respondents have been made which cannot be corroborated. For instance, there have been claims by many respondents across Europe about integrated utility behaviours that represent barriers to independent suppliers in the markets. Barriers apparently resulting from a lack full ownership unbundling. Such behaviours may well be regulated against, may even be considered illegal, and authorities may have powers to investigate them – and maybe do so. They are impossible to prove given the mandate and resources of the researchers of this project, yet they are widely reported by respondents and broadly documented in other researches. Such barriers may be considered allegations by the respondents, but where they appear to merit further consideration they have been raised since their potential impact on competition is substantial.

### Scope & Scale of Research

The project focuses on electricity and (in most cases) gas markets in 30 European countries, namely the EU27 states plus Great Britain, Norway and Switzerland. It was conducted over the course of more than a year with the cooperation and assistance of nearly all of the relevant national regulatory authorities (the report does not however represent their views and has not been ratified by them), around 150 suppliers and many other stakeholder organizations, across all focus markets. Great Britain was included in the project and cooperation was received from numerous suppliers, the regulator (OFGEM) and other stakeholders. Switzerland and Malta were included to a lesser extent since they are not yet open markets for household customers.

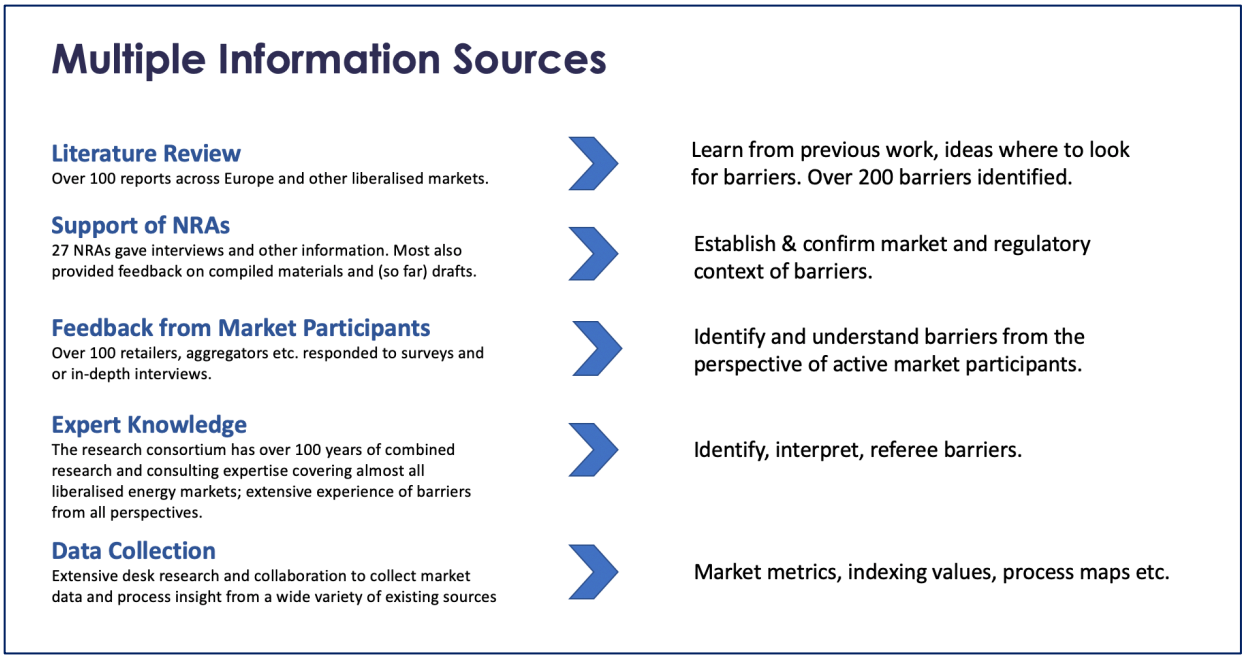

The project focuses on retail (supply), including also demand aggregation services, other additional offerings and new model retail, especially relating to the household segment customers (in some markets households and smaller SMEs may be difficult to distinguish). The project additionally concentrates primarily on barriers that are specific to the energy (electricity and gas) retail market – as opposed to barriers that are true of most markets, such as basic business costs and risk - and it gives priority to barriers for which a potential solution might be sought, as opposed to barriers which are a fact of any energy market and which could not realistically be overcome (such as the barriers relating to the core price volatility of energy as a commodity). The project does not aim to list every possible barrier in the market, however small.

### Sources of Information

Many sources of information were used as part of the project. These included an extensive literature review of over 100 public reports, to assist in the targeting of survey questions; interviews with national regulatory authorities (NRAs) to understand the regulatory context in markets; feedback from market participants (suppliers and other competitors) and extensive data gathering for the purpose of collecting market metrics, market processes and

index values. For the latter the task of identifying sources that could deliver comparable and reliable index values was a key challenge of the researchers. The expert knowledge of the project consortium (which has extensive experience from the markets and issues concerned was also used to add judgement to the process. Specifically, the core project team comprised over a dozen researchers and experts from nine European countries, including international experts who have analysed Europe's energy markets since even before they liberalized.

Figure 1 – Multiple Information Sources



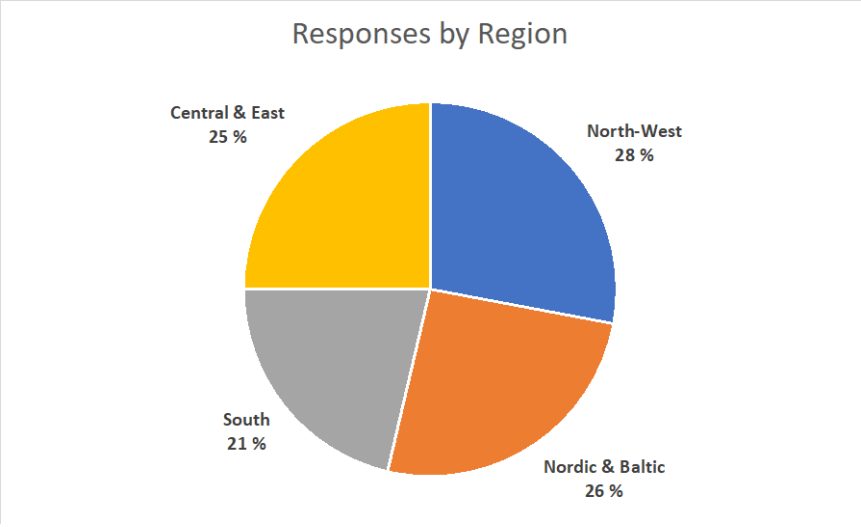

### Surveys & Interviews

The primary research mediums used in the project were an extensive questionnaire and in-depth interviews. The purpose of the questionnaire, which contained separate questions depending on the type of respondent, was to provide a comprehensive and structured identification, weighting and magnitude of the barriers as experienced and perceived by suppliers and other competitors. Questions were categorized and broken down according to what was known through the body of existing literature and the experience of the project consortium, ensuring that all known barriers were addressed by the questionnaire. The questionnaire additionally facilitated the identification of barriers that hitherto had not been revealed by the literature review, or which were country specific. Interviews provided additional support and clarification to the findings from the questionnaire as well as allowing respondents to focus on top-of-mind barriers and the interviewers to dig deeper into key and / or unclear issues. While some respondents provided both questionnaire and interview responses, many provided one or the other.

The survey was publicly and widely promoted (via web sites, social media and by other direct means) to potential respondents from 17th June until late October 2019 but remained open until late February 2020 so that stakeholders contacted during Country Handbook development had the chance to respond. The dissemination of information on the project was further facilitated by a widely promoted public website through which over 300 people subscribed.

### The Competitor Sample

143 questionnaire and interview responses were received representing 120 unique market-specific responses covering 28 focus markets. 71% of responses were through questionnaires versus 29% through interviews. Malta (a closed market for household customers) and Slovakia were the only markets from which responses were not received, although three additional markets received a level of response which was considered insufficient on which to conclude barriers based solely or primarily on respondent feedback. In these markets, namely Bulgaria, Cyprus, Czech Republic, the project consortium applied their expert insight and additional desk research to support the analysis of the markets. Switzerland, also a closed market for household customers, also naturally received insufficient response. The responses from 24 markets were therefore considered sufficient for the purpose of interpreting the barriers within those markets primarily based on respondent feedback. It is important to note that the response rate in no way impacted the index, which is not dependent on responses.




Analysis of the sample shows that responses were spread evenly among the regions. 66% of responses were non-incumbent competitors compared with 34% which were former incumbents in the markets concerned. In many cases the former incumbents are only former incumbents in one region within the overall country they are in. A large proportion of the former incumbents are furthermore active across multiple regions and countries, and therefore are both incumbents and non-incumbents, defenders and challengers. Among the non-incumbent players were a mix of more established competitors and more recent new entrants, along with more traditional supplies, new model suppliers and aggregators.

More information on the nature of the sample and responses can be found in the Final Report for this project.

### Confidentiality

The importance of data protection and anonymity within the project cannot be stressed enough. Most respondents provided information on condition of anonymity. It was promised by default to questionnaire respondents and was in most cases explicitly requested by interviewees. Many participants additionally stated that they were nervous to respond at all since they were active in a market where there were only a handful of suppliers (or at least independent suppliers) which they felt meant that their responses could easily identify them. This risk was perceived as even greater in cases where the participant had made public statements on issues that would be contained in the research (the risk of readers putting two and two together was a concern). In some cases, respondents stated that they even feared a backlash from other stakeholders if their identity was revealed, or (for

e.g. a brand-new entrant in a market with one brand-new entrant) stated that if we revealed that they were a new entrant the market authority would instantly know who they were and that they were afraid it might inhibit their entry process.

Under such circumstances, it was decided that not only would all responses be anonymous, but also that the type of respondents would not be revealed in connection with given responses on a country level. It has been claimed by a handful of market authorities that this policy reduces the value of the research. The researchers feel that it in fact increases the value of the research since it has allowed respondents to provide information in an uninhibited fashion in a European market where, by and large, independent suppliers – and especially independent new entrant suppliers – are few and far between.

### Deliverables

The project has three key deliverables:

- **28 country specific handbooks** detailing the barriers identified in each country together with suggestions for possible solutions. While most of the handbooks cover electricity and gas markets, some only cover electricity or cover gas to a lesser extent due to the absence or limited presence of gas. Additionally, two countries, Malta and Switzerland do not have country reports due to their closed nature with respect to household customers.
- **A robust, peer-reviewed barriers index** of how easy it is to do business in each country. The European Retail Energy Market Barriers Index, contained in the separate European Retail Energy Market Barriers Index Report, allows the objective comparison of market barriers across the focus markets. The report also includes a ranking of the focus markets.
- **An overall Final Report** containing a full project description and bringing together the findings and common learnings from all countries.

### The Barrier Index and Ranking

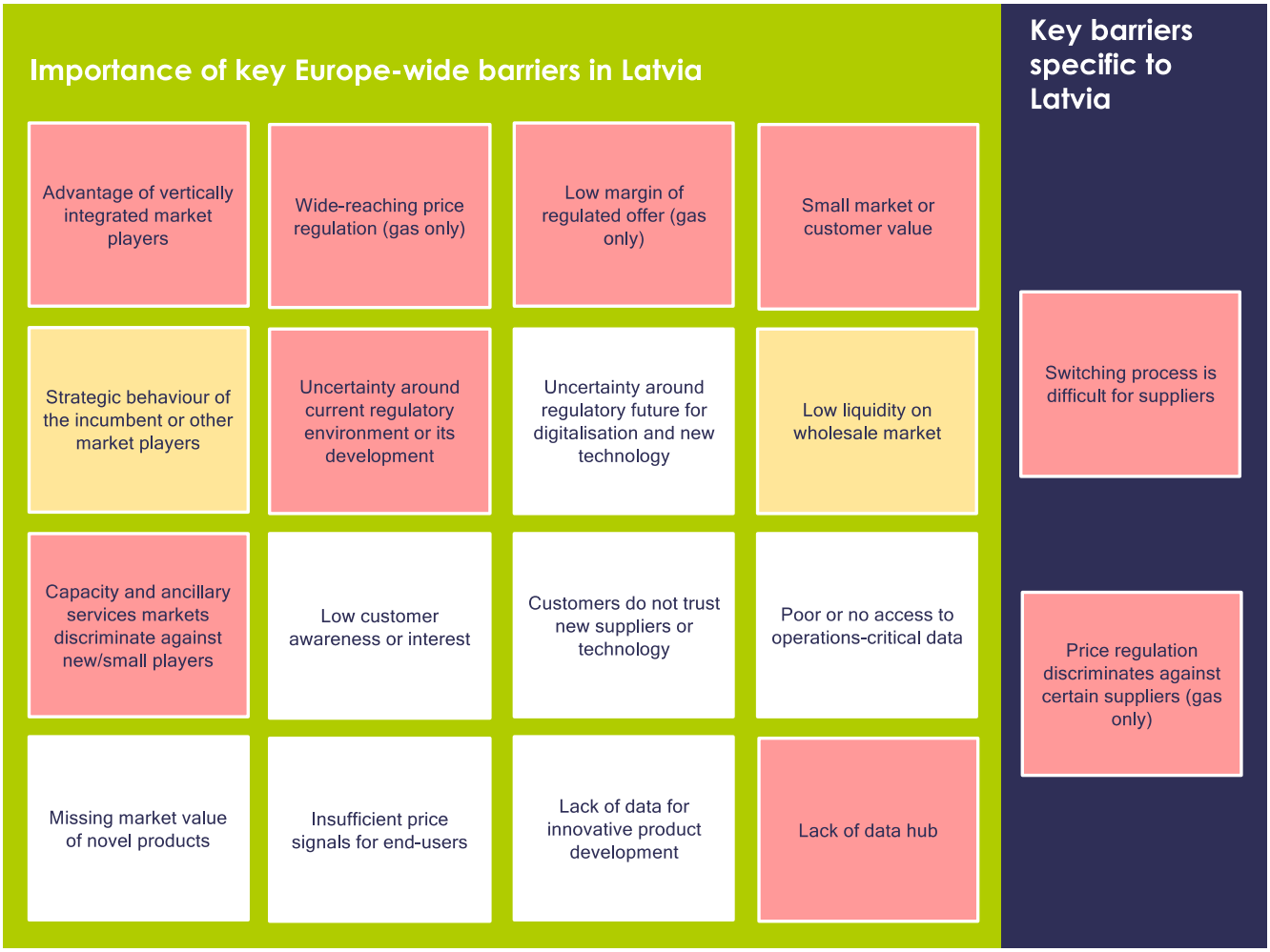
The purpose of the 'European Retail Energy Market Barriers Index' is to enable a degree of comparability between the barriers' context in each of the markets. It is based on metrics that can be collected for all markets, metrics for which available data currently exists. As such it provides a simple, best-available proxy benchmark measure for each of the categories of barriers identified by the project, for each market, and thereby ranks each market. It is intended to be used as an evolving periodical index and ranking on a European and national level.

The index and ranking should, however, presently be considered more of an approach and an indication than an absolute or definitive ranking. It represents the current state of market monitoring data in Europe and will evolve over time as data availability improves. Over time we would expect and recommend that governments and NRAs advance new metric collection to better enable future editions of the index and ranking.

A full description of the Index, its methodology and detailed findings and the ranking can be found in the separate Index report for this project. Within each country handbook the index values for that given country is presented.

## Key barriers in the Latvian market

The following figure highlights the key barriers identified in the Latvian market.




**LEGEND**

**Has not been raised, indicated or identified as a barrier in this country**

**Has been raised or indicated as an issue in this country**

- May include issues that still are present in the country or are experienced by suppliers even though regulation to address the issue has been enacted by the regulator and effects still awaited; reporting a lag between the regulatory framework structure and its awaited effects
- May include issues where suppliers suffer the effects despite the country being relatively advanced on this topic compared with other EU countries, pilot projects being in place or institutions working to overcome the problem.

**Has been identified as an issue in this country** and is supported by facts, data or substantial respondent evidence in light of limited initiatives deployed by institutions to control or overcome the issue.

## Key recommendations

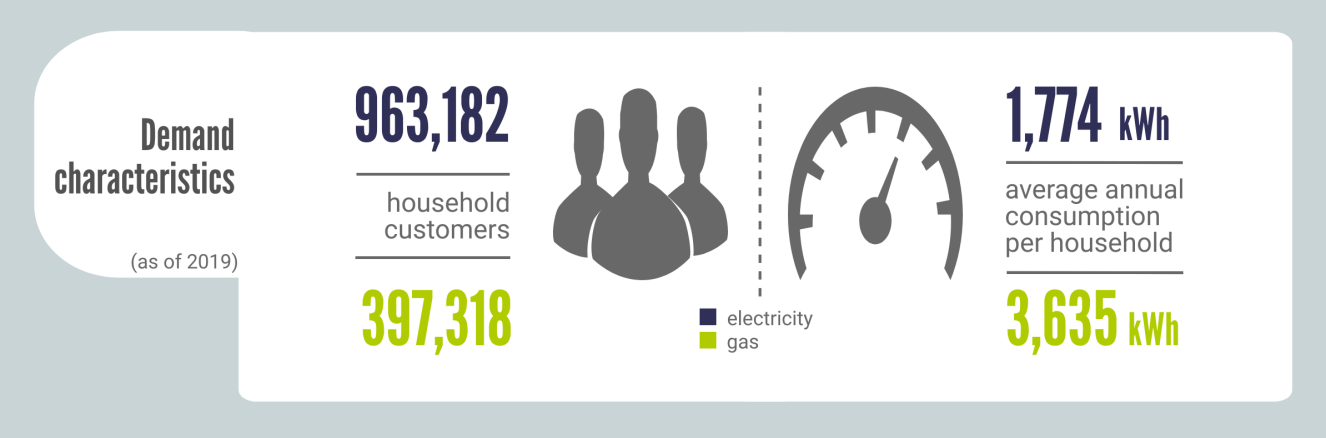
Considering the recency of liberalization, the Latvian market is developing steadily, making good progress, for electricity at least moving (but still with some way to go) away from an incumbent-dominated structure to a situation where newer entrants are able to establish and compete more effectively. Nonetheless, significant key issues remain that should be resolved in order to maximize the potential of the liberalized market to benefit customers and the energy system.

- **Regulated prices in the household gas market.** Currently, regulated prices are available to all household customers, are below prices that would allow competitive supplier reasonable profit margin, and only one company is permitted to provide these regulated prices. Together, these factors effectively lock new entrants out of the Latvian gas market. Making regulated prices less widespread, more related to market price, or allowing companies to compete over these customers could all serve to reduce the skew on the market that price regulation currently causes.
- **Lack of a data hub.** A centralized platform for customer data exchange should be prioritized in order to facilitate equal exchange of data between all players. Currently, the DSO has potential and actual power to disrupt the market in its role as information controller, although their independence is monitored by the NRA to promote a level playing field.
- **Regulatory uncertainty.** Although to some extent unavoidable in an evolving market, uncertainty around upcoming regulatory developments or directions makes it difficult for businesses to plan. Clearer communication of plans and schedules, along with increased consultation with market actors, could improve this issue.

# MARKET OVERVIEW

## Background

The opening of Latvia's electricity market began in 2004, when non-household customers were given the right to choose their electricity supplier. Households were given this legal right upon full market liberalization in 2007, but this was not implemented until 2015, when all electricity customers were able to engage directly with the market. Market expansion has since progressed steadily. In 2013, the Latvian wholesale electricity market was integrated with the Baltics, and electricity is now traded on the joint Nordic-Baltic exchange, Nord Pool. The XBID platform for cross-border intra-day trading launched in Latvia in June 2018.

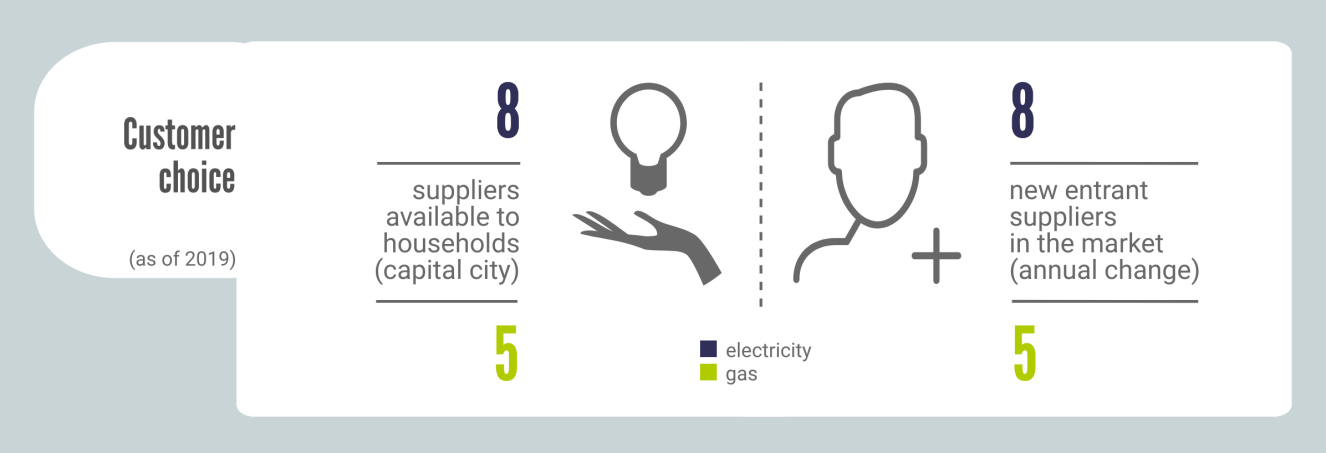



The Latvian gas market opened to competition more recently, opening fully in July 2017 following the expiry of an exemption from the Gas Directive. Non-household users then had to choose a new natural gas supplier, while household users had the option to stay with the incumbent (with regulated prices) or choose a new supplier and thus become a market participant. Several suppliers launched operations at this point. The opening of the market ties in with developments in infrastructure (e.g. Balticconnector pipeline and other interconnections, modernization of the Inčukalns underground gas storage facility) and markets to integrate the Baltic gas markets (see "Generation & interconnections" section below).

Indeed, the commissioning of new power and gas links to Europe in 2014-2015 marked a shift in mindset around energy in Latvia, from being a constant security threat to a business opportunity. Regional and European integration is ongoing, including integration of the Latvian, Estonian and Finnish gas markets in 2020 and a Baltic Capacity Calculation Region established together with the regulators in the other Baltic states, Finland, Sweden and Poland to harmonise capacity allocation and congestion management.

## Market structure

The regulator Public Utilities Commission (Sabiedrisko pakalpojumu regulēšanas komisija, SPRK) oversees both electricity and gas wholesale and retail markets. The TSO for electricity is JSC Augstsprieguma tīkls and for gas JSC Conexus Baltic Grid. In electricity, one dominant DSO covers 99% of the market, although 10 small local DSOs (with < 100 000 customers) also exist. At the end of 2019, there were 37 registered electricity suppliers, of which 27 were active, and the largest (Latvenergo, the incumbent) dominated the market. 17 electricity suppliers supplied electricity to household users, 25 suppliers to non-household users. In gas, at the end of 2019 there were 22 registered gas suppliers, of which 16 were active. 5 gas suppliers supplied gas to household users, 11 suppliers to non-household users. Supplier JSC Latvijas Gāze operates as an effective monopoly, dominating the gas market. In gas, there is only one DSO (JSC Gaso).




### Generation & interconnections

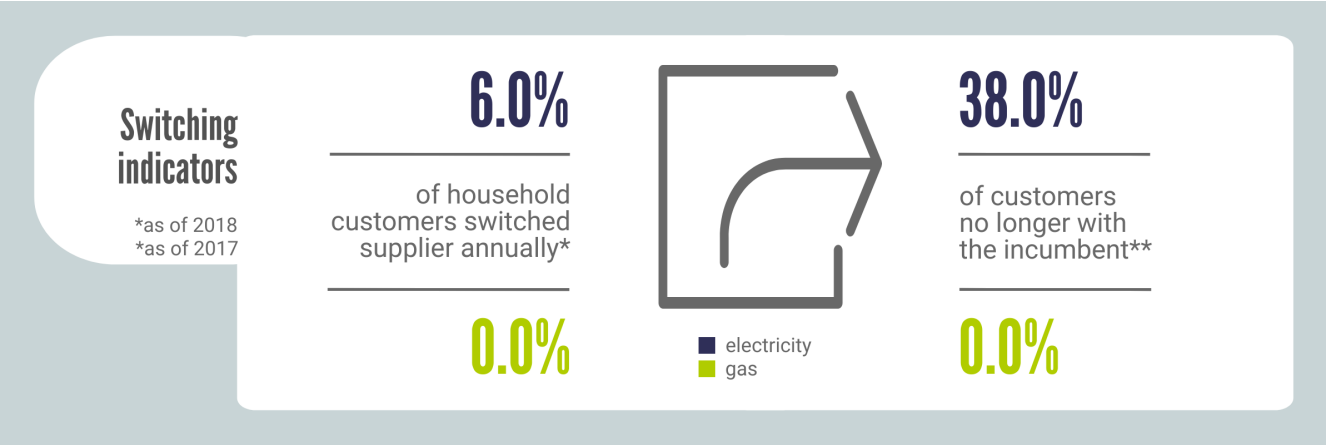
The country already generates around half of its electricity consumption from RES, predominantly hydropower and biofuels. Out of 2840 MW total generation capacity, wind accounts for 77 MW, hydro for 1563 MW, and cogeneration for 1299 MW, including natural gas, biogas and biomass. Co-generation of power and heat accounts for over half of Latvia's gas use (57% in 2014), and hence gas demand is strongly dependent on weather conditions. In 2017, Latvia's entire electricity consumption was traded on Nord Pool. As part of the National Energy and Climate Plan 2021-2030, Latvia aims to decrease its energy imports to 30% of national consumption by 2030. The Latvian electricity system is integrated into the Russian single energy system (BRELL) and network frequency is centrally regulated in Russia. However, like its Baltic neighbours, Latvia plans to detach in favour of increased connection either with the Nordic or Central European system pending successful implementation of The Baltic Energy Market Interconnection plan (BEMIP), With political support from the European Commission and European Union[1]. This will enable the Baltics to trade more easily on EU energy markets and will open up more diversity in primary energy sources, supporting energy independence. However, this is not likely to be realized before the end of the 2020s at the earliest. Similarly, in gas, Latvia is moving from an almost complete dependence on Russia for its gas to other sources, notably an LNG terminal that opened in 2015 in Klaipeda, Lithuania, with potential to

[1] The EU is actively seeking to integrate electricity and gas markets more deeply across the Baltic region, to achieve more competition and security of supply with less dependence on Russia, in its Baltic Energy Market Interconnection Plan (BEMIP).

incorporate biogas from across the Baltic. Since the beginning of 2020, the Latvian gas market is integrated with the Finnish and Estonian markets, with increasing harmonization planned over the next few years.

### State of unbundling

In Latvia's Energy Law, for both electricity and gas, a DSO may be vertically integrated with a supply company but must be a separate corporation, an independent legal entity, and with transmission and trading activities separated both in practice and in management. The separate identities must be communicated through e.g. branding. However, a legacy market structure persists through the major supplier and the major DSO being co-owned, allowing Latvenergo to retain considerable market influence beyond its immediate retail market share. Its subsidiary Enerģijas publiskais tirgotājs, spun off in 2014, is the "public trader", and the TSO, established in 2013, still rents network assets from another subsidiary of Latvenergo, "Latvijas elektriskie tīkli". Similarly, the previous monopoly gas supplier Latvijas Gāze has been split up, but its distribution and supply arms remain co-owned. Nevertheless, the regulator monitors DSOs to ensure they are fulfilling requirements around independence, promoting a level playing field for all market participants on equal terms.

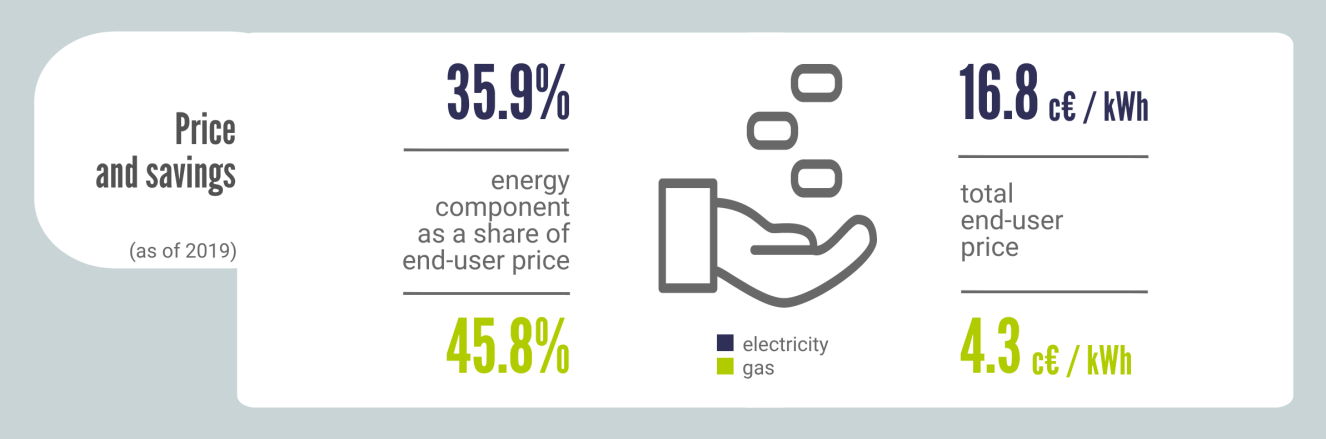



### Status of competition

In electricity, Latvenergo, the incumbent, dominates the retail market with an overall market share of 62%. Together, the top 3 suppliers control 80% of the market. In 2018, 6% of household customers and 18% of non-household customers switched electricity supplier, and correspondingly the non-household segment has more active electricity suppliers than the household segment, which opened later. Household customers' electricity consumption is low, 1774 kWh per year, so households accounted for only a small share (23% of the country's total consumption in 2017) compared to services (43%) and industry (28%). In gas, the ex-incumbent supplier JSC Latvijas Gāze still effectively operated as a monopoly on the household market until recently, with market movement beginning in the 2nd half of 2019 with an estimated few thousand customers switching. Only 9% of gas consumption was by individual households in 2018, down 2% from the previous year; as in other Baltic countries, the gas market is shrinking.

## Regulatory market characteristics

Price regulation exists for vulnerable household customers (vulnerable being broadly defined, with four categories, including also families with three or more children) in electricity, and additionally for inactive customers (who have not actively chosen a supplier) in gas. These regulated offers (essentially a tariff discount) are provided by the company designated as the "public trader" (by virtue of being the largest supplier), currently the incumbents Latvenergo and Latvijas Gāze, respectively but set to broaden to other suppliers. No licence as such is required to act as a supplier, only registrations, and until recently many registered supply companies were not yet active on the market. The proportion of active registered suppliers is in 2020 approximately 75%. The end-user bill includes energy, transfer and distribution tariffs, taxes and, as of the beginning of 2020, mandatory procurement components (MPC, which contributes to environmental goals).




Given the recency of full market liberalization, the Latvian authorities present a stance that is broadly pro-competition, although action on some fronts (e.g. price regulation in gas) is somewhat slow. There are no public plans for substantial changes to the structure of the market.

## Other market characteristics

Prices in wholesale are relatively stable for both electricity and gas, both of which are traded on international platforms (NordPool and GetBaltic). All electricity is traded on the NordPool spot exchange, but in gas trade is still mainly OTC. Nonetheless, as domestic generation relies heavily on hydro plants, electricity prices are somewhat sensitive to weather conditions affecting hydrological conditions. Margins for household suppliers are relatively small due to the low consumption, but not problematically so, as is the case in the other Baltic states. One feature of the Latvian market shared with it Baltic neighbours is the situation of the electricity system, which is coupled with the Russian system. Hence, balancing products are requested by the Latvian TSO but triggered by Russia, except the manual frequency restoration reserve (mFRR). The balancing market, on the other hand, is operated on a joint Baltic basis since 2018. National TSOs retain responsibility for imbalance in their area, but common imbalance settlement rules and prices are applied across the region. There is an ongoing project to integrate the balancing markets of the Baltics with the Nordic market.

## Context for aggregation/demand response

Broadly, Latvia's energy system is not considered unfriendly to innovation, and the authorities are aware that increasing intermittent generation as part of climate and energy independence strategies will require more flexibility in the system. Businesses are required to undergo independent energy audits, so potential interest in demand-side management to reduce consumption exists, and the TSO has participated in an international pilot of a flexibility platform to facilitate access to Demand Response (DR) for DSOs and Balance Responsible Parties (BRPs). However, very little activity has happened in demand-side management as yet. Smart-meter roll-out, which would put in place a key technological asset for aggregation and demand-response, is in progress, with targets of 80% by 2020 and complete by 2022. In addition, there is little evidence that demand-side flexibility is being actively taken into account in planning of legislation or markets, despite the opportunity that decoupling from Russia and integration with European systems presents for innovative grid and market development. Nonetheless, a concept proposal exists for a harmonized introduction of DR, particularly aggregators, across the Baltic region, developed in 2017 together with the other Baltic TSOs. The initial focus is creating a standardized product specifically for DR to participate in the mFRR, where aggregation could bring the greatest benefit. Other products such as the primary and secondary reserves (aFRR, FCR) cannot yet be opened as the Baltic countries are part of the Russian Synchronous System; decoupling from this system will require the Baltic states to take on more responsibility for balancing, hence flexibility.

# BARRIERS

The European Barriers to Entry and Competition in Retail Energy Markets project has researched barriers across 30 European markets. From this research, barriers to entry have been identified and grouped into four over-arching pan-European barriers' blocks.

**Over-arching pan-European barrier blocks**

| Barrier Blocks | | |
|---|---|---|
| | 1 | Regulatory disincentivisation |
| | 2 | Market inequality |
| | 3 | Operational and procedural hinderance |
| | 4 | Customer inertia |

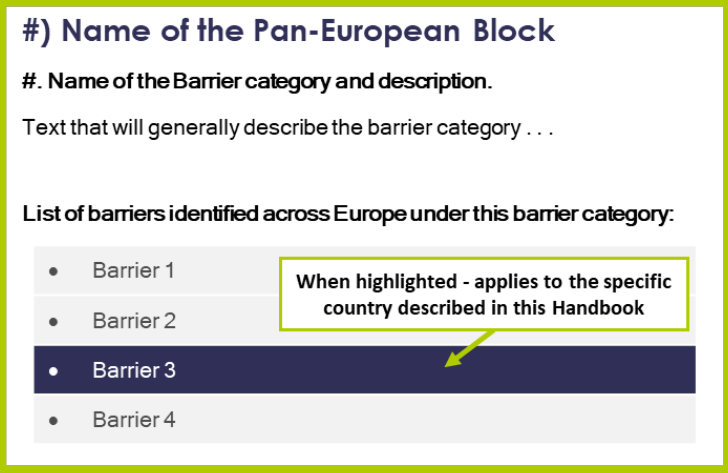
**Description of the four-over-arching pan-European barrier blocks:**

1. **Regulatory disincentivisation:** barriers arising as a consequence of the general regulatory framework of the natural gas and electricity retail markets. We address the impact of price regulation, burden (-sharing), regulatory unpredictability and access to innovation. All these items may disincentivize competition within the natural gas and electricity retail markets, as well as entrance by new suppliers.
2. **Market inequality:** barriers arising from an uneven playing field for different types of suppliers. Often, certain market players already have a competitive advantage by being very close to the formerly integrated DSO (or still being vertically integrated in case the de-minimis rule applies), controlling a large amount of generation capacity or having a large market share. If market rules do not prevent this, such players can exercise their market power to treat other market players in a discriminatory way, creating market barriers. We examine issues related to unbundling, historical roles and access to market mechanisms.
3. **Operational and procedural hindrances:** barriers arising as a consequence of the complexity and national/regional differences in standards and procedures in different process areas, affecting how easily new entrants can enter and operate in the energy retail market. We look at issues and differences in licensing, signing up and operations compliance, as well as data access, processes and data management from the suppliers' point of view.
4. **Customer inertia:** barriers arising due to customer behavior and attitude. For the energy market to function, end-users must be willing and able to switch supplier. If customers do not switch supplier, suppliers need not worry about losing customers, so there is no incentive for suppliers to improve their services, minimize prices or innovate to compete for customers. We examine barriers related to customer inactivity or disinterest in the energy markets.

Within each of these high-level blocks are contained sub-categories, which are also mostly pan-European in nature. Each of these sub-categories contain the specific barriers which relate to individual markets as described in the following chapter. Altogether, we identified 45 barriers, most of which broadly across Europe. Only a selection of them apply to the Latvian case as reported in the following chapters of this handbook.

# HOW TO READ AND INTERPRET THE FOLLOWING SECTIONS

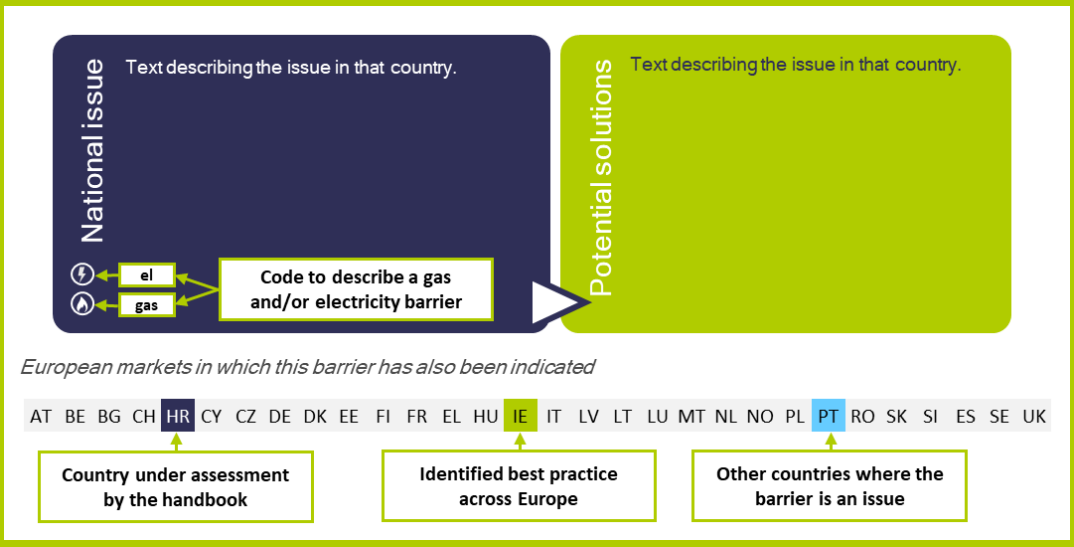
Each of the following four chapters explores one of the four pan-European blocks of barriers and report how each sub-category barrier apply to Latvia. When a barrier applies to Latvia, it will be highlighted in the table following a general description of the barrier itself as shown in the example below:




As shown in the figure above, the table lists all the barriers we have identified in Europe within the specific barrier category. **Only if a sub-category barrier is highlighted in the table does it mean that suppliers raised it as a barrier, and that it is a prevalent issue in Latvia.**

Highlighted sub-category barriers are then briefly described following a twofold methodology which

- reports what the suppliers are experiencing in the market as a national issue and
- suggesting potential solutions to the problem as depicted in the figure below.




At the end of each chapter, Latvia's performance within the category, according to quantitative indicators, is then presented.

For additional market context, please see Appendix 1: Processes, which gives a high-level graphical overview of the most critical steps involved in establishing and operating as a supplier in the national market.

# 1) Regulatory disincentivisation

Within regulatory disincentivisation, barriers across Europe have been sub-categorised into four areas encompassing 17 specific barriers[2]:

1. **Price regulation.** Regulated prices usually refer to regulation or control of end-user's prices by a public authority, usually the National Regulatory Authority (NRA). Price regulation can take different forms, such as setting or approval of prices, price caps or various elements of these. In Europe, there still exist Member States which have maintained end-user regulated prices during the market opening process and after, in the intention of protecting households or even non-household customers from significant increases in energy prices, especially in a context of limited competition. In some cases, this regulation has led to below cost prices and to low margin to cover the supplier activity risk, discouraging investments and the emergence of newcomers.
   According to CEER[3], 14 European countries out of 27 answering a recent CEER survey have price intervention in electricity for household consumers. Where regulated prices remain, NRAs tend to consider them as a significant barrier to entry for alternative suppliers. All Member States, where NRAs consider regulated prices as a significant barrier, are planning to remove them, at least for non-household customers. Across Europe, the following specific barriers related to price regulation were detected by this study. Those highlighted in blue have been raised, indicated or identified as barriers in Latvia:

   - Price regulation discriminates against certain suppliers.
   - High penetration of price regulation
   - Low margin of regulated offer (margin squeeze)

2. **Burden sharing.** Energy suppliers across Europe are often required to collect payments for services not part of their business, or to provide other services such as services related to energy efficiency, or to manage assets such as those of the metering system. These requirements can pose a barrier for suppliers' operation on the retail market by raising their costs and distracting focus from their core business and might deter entry into the retail market by newcomers. Across Europe, the following specific barriers related to "burden(-sharing)" were detected by this study. Those highlighted in blue have been raised, indicated or identified as barriers in Latvia:

   - Obligation to collect tariffs unrelated to energy on behalf of others.
   - Obligation to keep a minimum-security stock as a gas reserve

3. **Regulatory unpredictability.** The establishment of an internal natural gas and electricity market in the European Union is an ongoing process. European legislative packages are boosting this process, making

[2] Please note: these definitions are Europe focused, not specific to Latvia. Highlighted barriers have been identified as country specific.
[3] Monitoring Report on the Performance of European Retail Markets in 2018. CEER Report 4 November 2019.

market regulation evolve rapidly. Transposition of regulation into the national regulatory frameworks is not always smooth and NRAs' actions are sometimes unpredictable. This leads to uncertainties for suppliers related to unclear and unknown future developments of the regulatory framework, including the attitude of the institutions that regulate the retail market and oversee market operation and organization. This uncertainty is a barrier that impacts suppliers' business, preventing their entrance in the market, making strategic business planning difficult or forcing them to adopt different approaches during operation. Across Europe, the following specific barriers related to "unpredictability of regulatory framework" were detected by this study. Those highlighted in blue have been raised, indicated or identified as barriers in Latvia:

- Suppliers face uncertainty because of a newly liberalized regulatory environment or uncertain future development of the regulatory framework
- Uncertainty caused by industry actors influencing legislation, e.g. incumbent or associations shape legislation
- Uncertainty regarding future regulatory developments, especially in the field of digitalization and new technology
- Attitude of authorities hinders development of the market
- Uncertainty regarding environmental obligations and non-renewable generation capacity

4. **Access to innovation.** Most European energy market are currently designed based on practices as they were during the period of national monopolies by what today are incumbent suppliers. Allowing suppliers and new entrants to be innovative depends not only on the opportunity to compete on prices, but also to diversify, welcoming new products, market actors and business models. When national regulatory frameworks do not take into account innovation in the retail market (regarding e.g. availability and functionality of smart metering, the possibility of flexible contracting and tariffs, or whether the demand side can bid in the balancing system), this may pose a barrier for new market entries, particularly more modern players. If new entrants are to be enabled in order to increase the level of competition in the retail market, regulations must accommodate future developments on the energy markets, especially considering that in the future new entrants may not only be electricity and gas suppliers but also act as aggregators or energy service companies (ESCOs). Across Europe, the following specific barriers related to "innovation-friendliness" were detected by this study. Those highlighted in blue have been raised, indicated or identified as barriers in Latvia:

- Data protection issues
- Lack of incentivisation for novel pilot projects or post-pilot market rollout
- Lack of data for innovative product development
- No fit between new business models and existing regulation/obligations
- Missing flexibility in tariff structures
- Missing information and incentives for demand-side grid management
- Market structures does not incentivize novel products (missing perceived value)

## 1.1 Description of regulatory disincentivisation barriers in Latvia: Price regulation

**Price regulation discriminates against certain suppliers.** In the research this barrier was indicated as an issue in Latvia. Price-regulation can be discriminatory if it only allows certain market participants to serve price-regulated customers. By only allowing the incumbent supplier to offer the regulated price to a specific customer segment, other market participants are per se excluded from this market.

**National issue**

In gas, household supply at regulated prices is only available to the "public trader" retailer, a role designated to the largest supplier, which is the incumbent. This system tends to keep the **market structure skewed in favour of the incumbent**, making it harder for new entrants to break in. Hence, price regulation was felt to hinder free competition.

**Potential solutions**

Price regulation in gas was due to stop in 2019, which would remove this barrier entirely. While price regulation persists, its market-skewing effects could be minimized by allowing any supplier to act as a public trader, i.e. offer the regulated prices. However, this depends on the level of the regulated price (see below).

*European markets in which this barrier has also been indicated*

AT BE **BG** **HR** **CY** CZ DE DK EE FI FR EL **HU** IE **IT** **LV** **LT** LU NL NO **PL** PT RO SK SI **ES** SE **UK**

**High penetration of price regulation.** In the research this barrier was raised as an issue in Latvia. The price-regulated part of the gas market is not contestable for a new entrant as consumers with access to regulated services are extremely difficult to reach with competitive offers. This leaves only a small part of the market (non-household customers) is contestable. Price regulation thus maintains the old structure of the market, where consumers do not face risks and do not have to care about comparing offers and choosing a supplier.

**National issue**

In gas, "public trader" tariffs are available to **all customers if they have not actively chosen** a supplier, not just the vulnerable. This hinders free competition as only a single player - the incumbent - can sell to this market segment, in which it is hard for smaller new entrants to offer sufficiently competitive prices to attract customers. This maintains the old pre-competition market structure instead of allowing it to diversify. Electricity prices are regulated only for vulnerable customers, a small market segment.

**Potential solutions**

Price regulation in gas was due to stop in 2019, which would remove this barrier entirely. While it persists, shrinking the proportion of customers eligible for regulated prices would help open a larger part of the market to competitive offers. This could be accomplished by interventions to encourage non-vulnerable customers onto the market, for example by raising their price after a certain period with the default supplier, as in Norway.

*European markets in which this barrier has also been indicated*

AT BE **BG** **HR** CY CZ DE DK EE FI **FR** EL **HU** IE **IT** **LV** **LT** LU NL NO **PL** **PT** **RO** **SK** SI **ES** SE UK

**PORTUGUESE BEST PRACTICE CASE: Roadmap for removal of regulated retail prices.** Portugal removed end-user price regulation for non-household customers and the transitional period ended in 2016. As part of the phase-out process, which started in 2010 for gas non-household customers and in 2011 for electricity non-household customers, a transitional period was defined by the government in Portugal in order to enable customers supplied under regulated end-user prices to choose a new market supplier and move to the liberalised market. During this period, the NRA (ERSE), sets a tariff (called the 'transitional tariff'), which may include an additional value, whose objective is to promote customers to switch to a market tariff.
Lastly, under the terms of Government Ordinance N. 39/2017 of 26 January 2017, consumers who still have regulated tariffs have a transitional period until 31 December 2020 to choose an electricity market supplier. While, under the terms of Government Ordinance N. 144/2017 of 24 April 2017, consumers who still have regulated tariffs have a transitional period until 2023 to choose a natural gas market supplier.

**Low margin of regulated offer (margin squeeze).** In the research this barrier was indicated as an issue in Latvia. If the regulated price is set to such a low level that only companies which benefit of economies of scale (i.e. the incumbent) are able to generate a sustainable margin, all other market participants struggle to compete. Furthermore, a lack of transparency in the pricing mechanism increases the barrier by making it difficult for market players to anticipate the regulated price and price against it.

**National issue**

The mechanism for setting regulated tariffs for households in gas (currently only available to the incumbent, see above) is felt to be non-transparent, although the methodology is publicly available. Nonetheless, rates often do not reflect the actual market situation, and are instead very low. The incumbent with its broad customer base can survive offering these low prices better than a new entrant with fewer customers and higher establishment costs. Suppliers even fear that some kind of compensating mechanism is incorporated in the regulated price, implying a government revenue source for the incumbent unavailable to other players.

**Potential solutions**

The regulated price functions as a market benchmark, effectively being the main competitor, and a recent new entrant is pricing against it. More clarity around price-setting mechanisms would allow other gas suppliers to price competitively and dynamically against the regulated price. If indeed compensating mechanisms do contribute to keeping prices low, these should be either made available to all players or removed.

*European markets in which this barrier has also been indicated*

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**SPANISH BEST PRACTICE CASE: Low margin of regulated offer.** Before 2014, the price regulation regime (PVPC) raised many complaints from electricity companies, claiming that the price was set below cost or may have too limited margin to cover the risk of activity.
Hence, a new Royal Decree was issued (RD 216/2014), establishing a new methodology for calculating the PVPC, including the energy cost, the applicable access tariffs and a commercial margin.
The main difference is that the energy cost is now calculated on an ex-post basis, using the average price resulting in the spot electricity market during the period covered by the bill. In the case of consumers with an operative smart meter installed (as of now, more than 98%), since 1 October 2015, a real consumption tariff following the spot price, is applied. The real time price is published by the electricity TSO through ESIOS platform.
Having a pass-through of the energy cost from the electricity spot market is considered as a best practice within the price regulation category. This prevents the energy component of the regulated tariff to be set below cost. However, the customers exposure to the volatility of the spot market may trigger further Government interventions.
Discussions still exist about the value of the commercial margin, which still is seen as too low by reference suppliers and limits the ability to compete of new and small companies. Also, having a price regulation in place that applies to the 95% of the retail market is perceived as hindering competition among suppliers. Suppliers wish a phase-out of price regulation regime, with a clear plan defined by the relevant institutions.

## 1.2 Description of regulatory disincentivisation barriers in Latvia: Burden (-sharing)

*No barriers around burdens on suppliers or burden-sharing were identified in Latvia.*

## 1.3 Description of regulatory disincentivisation barriers in Latvia: Regulatory unpredictability

**Suppliers face uncertainty because of a newly liberalized regulatory environment or uncertain future development of the regulatory framework.** In the research this barrier was raised as an issue in Latvia. In the relatively new liberalized regulatory environment, sources of uncertainty may include poorly defined responsibilities between actors, unclear regulatory orientation into the future, etc.

**National issue**

The market environment for gas was reported to feel unstable, perhaps partly as a consequence of rapidly switching to the common FinEstLat integrated market only a few years after initial market liberalization. Uncertainty is a barrier to planning operations and development.

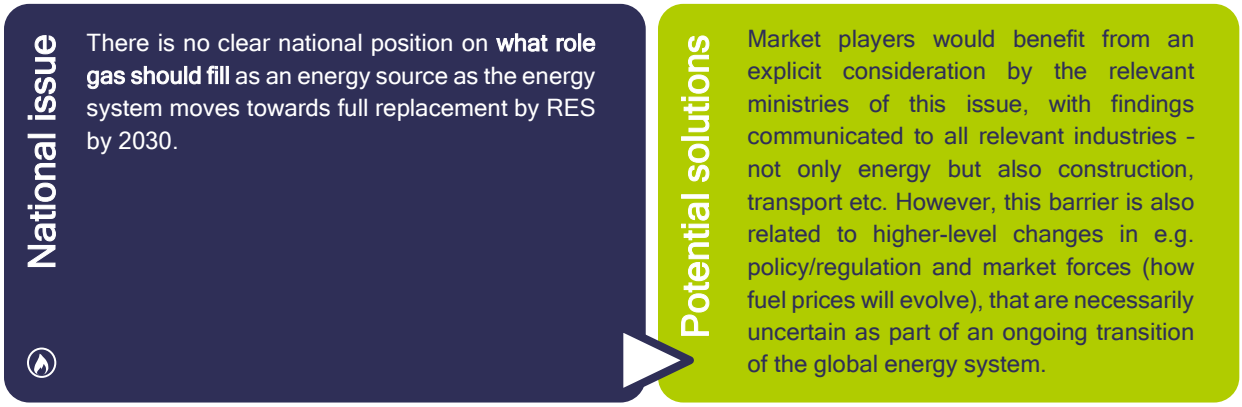
**Potential solutions**

Looking across many European markets, this study has found that regulatory uncertainty tends to be linked with three things: (1) many simultaneous developments; (2) unclear timelines for implementing changes; (3) poor communication of regulator with stakeholders. Hence, a more directed and firmer planning scheme, together with regular updates and consultation with market players, would alleviate this barrier.

*European markets in which this barrier has also been indicated*

AT BE BG HR CY CZ DE DK EE FI FR EL HU IE IT **LV** LT LU NL NO PL PT RO SK SI ES SE UK

**Uncertainty regarding environmental obligations and non-renewable generation capacity.** In the research this barrier was raised as an issue in Latvia. Uncertainty around the future of the generation mix and capacities increases price risk.




*European markets in which this barrier has also been indicated*

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## 1.4 Description of regulatory disincentivisation barriers in Latvia: Access to innovation

There is very little activity around in demand response or other novel products in Latvia for the time being, with no commercially active DR products and only a nascent prosumer market. Barriers around DR were not raised by respondents in Latvia, but this is more a result of the negligible extent of commercial DR in this market rather than an absence of the underlying issues. Problems such as data accessibility, customer access, or regulation around novel business models could yet present barriers to DR, distributed energy resources and other innovative products as they become more established in the country and fully exposed to the market landscape. For example, Latvia's data systems (see section 3.2) currently imply potential for certain actors to restrict data access for new players, and smart meter roll-out is not a government priority (see Appendix 1: Processes, section 6).

**Lack of incentivisation for novel pilot projects or post-pilot market rollout.** From our studies of this market, it appears that this would pose a barrier in Latvia. Lack of financial incentives as well as missing technical support can be a major barrier for conducting pilots in DR and other novel technologies, as the piloting firm then bears all the risk for this experimental work.

**National issue**

Few novel pilots have been conducted; the continuation of a flexibility platform pilot beyond the project period is far from clear due to uncertainties around how it would be supported. Rolling out innovative technologies in the Latvian residential market faces the challenge of **how to collectively encourage and organize apartment owners** to install necessary technology in shared spaces, given that most people live in privately owned apartments in larger blocks.

**Potential solutions**

As the liberalized market matures in Latvia, more novel players are likely to be attracted to the market with new business models and services. Hence, this barrier is likely to decrease naturally. The authorities could learn lessons from other countries where pilots are explicitly commercially encouraged by the promise of remaining on market after the pilot period, e.g. Finland.

*European markets in which this barrier has also been indicated*

AT BE BG HR CY CZ DE DK EE FI FR EL HU IE IT LV LT LU NL NO PL PT RO SK SI ES SE UK

**FINLAND BEST PRACTICE CASE: Incentivizing novel projects**

Finland was raised by respondents as the best example among the Nordic countries of authorities encouraging pilot projects in novel services/products. The high opinion was mainly due to the practice of encouraging post-market roll-out of the service/product upon project completion. This raises market players' confidence that the authorities take seriously the need for integrating novel players into the system, and the potential for soon becoming commercially active naturally acts as a strong attraction for companies to get involved in such pilots. Encouraging participation in this way benefits the energy system by making it more likely that projects and players providing crucial new developments will be found. Under the Finnish approach, with good opportunities for suppliers to cooperate with the TSO, flexibility development happens through pilots. Indeed, Finland's energy system is felt to be the most conducive (at least in the Nordics) for products such as DR and aggregation, indicating that lessons have been learnt effectively from pilots.

**Missing flexibility in tariff structures.** From our studies of this market, it appears that this no longer poses a barrier in Latvia, providing an example of a potential solution for other countries to learn from. The potential of tariff structures to be flexible is a main driver of demand flexibility as it allows the design of incentive-based tariffs, e.g with several Time-Of-Use tariff zones, encouraging customers to consume when it is cheaper. Rigid or flat structures, which are defined by regulation, hinder new and innovative demand-shifting offerings on the market.

**LATVIAN BEST PRACTICE CASE: Grid tariff flexibility**

Inflexible tariffs can **no longer pose a barrier** to innovative products in Latvia, as recent regulatory changes enabled networks to charge more dynamically for distribution. In 2016 **differentiated distribution tariffs** were introduced for electricity market, which have been shown to **reduce end-user costs**. In 2019 differentiated distribution tariffs were introduced in natural gas market. Through these tariffs, end users are incentivised to decrease their connection capacities if appropriate, reducing their distribution costs and freeing up system capacity both for security and efficiency of supply and new connections.

*European markets in which this barrier has been indicated*

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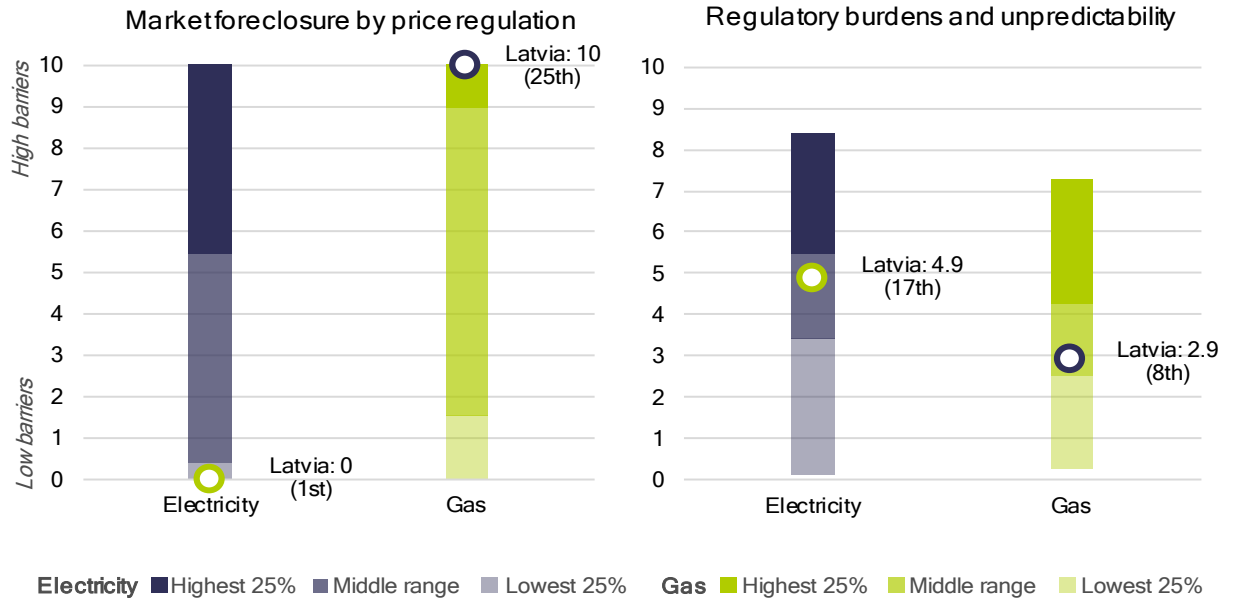
## 1.5 Latvia's performance in this barrier category

The following figure shows quantitative indicators of how far regulatory disincentivisation acts as a barrier in this market. The values for Latvia are shown against the range across all analyzed countries. These scores contribute to the performance index. The performance indicators of regulatory disincentivisation are the following:

- **Market foreclosure by price regulation:** The index consists of two sub-indicators, the penetration of price regulation (among residual customers), and the mark-up of the regulated offer. A high score is attributed if a high share of customers is supplied at regulated price, and the mark-up is significantly lower than the average mark-up in the competitive markets.
- **Regulatory burdens and unpredictability:** The index consists of two sub-indicators. Regulatory burdens reflect the non-energy share of the energy bill in an average household, which are regulated (taxes, network fees). Regulatory unpredictability was measured via the related question in the supplier survey conducted for this project. A high score is attributed if the share of the non-energy elements is high, and if survey respondents scored the question highly (as an important barrier).

**Performance indicators**




Latvia was ranked joint 1st across Europe for price regulation in electricity, where no prices are controlled, but 25th in gas, where low regulated prices effectively lock out new entrants from the market. For regulatory unpredictability, Latvia was ranked 17th in electricity, 8th in gas).

## 2) Market inequality

Within market inequality, barriers across Europe have been sub-categorised into two areas encompassing 8 specific barriers[4]:

1. **Unbundling and market power.** In order to facilitate better competition and improve performance of the individual parts of the energy companies, the Energy Directives introduced rules for legal, functional and accounting unbundling between DSOs and supplier. Although legal unbundling has been implemented throughout all EU member states, barriers arising from vertical integration can still be observed in many markets, raising the question if the required level of unbundling is sufficient in order to meet the goal of a fair and competitive retail market. Companies serving less than 100 000 customers are only obliged to implement accounting unbundling.

   In order to avoid confusion among end customers between the separate parts of integrated energy businesses, brand unbundling has been a focus area for NRAs over the last years. Nevertheless, in several EU countries, the difference in the branding of the supplier and the DSO is perceived as insufficient. Strategic and unfair advantages for incumbent suppliers around transparency, pricing and access to information and data occur in most of the European countries studied. Access to production capacities can also be limited for small suppliers if market players with a large generation portfolio can withdraw production capacity from the accessible markets. Balancing and ancillary services markets can also be distorted as they are often still designed to mainly benefit large-scale generation, discriminating against smaller market participants. Below, we describe these barriers related to market power in more detail. Across Europe, the following specific barriers related to “unbundling and market power” were detected by this study. Those highlighted in blue have been raised, indicated or identified as barriers in Latvia:

   - Lack of brand unbundling
   - Discriminating, strategic behaviour of incumbent, and obstruction by other market players.
   - Strategic, unfair advantage of vertically integrated market players and lack of transparency.
   - Limited or biased access to production.
   - Discrimination against new and small market players in capacity and ancillary services markets.

2. **Equal access to and maturity of wholesale market.** The wholesale markets present one of the most important sources for energy procurement for all market participants. New and small suppliers tend to have weaker bargaining position in bilateral negotiations, which occurs higher sourcing costs, therefore leading to a competitive disadvantage. Access to a well-functioning wholesale market (an energy exchange) therefore enables smaller suppliers to buy energy for competitive prices.

[4] Please note: these definitions are Europe focused, not specific to Latvia. Highlighted barriers have been identified as country specific.

Barriers related to the wholesale market can arise by discriminatory market platform access and the absence of any viable alternative. Furthermore, a lack of available products and low liquidity can both lead to an increase in risk, disadvantaging small market participants substantially more than large, established suppliers. Across Europe, the following specific barriers related to "equal access to and maturity of wholesale market" were detected by this study. Those highlighted in blue have been raised, indicated or identified as barriers in Latvia:

- Discriminatory market platform access (standards, guarantees, etc.)
- **Low liquidity in the wholesale market**
- High price or volume risk in energy procurement

## 2.1 Description of market inequality barriers in Latvia: Unbundling and market power

**Discriminating, strategic behaviour of incumbent, and obstruction by other market players.** From our studies of this market, it appears that this has the potential to pose a barrier in Latvia. In other markets, the incumbent or existing suppliers are able to use tactics in pricing, customer access etc. not available to new entrants without an established customer base. Market players with a high market share may also act obstructively, especially around data exchange.

**National issue**

Although market players have not yet found this to be a barrier, it appears that there would be potential for unfair strategic behaviour by the incumbent given that is still dominates the market and is co-owned with the nearly universal DSO.

**Potential solutions**

In many other countries analysed in this study, the lingering market dominance of the incumbent and its close integration with large DSOs poses a major barrier to operations by new entrants. Carefully designed rules around e.g. switching and customer data access can ensure that, despite the incumbent retaining large market share, other companies can compete on the same terms.

*European markets in which this barrier has also been indicated*

| AT | BE | BG | HR | CY | CZ | DE | DK | EE | FI | FR | EL | HU | IE | IT | LV | LT | LU | NL | NO | PL | PT | RO | SK | SI | ES | SE | UK |
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**Strategic, unfair advantage of vertically integrated market players and lack of transparency.** In the research this barrier was raised as an issue in Latvia. If a DSO is co-owned with a supplier, the holding group may benefit unfairly from its market power, particularly in terms of data information access. For example, the co-owned supplier has the potential to leverage access to network data to target customers based on consumption profiles or win back customers during the switching process.

**National issue**

Latvia's electricity market structure is concentrated and integrated: the incumbent Latvenergo is co-owned with the near-universal DSO and its subsidiary "Enerģijas publiskais tirgotājs", spun off in 2014, is the "public trader" with sole right to supply regulated prices.

The market structure in gas remains monopolistic. The incumbent's advantage of vertical integration exacerbates this as the DSO has power to hinder the switching process (see section 3.1.8). This favours the existing supplier and was reported as a significant barrier.

**Potential solutions**

The concentrated market power in electricity would appear to have potential to act as a barrier to new entrants who do not have e.g. the same access to information. However, the NRA assesses DSO independence with the aim of ensuring a level playing field for all market participants. Indeed, the design of key process such as switching (see section 3.1) are reported to put all players on a level playing field, indicating that the DSO is not acting to favour its sister supply company and hence not posing a barrier.

If similar requirements were applied to gas, that would likely even the playing field for new entrants.

*European markets in which this barrier has also been indicated*

| AT | BE | BG | HR | CY | CZ | DE | DK | EE | FI | FR | EL | HU | IE | IT | LV | LT | LU | NL | NO | PL | PT | RO | SK | SI | ES | SE | UK |
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**GREAT BRITAIN BEST PRACTICE CASE: Unbundling of DSOs and supply businesses**

Great Britain provides an example of well-functioning separation between distribution and supply. Ten of the 14 electric DNOs (distribution network operators) are free standing companies, while 4 are part of groups that include generation and supply businesses. Of the 4 companies that distribute gas, only 1 is part of a group that also owns a gas supply business. The companies that have generation or gas supply affiliates are effectively unbundled. In this study, we found no evidence of incomplete unbundling presenting a problem in Great Britain. DNOs are prohibited from providing end-user services, they are invisible to the customer, and no suppliers in the study had experience of the supplier/DNO relationship being exploited.

**Discrimination against new and small market players in capacity and ancillary services markets.** From our studies of this market, it appears that this could pose a barrier in Latvia. The balancing landscape remains designed for large-scale generation, excluding smaller-scale/aggregated generation or demand-side bids from participating in balancing markets to the benefit of incumbents and other established market players.

**National issue**

Currently, only generation can participate in the Baltic balancing market, with only one market participant in each country. This was not explicitly raised as a barrier by respondents, but it appears that this is a consequence of the lack of DR actors interested in accessing the balancing market. There remains clear potential for a concentrated balancing market with products focused on generation to pose an entry barrier for smaller, demand-side players.

**Potential solutions**

Generation-focused balancing markets in other European markets, e.g. Finland, have made successful steps towards welcoming demand-side actors by actively designing products suitable for the size, response time and availability of demand side bids. This requires the authorities to want to integrate DR into the energy system in order to make the necessary developments.

It is noteworthy that Latvia's energy system, like the other Baltic countries, still works synchronously with the Russian system. Baltic TSOs are responsible for system control, but Russia maintains control of triggering reserves. Decoupling the Baltic national systems from the Russian system is hoped to be implemented by 2025; until then, DR will likely be restricted to the mFRR at best due to challenges in developing larger-scale products compatible with this coupling.

*European markets in which this barrier has also been indicated*

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**FINLAND BEST PRACTICE EXAMPLE: Consumption bids in balancing**

Several respondents active in aggregation and demand response expressed satisfaction at how Finland has redesigned balancing products to make them amenable for demand-side bids, complemented by its market-centric approach to DR. This indicates a willingness to let flexibility play a bigger part in the evolving energy system. Indeed, Finland's attitude to DR is positive and flexible, with respondents feeling that Fingrid is easy to work with and open to novelties. Many of the market structures for DR are an example of how to incorporate demand-side flexibility into the energy system. Some products are necessarily constrained by e.g. fast response times or minimum bid size due to their function, which make them difficult for DR providers to fulfill. However, open-minded amendments such as allowing pooling of loads, enabling step-wise activation or reducing minimum bid size where possible have opened up several products to DR. Developments remain ongoing, e.g. imbalance settlement for aggregators is currently under discussion. Progressive changes at the consumer end have also helped open the aggregation market in Finland, for example allowing 3rd party providers to access customers. Market players reported that the other Nordic countries are now developing in the same direction that Finland already has done, in this and other DR- and novelty-related aspects.

## 2.2 Description of market inequality barriers in Latvia: Equal access to & maturity of wholesale market

**Low liquidity in the wholesale market.** In the research this barrier was raised as an issue in the gas market in Latvia. A lack of liquidity in the wholesale market is a barrier to operation as it leads to higher prices and risks, and therefore increases sourcing costs.

**National issue**

Limitations on other Baltic gas markets (Lithuanian household market effectively closed via regulated prices, Estonian market small), with which Latvia is most closely connected, will impact the functioning of the increasingly liberalized Latvian market.

**Potential solutions**

A joint Baltic gas market with clear and transparent rules would ease cross-border gas trading. The first stages of a joint Finnish-Estonian-Latvian gas market will open in 2020, paving the way for full integration. A more integrated and hence effectively larger market is likely to increase liquidity of the market.

*European markets in which this barrier has also been indicated*

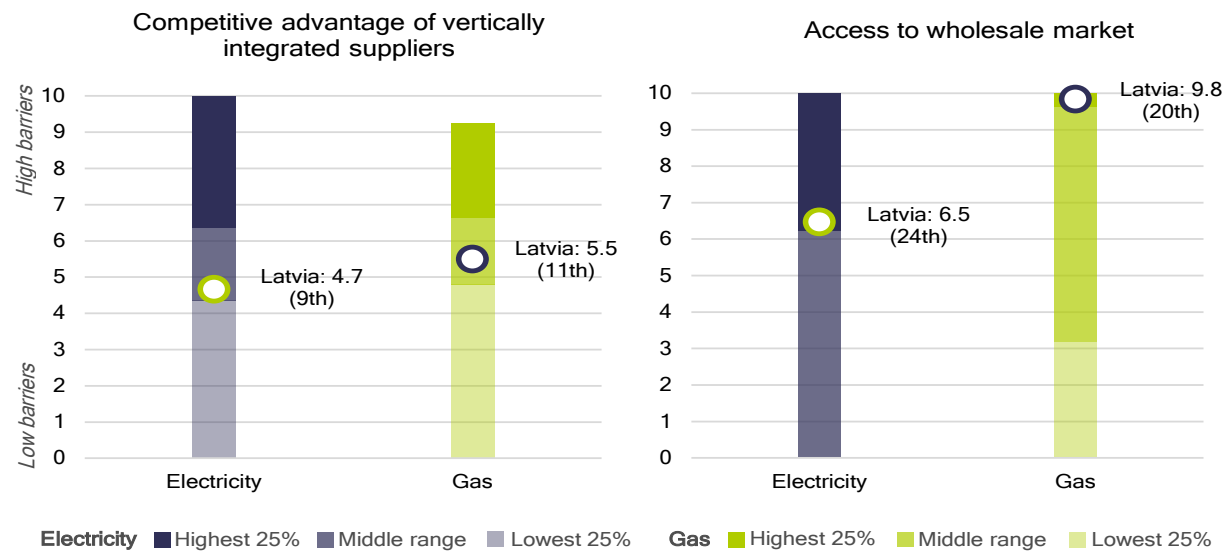
AT BE BG HR CY CZ DE DK EE FI FR EL HU IE IT LV LT LU NL NO PL PT RO SK SI ES SE UK

## 2.3 Latvia's performance in this barrier category

The following figure shows quantitative indicators of how far market inequality acts as a barrier in this market. The values for Latvia are shown against the range across all analyzed countries. These scores contribute to the performance index. The performance indicators of market inequality are the following:

- **Competitive advantages of vertically integrated players.** The index consists of two sub-indicators, the market share of vertically integrated suppliers (on the residential competitive market), and the strictness of DSO unbundling. A high score is attributed if the vertically integrated suppliers have a high aggregated market share, and the unbundling regime is not very strict (brand unbundling is not in force, high share of local, integrated companies).
- **Access to wholesale market.** The indicator measures the accessibility of the wholesale market by quantifying the liquidity of wholesale markets. High score is attributed if the traded volume is relatively low compared to the consumption of the country (churn rate). Traded volume includes volumes that are traded at hub as recorded by brokers (OTC) or exchanges and does not include 'contracted' (LTC or other bilateral deals) volumes which are conducted 'off market'.

**Performance indicators**




Latvia was ranked 9th for the advantage of vertically integrated players in electricity, 11th in gas. It was ranked 24th and 20th respectively for access to wholesale market.

## 3) Operational and procedural hindrances

Within operational and procedural hindrances, barriers across Europe have been sub-categorised into two areas encompassing 13 specific barriers[5]:

1. **Sign-up & operations compliance.** Sign-up, licensing or registration, along with other administrative requirements or system establishment such as arranging contracts with relevant stakeholders (TSOs, DSOs, BRPs) are among the first steps that a new supplier undergoes to enter and operate in a retail energy market. To deliver natural gas or electricity to final consumers in Europe, an energy supplier usually needs to be registered to a certain institution list, or to proceed with a notification, or follow a process to grant a licence. Entrance processes for suppliers often requires commitments such as a minimum standard of customer service obligations, requirements on service quality, to provide financial guarantees or to have a communication system in place.
   In most responding NRA countries, suppliers need to register and make contracts with certain stakeholders (mainly TSOs and DSOs) to procure the access to the energy grid: transport capacity, balancing. This procedure can be very different from a country to another. Accessing wholesale markets and balancing may also require a license or prior agreement/registration with the market operator. In some markets, business processes to enter and operate in the retail market can be extremely detailed and burdensome. The lack of a functioning national wholesale market may also hinder the entrance of retail companies that are not vertically integrated. Across Europe, the following specific barriers related to "sign-up & operations compliance" were detected by this study. Those highlighted in blue have been raised, indicated or identified as barriers in Latvia:

   - Poor availability of information for market entrants & active participants
   - Heavy administrative process for entry (registration / licensing)
   - High financial requirements (incl. long working capital cycles) and forced risk during operations
   - Excessive reporting requirements during operations
   - Excessive information requirements around billing and energy labelling
   - Highly complex or country-specific systems & processes
   - Regional differences or differences between DSOs within a country
   - **Cumbersome or biased switching process**
   - Unduly burdensome environmental obligations
   - Unduly burdensome or insufficiently regulated market exit

2. **Data access & processes.** Data access and management refers to the processes by which data are sourced, validated, stored, protected and processed and by which it can be accessed by suppliers or

[5] Please note: these definitions are Europe focused, not specific to Latvia. Highlighted barriers have been identified as country specific.

customers. In a well-functioning energy retail market, it is important that the information required to operate in the market is available to newcomers (subject to applicable legislation on data protection). This may include information on, for example, individual consumption or more specific meter details. This data is required in order for suppliers to carry out their market role, such as initiating a switch, or billing a customer. A standardized approach to the provision and exchange of data creates a level playing field among stakeholders and helps to encourage new, challenging market actors to enter the market. In order to avoid data management and access processes acting as a significant barrier to entry, Member States' initiatives to standardize data format and processes, including investments in data hub infrastructure, have the potential to make a positive impact. Across Europe, the following specific barriers related to "data access & processes" were detected by this study. Those highlighted in blue have been raised, indicated or identified as barriers in Latvia:

- Lack of data hub
- Complex, heterogenous IT infrastructure and/or low level of digitalisation
- Missing access or poor quality of operations-critical data

## 3.1 Description of operational and procedural hindrances barriers in Latvia: Sign-up & operations compliance

**Cumbersome or biased switching process.** In the research this barrier was raised as an issue in Latvia. Switching is difficult for the suppliers due to the amount of information that must be provided and the time it takes. Existing suppliers have an advantage because they are the default supplier if the switch is not completed.

**National issue**

The switching process was reported to be administratively heavy for suppliers. Moreover, in gas, the DSO may hinder the switching process at any time and demand a written agreement to switch from the customer, even if there are no complaints. Hence, the switching process favours the existing supplier, who has no obligations to "defend" their customer. This was reported as a significant barrier.

**Potential solutions**

Developing a more streamlined process for suppliers to switch customers has the potential to significantly improve the situation and hence favour market activity by customers. This is conceptually linked with having a centralized data exchange (see section 3.2), which would remove much power from the DSO and hence prevent abuse of their current position as information controllers. Switching processes in gas could benefit from being aligned with those in electricity, where switches are reported to the DSO on the same day each month by all players and enacted immediately, so that all suppliers are on the same terms regarding customer win-back.

*European markets in which this barrier has also been indicated*

| AT | BE | BG | HR | CY | CZ | DE | DK | EE | FI | FR | EL | HU | IE | IT | LV | LT | LU | NL | NO | PL | PT | RO | SK | SI | ES | SE | UK |
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**IRELAND BEST PRACTICE CASE: Switching and win-back functions well despite DSO integration**
The central messaging centre in Ireland is well designed, requiring timely messaging of switches and with fair access to that information for all players. Switching messages must be sent only after a customer signs a new contract, but within four days. Win-back may only start after this and is restricted to a 10-day window. Hence, despite there not being a centralized data hub that includes data storage as well as messaging, access to information and the opportunities arising from it are considered equal across market players. Other industry processes were felt to be similarly well-developed and fair.

## 3.2 Description of operational and procedural hindrances barriers in Latvia: Data access & processes

**Lack of data hub.** From our studies of this market, it appears that this has the potential to pose a barrier in Latvia. There is no centralized data hub and hence access to DSOs' information, although the dominant DSO (covering 99% of the market) essentially provides centralized data exchange. This gives the DSO potential power to exploit information flows for the benefit of its integrated supplier, and increases the time and effort required by suppliers to access customer or network data elsewhere, e.g. to enact a switch or target potential new customers.

**National issue**

There is currently no specific data hub in Latvia, which has the potential to create barriers in concert with the information advantage of vertically integrated suppliers: the dominant DSO effectively controls all information exchange and has the potential to abuse its position, especially in gas (see section 3.1).

**Potential solutions**

In several other European countries, a centralized platform for consumption and contract data has eased issues around not only data access per se but also incumbent advantages and even customer engagement. If the regulator or TSO DSO were to develop a well-designed data hub platform for Latvia, it would likely have similarly widespread market benefits.

*European markets in which this barrier has also been indicated*

| AT | BE | BG | HR | CY | CZ | DE | DK | EE | FI | FR | EL | HU | IE | IT | LV | LT | LU | NL | NO | PL | PT | RO | SK | SI | ES | SE | UK |
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**DENMARK BEST PRACTICE CASE: Denmark's DataHub**
The development of the DataHub is held up by market actors in other countries as a good example of regulatory development that involved and cooperated with market players. A key aspect of the successful development process was that a single organization (the TSO) had a clear system-wide responsibility to implement the changes, enabling streamlining of the process. Market players report the launch of the DataHub as the most important recent innovation in Denmark's energy system.

**NORWAY BEST PRACTICE CASE: A well-designed data hub improved market equality in Norway**

The Norwegian market is characterized by a large number of small, local, currently vertically integrated supplier-DSOs. Across Europe, this study has found vertical integration to cause issues around data access, where the integrated supplier (usually the incumbent) has an advantage in data access through its affiliation with the DSO, which collects and controls the information. However, such issues were not raised in Norway.

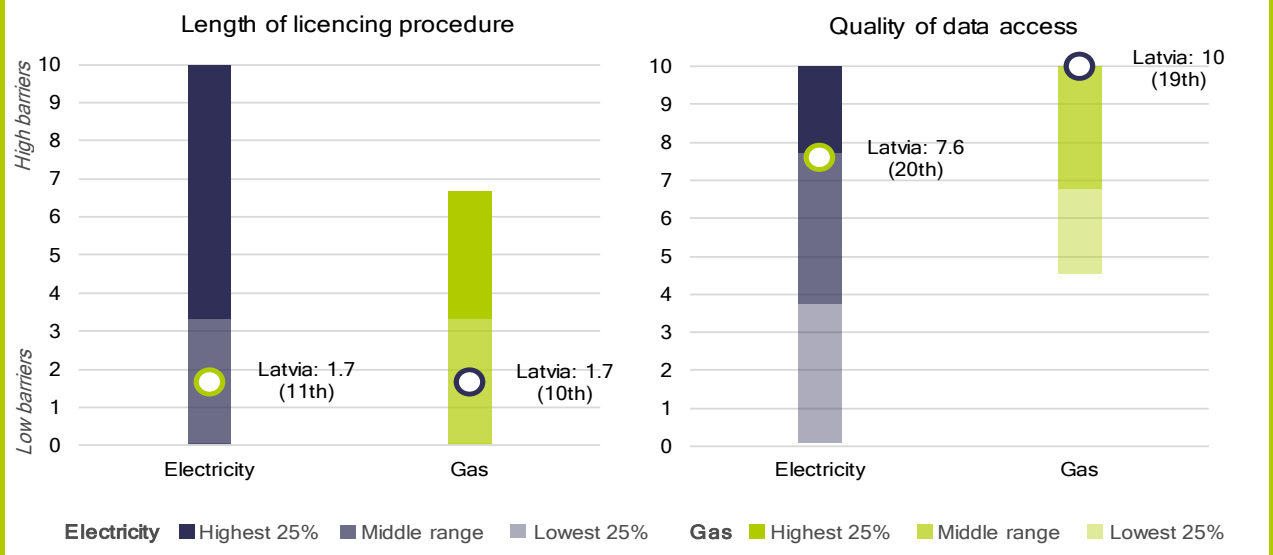
This favourable situation results from the existence since 2019 of a centralized data platform, Elhub, that is functioning near-perfectly according to suppliers to even out the playing field around data access (see section 3.2). Previously, independent suppliers faced delays and obstruction in obtaining customer data from DSOs. The impact on data exchange was so great that one supplier described their dealings with DSOs as “different pre- and post-Elhub worlds”. The Elhub moreover allows the regulator to technologically control that actors are behaving appropriately.

## 3.3 Latvia’s performance in this barrier category

The following figure shows quantitative indicators of how far operational and procedural hindrances act as a barrier in this market. The values for Latvia are shown against the range across all analyzed countries. These scores contribute to the performance index. The performance indicators of operational and procedural hindrances are the following:

- **Length of licensing procedure.** The complexity of the licensing procedure is quantified using the legal deadline of the licensing procedure. A higher score is attributed the longer the regulator’s authorization period, while a score of 0 is attributed if there is no licensing obligation in the country,
- **Quality of data access**. Barriers relating to the quality of data access are measured with a checklist indicator, which focuses on the DSO’s practices regarding data collection and access provision to suppliers. A high score is attributed if the format of the data provision is not standardised, third party access is not available via website or data hub, and the smart meter rollout is small.

**Performance indicators**




Latvia was ranked 11th in electricity and 10th in gas for length of licensing procedures. For quality of data access, it was ranked 20th and 19th respectively.

## 4) Customer inertia

Within operational and procedural hindrances, barriers across Europe have been sub-categorised into one area encompassing 6 specific barriers[6]:

1. **Customer orientation.** Whether customers want to or can engage with the market depends on a broad range of market characteristics, including how well authorities inform and support customers and how energy companies are viewed by the customer. For example, if there is no trusted central place to compare offers from different suppliers, customers may struggle to make an informed choice; or if customers perceive all energy companies as irresponsibly profit-driven, or providing a poor service, they may feel there is nothing to be gained from switching. Moreover, across Europe, most energy markets have been liberalized relatively recently (last 20 years, some only a few years ago), so for a considerable portion of customers the potential for them to engage may still feel unfamiliar. Across Europe, the following specific barriers related to "customer orientation" were detected by this study. Those highlighted in blue have been raised, indicated or identified as barriers in Latvia:

[6] Please note: these definitions are Europe focused, not specific to Latvia. Highlighted barriers have been identified as country specific.

- Lack of information regarding available offers and switching possibilities
- Low customer awareness or interest makes it difficult to attract customers
- Insufficient price signals for end-users
- Changing supplier is cumbersome or has little pay-off for the customer
- Consumers prefer status quo
- Lack of trust in new or foreign suppliers and in new technology

## 4.1 Description of customer inertia barriers in Latvia: Customer orientation

**Lack of information regarding available offers and switching possibilities.** From our studies of this market, it appears that this has the potential to pose a barrier in Latvia. If customers have no neutral way to compare offers or information on how and why to switch supplier, it makes it hard for customers to engage with the market on their own terms and hence discourages participation.

**National issue**

There is potential for customers to be constrained by a lack of information. Only the public trader (the ex-monopoly incumbent for both electricity and gas, currently) is required to publish price information on official website, and then only for its regulated prices. Nonetheless, various products are offered on the market that differ in pricing and other aspects, e.g. products with a fixed price for different time periods or variable market-based products, that could inform and encourage customer choice.

**Potential solutions**

A transparent, neutral comparison site, would benefit customers by allowing straightforward comparison of all available offers. In developing such a platform, Latvia could draw lessons from other countries in this study, where it was felt that the comparison site is too narrow, focusing on price differences and preventing other aspects of the offer, e.g. green energy content, from reaching the customer.

*European markets in which this barrier has also been indicated*

AT BE BG HR CY CZ DE DK EE FI FR EL HU IE IT LV LT LU NL NO PL PT RO SK SI ES SE UK

**NORWAY BEST PRACTICE CASE: Customer information**

Norway has one of Europe's highest switching rates, driven by an informed and interested customer base who have by a wide margin the highest household electricity consumption. DSOs must provide customers with neutral information on how to choose a retailer which is available in the network area, and information about the national price comparison web site. The national price comparison website Strompris.no ranks contracts according to their estimated total cost and is monitored by the regulator to ensure that prices there reflect those on the suppliers' own websites. NVE also publishes a weekly online view of retail market prices. Underlying this, the focus of the market on similar products (open-ended spot-linked contracts) makes it easier for customers to compare offers between suppliers as there are fewer variables to account for. In addition to information on available offers, the authorities actively provide plentiful information on how and why to switch, and the switching process is easy and fast for the customer.

**Low customer awareness or interest makes it difficult to attract customers.** In the research this barrier was raised as an issue in Latvia. If customers are not well informed about their opportunities to participate in the market or are not motivated to use them, they are not driven to seek out or engage with new energy suppliers.

**National issue**

Attracting customers upon move-in is in practice unrealistic process from a gas trader's perspective. Customers tend to stay with the previous supplier, usually the incumbent. The liberalized market is relatively new, and many customers may therefore not be accustomed to engaging with the market.

**Potential solutions**

Despite the difficulty in engaging gas customers, market players consider customer awareness to be sufficient. More information from the authorities to customers moving to a new house could stimulate them to engage with the market, as is implemented in Norway and has worked in trials in Great Britain. As the market matures, customer engagement will likely increase as the opportunities to do so become more familiar.

*European markets in which this barrier has also been indicated*

| AT | BE | BG | HR | CY | CZ | DE | DK | EE | FI | FR | EL | HU | IE | IT | LV | LT | LU | NL | NO | PL | PT | RO | SK | SI | ES | SE | UK |
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**Changing supplier is cumbersome or has little pay-off for the customer.** In the research this barrier was raised as an issue in Latvia. If there is little financial gain for customers to switch, it discourages them from participating in the market.

**National issue**

Prices offered by different suppliers vary very little, so customers have **little opportunity to save** by switching. Hence, customers choose supplier based on quality of services provided. This tends to favour the incumbent, as customers prefer to stay with a familiar supplier rather than risking a new supplier.

**Potential solutions**

This barrier is likely to diminish naturally, as more suppliers enter this relatively newly opened market and begin to diversify to attract customers.

*European markets in which this barrier has also been indicated*

| AT | BE | BG | HR | CY | CZ | DE | DK | EE | FI | FR | EL | HU | IE | IT | LV | LT | LU | NL | NO | PL | PT | RO | SK | SI | ES | SE | UK |
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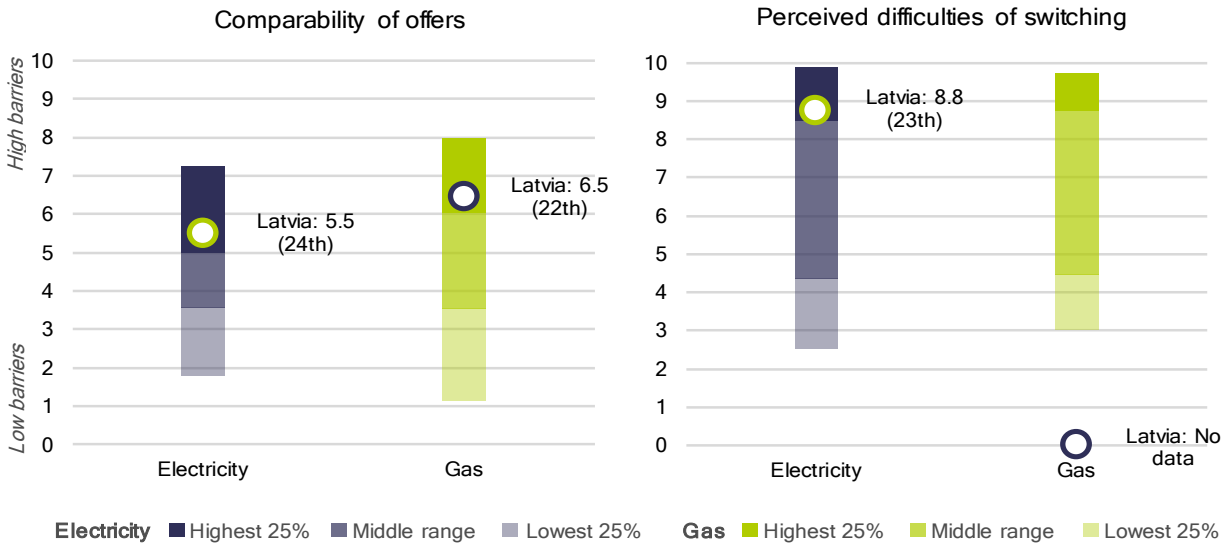
## 4.2 Latvia's performance in this barrier category

The following figure shows quantitative indicators of how far customer inertia acts as a barrier in this market. The values for Latvia are shown against the range across all analyzed countries. These scores contribute to the performance index. The performance indicators of customer inertia are the following:

- **Comparability of offers.** The index consists of two sub-indicators. The first measures consumers' ability to compare offers, based on a survey commissioned by the DG Justice and Consumers. The second is a checklist indicator which quantifies the availability of comparison websites, based on their number and functionalities. A high score is attributed if the consumers gave low scores for comparability, and there are no comparison websites in the country.
- **Perceived cost of switching.** Difficulties around the switching process are also measured based on DG Justice's survey. The indicator incorporates the experience and opinions both of customers who have switched, and also of those who have not because they faced obstacles or thought it might be too difficult. A high score is attributed if a high share of consumers reported a bad experience of or poor opinion on the switching process, among all customers who considered switching.

**Performance indicators**




Latvia was ranked rather low on all aspects of customer orientation. Comparability of offers was ranked 24th for electricity and 22nd for gas. Perceived difficulties of switching in electricity were ranked 23rd; in gas, there is no switching as the market is effectively closed.

## 5) Other

Other aspects of the market not directly related to its functions, as addressed above, may also impact suppliers' ease to enter and operate in the market. These relate to characteristics of the market that are not necessarily a barrier per se, but their impact on the energy retail environment could be minimized to benefit market function.

## 5.1 Description of other barriers in Latvia: Other

**Small market or customer value.** In the research this barrier was raised as an issue in Latvia. A small population and/or low consumption hinders profitability. Market size as a barrier could be ameliorated by better harmonization of markets.

**National issue**

Latvia is a small country with a small population, which necessarily limits market opportunities. Moreover, the biggest household electricity market segment by far is customers living in apartments, each of which provides little value to suppliers as consumption is low. This makes it hard for suppliers to grow. Nonetheless, it was reported that Latvia is the only Baltic country where new entrants are able to make a profit in electricity. The household gas market is limited.

**Potential solutions**

Market size as a barrier could be ameliorated by better harmonization of markets. This would allow actors to more easily operate across a wider region than a single country, giving them access to more customers on the same conditions and hence more opportunity to scale up effectively.
However, the potential for harmonizing gas markets is limited by how Latvia's closest markets function (Lithuania not integrated in the FinEstLat market, small in Estonia).

*European markets in which this barrier has also been indicated*

AT BE BG HR CY CZ DE DK EE FI FR EL HU IE IT **LV** LT LU NL NO PL PT RO SK SI ES SE UK

# FINDINGS & RECOMMENDATIONS

In the relatively short time since full electricity market opening in 2015, Latvia has moved efficiently away from an incumbent-dominated structure to a situation where newer entrants are able to establish and compete effectively. Indeed, the Latvian market appears to be the most supplier-friendly in the Baltic region, with some market processes reported to be designed in a way that puts players on a relatively level playing field. However, there are still only a small number of suppliers active on the household electricity markets, indicating a lack of interest that could be due in part to the limited potential of this small, low-consumption market but also reflects a several key barriers.

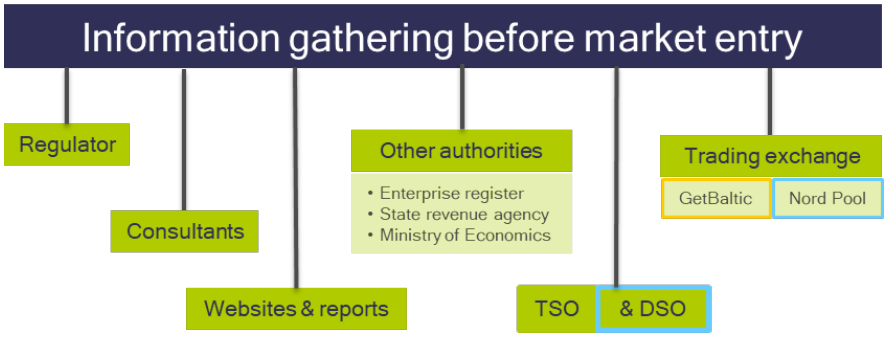
The landscape for gas is less positive: the household market remains effectively closed to new entrants due to the continued presence of universally accessible regulated prices, which may only be provided by the incumbent. The price-setting mechanism is non-transparent and often yields very low margins, making it a severe financial challenge for new entrants to offer competitive prices that could attract customers away from the incumbent. The incumbent remains the default supplier for customers who have not actively chosen a different supplier. In this way the issue of price regulation is linked with a potential unfair market advantage of the incumbent, which also affects the electricity market. The incumbent advantage arises both because of its position as the ex-monopoly supplier and its vertical integration with the DSO, through which the DSO is able to favour the incumbent supplier in procuring services at the expense of independent suppliers. In both electricity and gas, another aspect of the vertical integration advantage, namely easier access to data through the affiliated DSO, could be alleviated through the introduction of a data hub providing equal access to customer data for all players.

Regulatory uncertainty was felt to be an issue, particularly in gas, as it hinders effective business planning. Looking across the many other European markets where this barrier was also identified, regulatory uncertainty tends to be linked with three things: (1) many simultaneous developments; (2) unclear timelines for implementing changes; (3) poor communication of regulator with stakeholders; all of which are to some extent unavoidable in a rapidly developing market. Nonetheless, a more directed and firmer planning scheme, together with regular updates and consultation with market players, would alleviate this barrier. Perhaps surprisingly for a relatively young market, this study uncovered few barriers to innovation in Latvia, but this is likely to be a consequence of the lack of commercial activity so far in areas such as demand response and microgeneration. Barriers such as regulation providing a poor fit to novel businesses, or difficulty accessing data to develop novel products, may yet arise; a pre-emptive regulatory approach that learns from similar barriers in other countries could help Latvia leapfrog over some of the growing pains as it progresses towards a more flexible future energy system.

# APPENDIX 1: PROCESSES

This section describes market processes in energy retail in Latvia. This provides context for the market barriers described above by giving a high-level overview of the most critical aspects involved in establishing and operating as a supplier in the national market. The stages of market entry and operation are described in sequence, each with an illustration ("process map") showing that stage's various processes together with comments/details on market specifics.

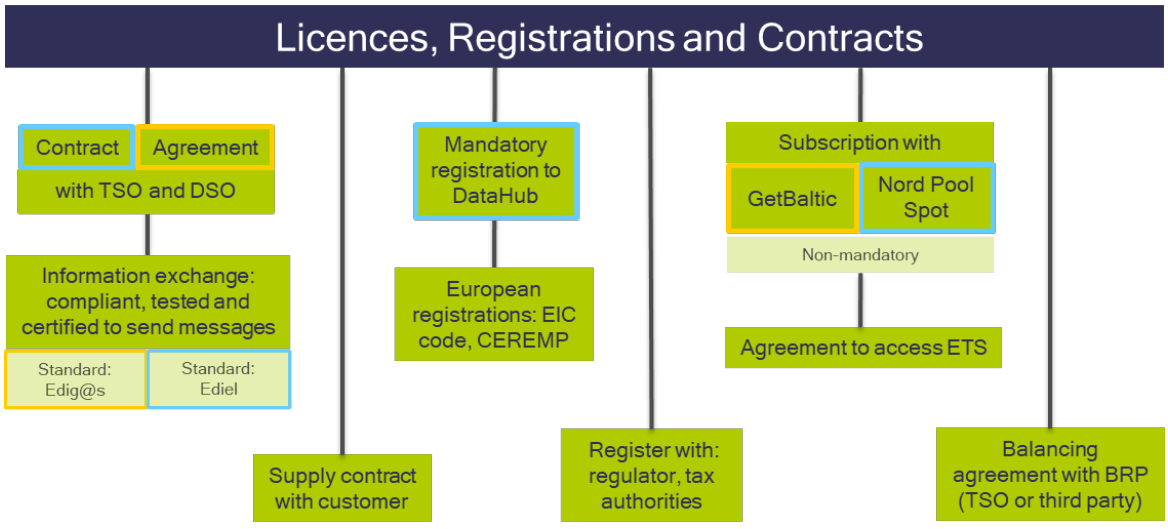
## 1) Information gathering before market entry




**Further comments**

Both the regulator and TSO have much information available in English.

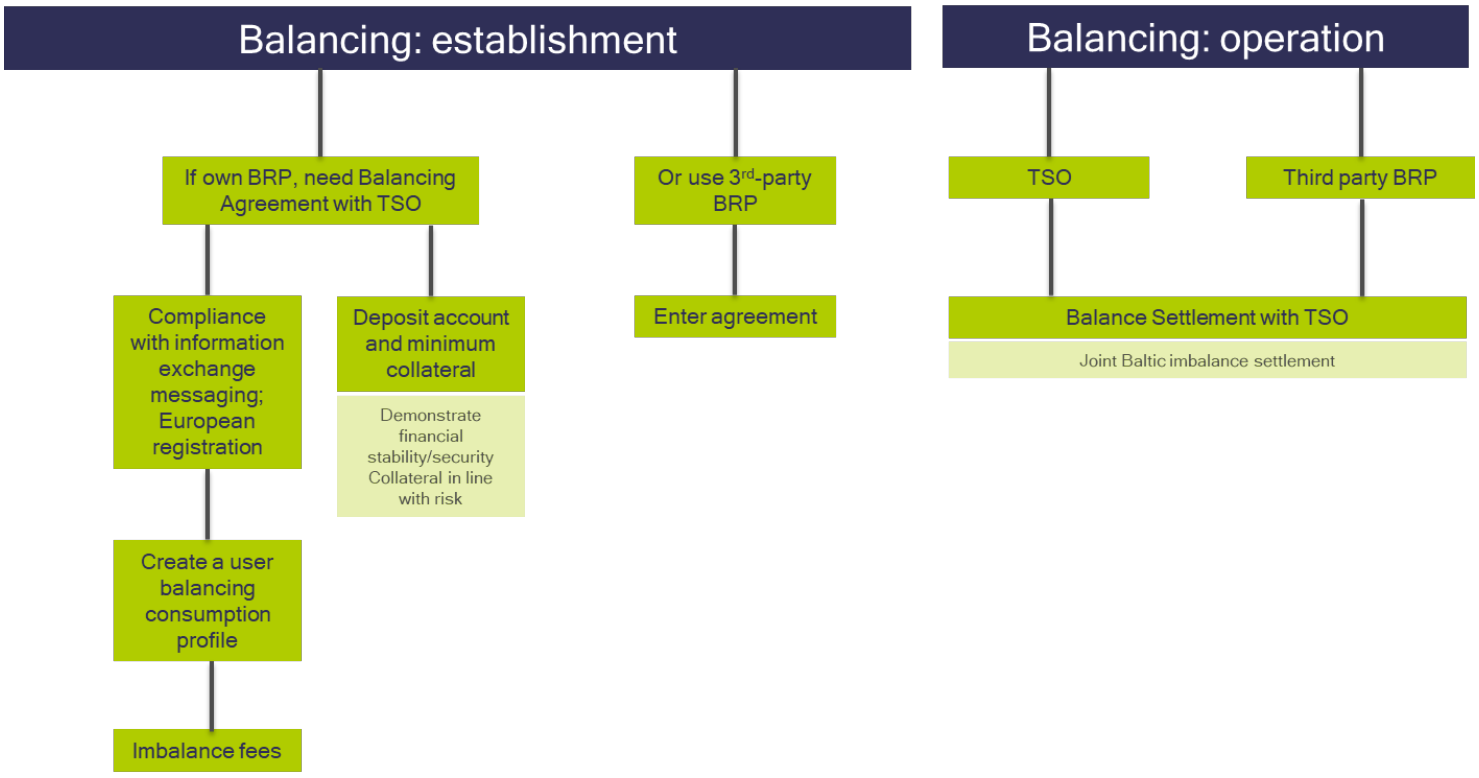
## 2) Licences, registrations and contracts



**Further comments**

No licence as such is required to act as a supplier, only registration with the regulator.

## 3) Balancing

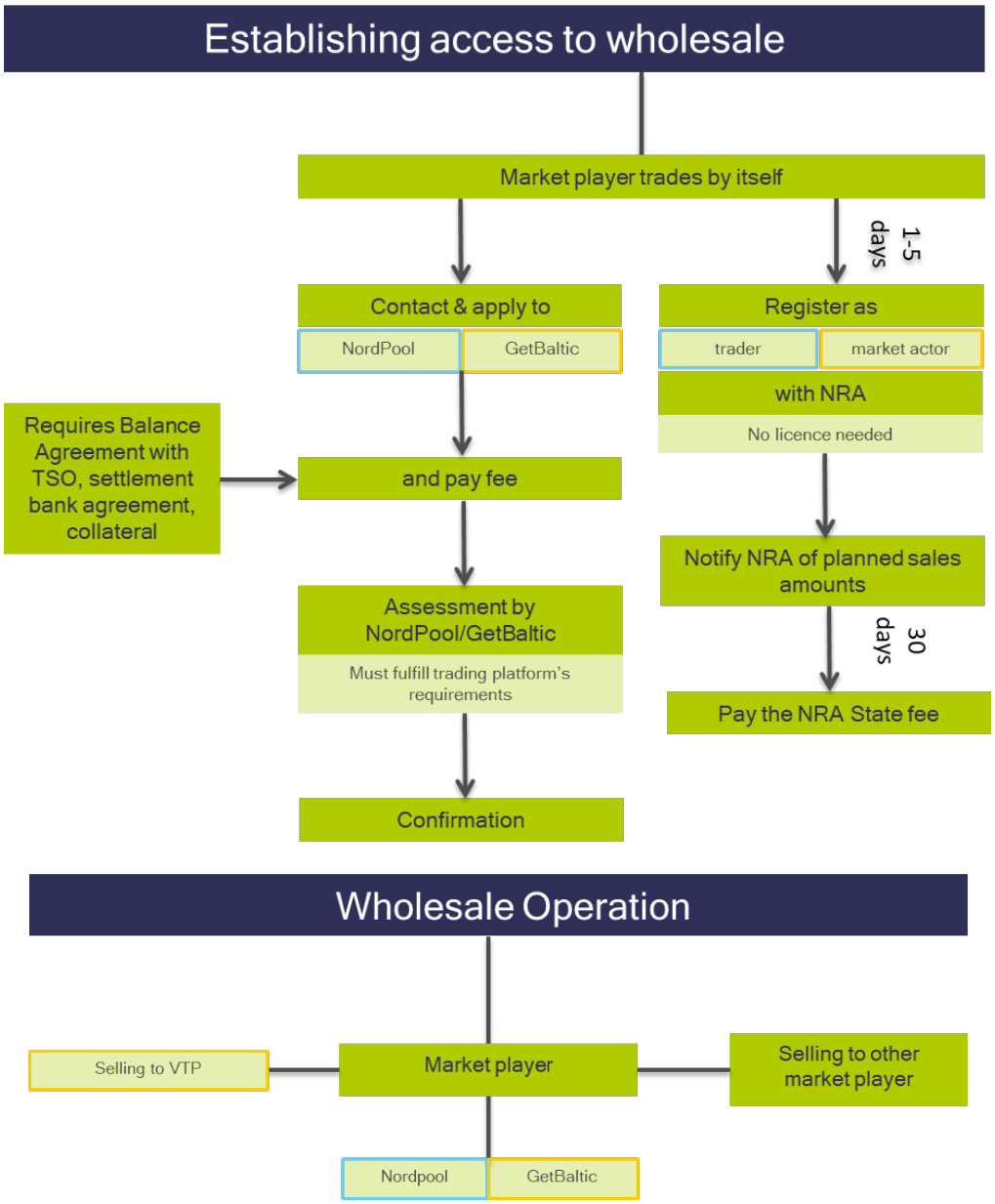



**Further comments**

Market participants can become a balancing service provider by entering into a balancing contract with the TSO. Any market participant - suppliers but also producers and potentially customers - must have a balancing service agreement with the relevant DSO.

- Balancing products are activated from Russia on the instruction of the Latvian TSO

## 4) Wholesale



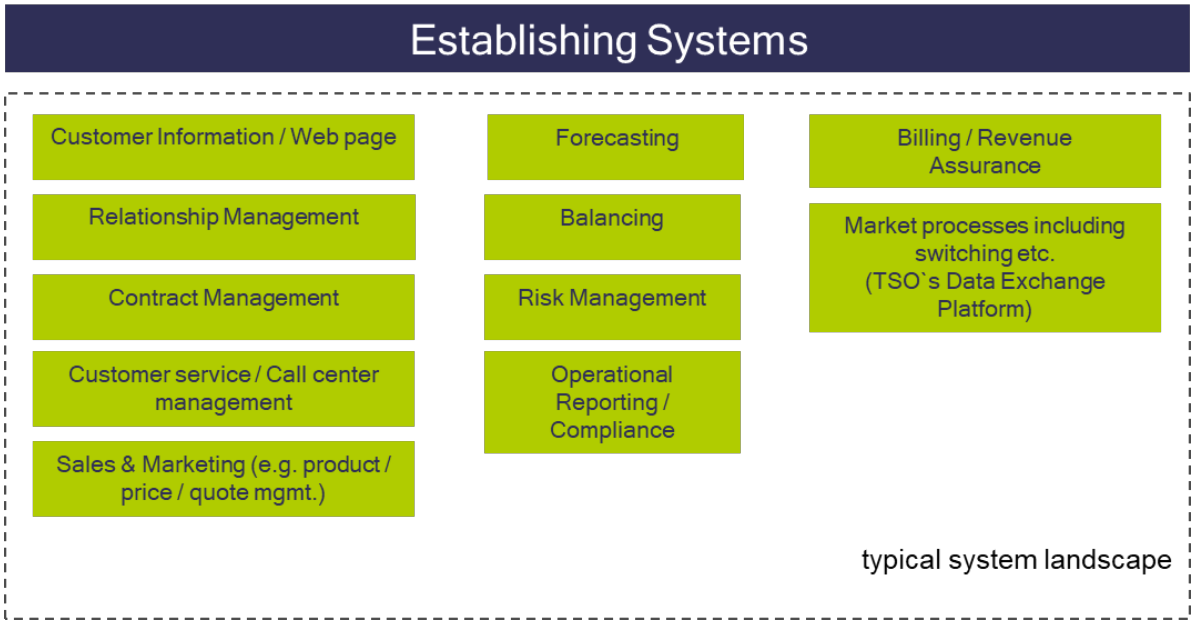

**Further comments**

EPEX Spot plans to launch day-ahead and intraday trading in 2020, pending implementation of multi-NEMO agreements in the day-ahead market (intra-day already implemented).

- Cost of registering and monitoring with the regulator depends on turnover: min. EUR 200, but typically c. EUR 2000
- Cost of NordPool: c. EUR 34 250 per year (not including variable trading fees)
- Cost of GetBaltic: EUR 5 000 per year (exchange fee only)
- It is possible to have one registration for access to all NordPool Spot markets, but for this to be possible the participant must have at least one legal representative.

The public trader is obliged to purchase a certain proportion of its energy from renewable or co-generation sources.

## 5) System landscape




**Further comments**

The regulator ensures the transparency of supply contracts' terms and conditions.

Market processes and system requirements in Latvia were felt by market players to be poorly standardised and digitalized to some extent to, but not enough to present a considerable market barrier.

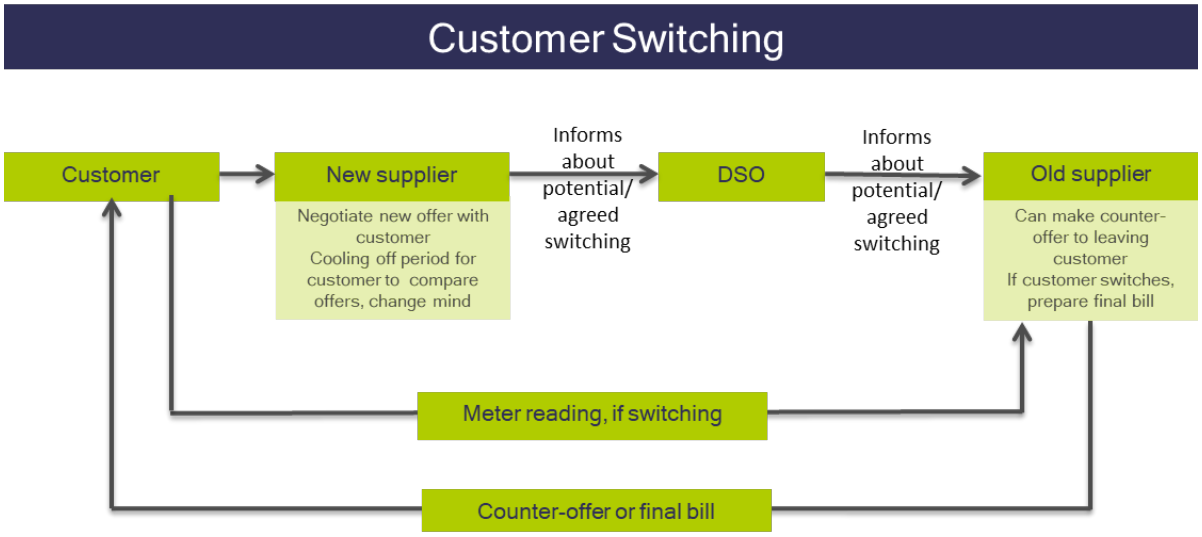
## 6) DSO-related operations & market communications


**Further comments**

Latvia effectively has a centralized data hub, as message exchange is handled by the main DSO that services 99% of all household customers. The transmission system owner, "Latvijas elektriskie tīkli", is part of the holding group of the incumbent supplier Latvenergo, but deemed by the regulator to be sufficiently independent from its supply activities. The regulator also monitors independence between the largest DSO, also in the Latvenergo group, and the supply side.

- Smart meters are due to be rolled out through to 2023 on a program from the principal grid operator, Sadales tīkls, although no decision on smart meter programs has been made by any government authority.

## 7) Customer switching & moving




**Further comments**

Switches are reported to the DSO on the 15th of every month and enacted immediately, putting both old and new supplier (often incumbent and new entrant, respectively) on a level playing field in terms of opportunity for win-back. A key demographic for new entrants is customers living in apartments. Although consumption in this demographic is low and margins therefore small, it is by far the largest market as most Latvians live in apartment blocks. Houses are in general not electrically heated, with some historical exceptions.

## 8) Operational obligations/duties

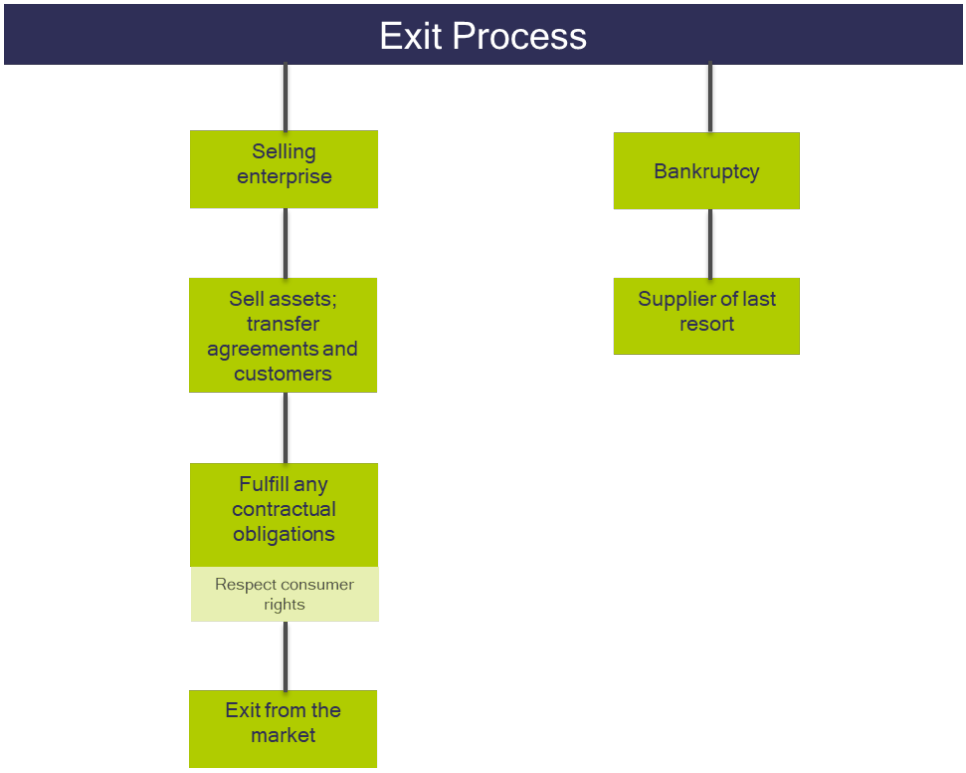

**Further comments**

Regulated service providers and network operators who fail to comply with their legal obligations can be fined/sanctioned by the regulator for up to 10% of their annual turnover. The prices and tariffs charged by regulated utilities, including suppliers offering regulated-price contracts, must reflect the cost of the regulated services.

All household suppliers' product portfolios must include a universal offer (fixed price for 12 months, without restrictions/penalties for early termination). Exchange-linked tariffs are also available, although these are not yet being taken up widely by customers.

- Customer complaints are handled by the regulator, who can place requirements on suppliers for how to deal with the issue
- Only the public trader (the ex-monopoly incumbent for both electricity and gas, currently) is required to publish price information on official website, and then only for its regulated prices.
- The public trader supplies vulnerable and inactive customers at regulated prices
- Contracts may not include termination fees

## 9) Market exit



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