

Project Manager  
Energy Market Investigation  
Competition and Markets Authority  
Victoria House  
Southampton Row  
London  
WC1B 4AD

13 August 2014

Dear Sirs,

### **Good Energy's response to the Energy Market Investigation Statement of Issues**

Thank you for the invitation to respond to the above document. Good Energy is a fast-growing 100% renewable electricity supply company, offering value for money and award-winning customer service. An AIM-listed PLC, our mission is to support change in the energy market, address climate change and boost energy security.

#### Executive Summary

Good Energy welcomes this investigation by the CMA, as we believe that the market is currently tilted in favour of the dominant large suppliers. We do not however, prescribe to the view that vertical integration is a cause of the market failure, but that VI is actually a symptom of the way the market is designed, because a logical solution for companies is to adopt VI to reduce imbalance risks and thus prices. The problem for competition and consumers lies in the fact that the big suppliers adopt similar trading strategies, which cause market liquidity issues as they do not trade in the market in a similar manner. One solution maybe to prevent VI companies from being over dominant in generation as they then control the power that should be going to market. If all VI companies were prevented from being generation dominant then they would have to buy power in the market creating liquidity.

As a result of this market dominance, smaller suppliers and new entrants find it harder to compete than they should do. This is compounded by excessive regulation, which not only imposes disproportionate costs on smaller suppliers, but also takes away small suppliers' ability to innovate and differentiate themselves from the larger suppliers.

As an innovative, renewable supplier we can see better than most that over time the market is changing, and whilst we believe the CMA has scoped several worthy issues; we believe it could also recognise several other changing features of the market. These are increasing local generation, more engaged consumers and the fact that a shift to renewables is as much about energy security as it is about decarbonisation.

If future customers are to be served well by the future energy market, then choice driven by competition is key. Yet the barriers to entry are high, and rising ever higher with the need to deliver complex and costly solutions from the start, (usually stemming from a regulatory response to mistreatment of customers by the large suppliers), rather than allowing suppliers to grow in sophistication as customer numbers grow. Unless the barriers to entry and growth are reduced, then customers will continue to be ill served.

Set out below are some of the key points we wish to bring to your attention. For your ease, we have listed them against the relevant paragraph numbers in your statement of issues.

#### **Paragraph 16**

### *Non-storability and the need to balance generation and demand in real time.*

Whilst we agree that this is a current market characteristic. It is also the case that the advent of renewable generation the economics of storage, both at a macro and micro level will change. There is however a question as to whether the value of storage can be properly reflected in the market. Storage is currently seen (as is demand reduction) as a last resort measure when all else fails. This means that the full value of storage use on a day by day basis cannot be realised.

### *Natural monopoly characteristics of transmission and distribution*

Whilst we agree they are natural monopolies, they do play a key role in the system and by their actions can support or hinder competition. For example in their connection policies where new connections can be constrained by incumbents sitting on closed generation site connections in case they decide to re-use the site.

### *Small-scale customers do not respond to short-term wholesale price changes/methods of rationing are blunt*

This statement is currently true, however, with the advent of smart metering and the fact that over half a million customers now have micro-generation this situation could be improved. To do so would require the industry to ensure its "smart" systems are capable of providing this kind of service, and that new innovative companies can offer this service without hindrance from the current market design. For example, many medium size businesses have half hourly capable meters, but because of the cost of settling half hourly data through central systems they continue to be settled on profiles, as the financial benefits are lost in the costs. In the domestic market, demand response will be difficult to achieve for example, under the current RMR regime which restricts tariff offerings, and promotes single rate tariffs to customers through its overall cheapest tariff messaging.

### *Prevalence of regulation*

In our view there are three arms of regulation within the energy market;

1. Regulations to make the market function
2. Regulations to protect customers, especially vulnerable customers
3. Regulations to deliver Government policy

On the first of these, there is clearly a need for such rules and regulations to exist for the market to function. There is an argument that the design of the market rules are overly complex and have not fundamentally changed since market opening, where the driver was to allow fourteen reasonably large companies to compete with each other whilst protecting as far as possible their 100% regional market share.

The second arm of regulation is equally important. However, **over time the regulations have moved from an ethos of protecting vulnerable customers who struggle to engage with the market (e.g. elderly or disabled) to protecting those who are capable of switching, but do not do so.** The recent Retail Market Reform (RMR) is a case in point. It reduces the number of tariffs on offer and mandates customers are told about their cheapest tariff from their current supplier. However, this lessens the incentive to switch supplier. They have also increased the amount of time it takes the customer to switch as sales agents need to "read out a long list of principle terms" at point of sale. Call times since RMR have increased by 66%. Customers who were prepared to switch for a better tariff find their choice curtailed and crucially for smaller suppliers cash incentives to engage customers were prohibited under RMR with the overall effect of

reducing the likelihood of switching. Also RMR has also created bills of borderline illegibility with information customers do not want or need to meet regulatory requirements, further disengaging customers.

The final arm of regulation is where they are used to deliver Government policy. More often than not the Government/regulators engage the six largest suppliers to help design the implementation of new policy. As a result, small suppliers are either exempted and find a significant hurdle to scale as they grow and become mandated to participate, or are mandated to deliver straight away at a significant disadvantage of economies of scale.

A good example is the current Government policy on energy suppliers delivering the £12 rebate. In its consultation response<sup>1</sup>, the Government stated:

“126. Some suppliers have requested that they be refunded with any costs they incur with respect to delivering the rebate. Suppliers have said that there will be costs involved in administering and funding the delivery of the rebate. We do not see that there is a case for refunding these costs. In entering a regulated competitive energy market, suppliers accept that their costs will include delivering and complying with regulatory requirements”

This view, that commercial entities should deliver government policy and accept any cost stems from a “big6” utilities view of the market and failure to recognise that there are several smaller energy retailers in the market who do not have the same balance sheets. This in turn creates nervousness in financiers as to what energy companies could be required to do by licence at their own expense.

#### *The external costs of climate change*

The UK needs to renew its generation infrastructure. Much of which was built when coal, gas and nuclear was receiving significant state aid. It does not follow that prices would be 33% less if the renewable generation was not supported and the UK built gas and coal fired stations instead. This is not just the cost of climate change but the cost of energy security in the UK. The figure also includes items such as the warm home discount, which are social rather than environmental costs. Additionally, the 33% is based on price, and thus makes no account of energy efficiency measures that reduce consumption. There is a downward trajectory on energy consumption as appliances become more efficient. Smart metering will probably accelerate that progress as customers get a better handle on their energy usage. Therefore even if prices were to rise 33%, it does not follow bills would be 33% higher.

It should also be considered in context. The Committee for Climate Change in their 4<sup>th</sup> Carbon Budget review<sup>2</sup> stated that to date climate mitigation policies have added £50 to households bills to 2012, but increased gas wholesale prices have added £500 (a 60% increase).

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<sup>1</sup>[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/321320/Government Electricity Rebate Consultation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/321320/Government_Electricity_Rebate_Consultation.pdf)

<sup>2</sup>[http://www.theccc.org.uk/wp-content/uploads/2013/12/1785a-CCC\\_AdviceRep\\_Singles\\_1.pdf](http://www.theccc.org.uk/wp-content/uploads/2013/12/1785a-CCC_AdviceRep_Singles_1.pdf)

Finally, The UK currently imports 61% of the fuel it uses to generate electricity<sup>3</sup>. By replacing current fossil fuel dependency with home grown renewables, it will deliver greater energy security and because most renewables are near zero marginal cost, more stable prices.

#### **Paragraph 18**

We agree with the list of forthcoming changes as listed in this paragraph. However, the investigation should take into account the move to a more decentralised generation base, including community energy models. The old model of large generation stations delivering to passive end customers is changing. More generation is being produced by smaller sites closer to the point of use. Additionally over half a million consumers generate some form energy themselves, so called “prosumers”.

This challenges the current controls in place where the national grid manages what generation comes online to meet demand, to one where National Grid are trying to balance a system where significant generation, as well as demand is outside their control. Add to this smart metering enabling demand response, and it questions whether a national control is the right approach, or whether Local Network operators need to be more active in balancing their own areas.

Also, Smart meters may lead to smart settlement in the electricity market where all customers are settled based on actual half hourly data. This opens up several opportunities, but also risks as suppliers lose the comfort of having customer usage profiled on expected usage.

#### **Paragraph 28**

We strongly support the CMA’s decision to test two hypotheses. However, we are firmly of the view that vertical integration is a symptom of market failing rather than a cause. The market has strong signals on parties to balance their purchases and sales in every half hour of the day, with the price of imbalance not known until after the event, thus creating an uncertain exposure. However, retailers can only change retail prices after 30 days notice, and in general customers prefer stable prices often opting for fixed price tariffs, thus locking their prices for several years. In such a market, there is a strong incentive to become vertically integrated to manage the imbalance risk.

Vertical integration is not perfect. In any half hour, all vertically integrated companies are likely to be long or short and thus trading that discrepancy. The issue is that the big 6 suppliers are not only vertically integrated, but all pursue similar trading strategies, meaning they are all equally likely to be long or short simultaneously, thus creating market illiquidity. A solution maybe to cap vertical integration, such that no VI company can have a generation capacity in excess of its customer demand. If this was the case, then all suppliers would have to buy in the market creating a market for independent generators to operate. This in turn would reduce the dependency of smaller suppliers on buying from the large VI companies creating a more competitive retail market. It would also ensure that most of the financial benefits consumers get from vertical integration remain.

We welcome the review as to whether prices are open manipulation in a thinly traded wholesale market. We would also encourage the CMA to consider the proposed reform of electricity imbalance pricing in this context. The EBSCR reforms are focused on increasing the volatility of imbalance pricing to encourage parties to balance even tighter, although as the price is not set until after the event, the signal is one of

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<sup>3</sup> <http://www.goodenergy.co.uk/energy-security-data>

hypothesis of what it might be rather than what it is. The reforms will set the price by the marginal action, rather than the average action of the top 500MW as at present. It also proposes single price cash out structure and we are concerned that it could allow a party or tacit collusion by several parties to manipulate the imbalance market to favour its own imbalance position. The reforms will also place even greater pressure to adopt a vertical integration business model.

Finally, even if the market was well-functioning, access to the market is only available directly to signatories to the BSC. Many decentralised generators are non-BSC signatories and thus trade outside the wholesale market and in the Power Purchase (PPA) market. Liquidity in the PPA market is as equally important as the main wholesale market.

### **Paragraph 37**

We support the focus on the reforms listed in Paragraph 36, we believe the CMA should consider whether in fact these reforms have or have the potential to increase the adverse effect on competition, rather than alleviate them.

### **Paragraph 41**

In assessing theory of harm 2, we would encourage the CMA to consider the collateral terms offered by the large companies to their smaller competitors. Ofgem's Secure and Promote reforms did not encourage competition in the market just by enforcing an obligation on larger parties to trade with smaller parties, as it only required them to offer credit terms based on individual rather than blanket terms. Many smaller suppliers trade near to the curve, rather than further out to avoid tying up working capital in credit for long periods.

### **Paragraph 45**

In addition to looking at unilateral market power in the wholesale market we believe that the CMA should look at the imbalance market reforms proposed by Ofgem. By moving to a marginal cost pricing and a single price model we are concerned that a large portfolio generator could manipulate the market price in their favour. Currently the market price is set by the average of the top 500MW of imbalance actions (so called PAR500), rather than the proposed PAR1.

### **Paragraph 48**

One of the solutions to independent retailers is to purchase directly from embedded generators via a PPA. Independent decentralised generators rely on this market to sell their power as they are not BSC signatories. As the size of the decentralised market grows, then liquidity in this market is needed to give new entrant generators (and their investors) confidence that they will be able to sell their output. If this market is illiquid then it will deter new entrant generators more than wholesale market liquidity.

### **Paragraph 50**

As mentioned above, the recent retail market reform has mandated that suppliers should sign post to customers the savings that could be made if they switch tariffs. Whilst we see some benefit in this, we also believe it can create a false illusion that if the customer is on the cheapest tariff available from their supplier, then a better deal could not be achieved by switching supplier, or it will be minimal. This RMR change actually supports the continued dominance of incumbents as it reduces the incentive to switch.

### **Paragraph 51**

Whilst we accept the driver of price is a key differentiator, we believe that there is also an issue that incumbent suppliers, switching sites and even regulators playing down non-price differentials such as service or energy provenance and focus on price. Smaller suppliers dominate the Which? energy customer satisfaction table, and lead the way in green tariffs but the dominance of the larger suppliers is not being sufficiently eroded by this.

One example under provenance is that larger suppliers do not promote their fuel mix in line with spirit of the fuel mix disclosure regulations<sup>4</sup> and thus most customers of incumbent suppliers do not know the fuel mix of their supplier.

The regulator, Ofgem also focuses on price rather than a more rounded approach as can be seen from their Go Energy Shopping web site<sup>5</sup>. If the non-price differentiators were more visible it could appeal to domestic and small businesses as an additional incentive to switch.

#### **Paragraph 55**

The argument put forward by the big six suppliers regarding their convergence on price announcements is that they are equally affected by market conditions. However, smaller suppliers often announce price changes out of step with the larger suppliers and each other as they practice different purchasing strategies. We believe the CMA should compare the timings of price changes of the big 6 suppliers over time with those of their smaller rivals.

Whilst one would expect some similarities, the differing degree of gas to electricity mix and varying degrees of vertical integration of the UK's largest suppliers should lead to their purchasing strategies being different to the others. We therefore believe that tacit collusion exists in their belief that being similar is a prudent risk based solution to defending their market share, rather than competing for new business.

#### **Paragraph 58**

In relation to the recent retail market reform we would suggest the CMA consider which of the reforms bolster competition and which are a tacit acceptance that customers who do not switch should be protected. It should also consider the impact on new entrants of introducing significant structural reform across all suppliers based on evidence of mistrust by consumers of the way they were treated by the larger suppliers only.

#### **Paragraph 59**

As part of the investigation, the CMA should consider how much the design of the obligations was influenced by the larger suppliers (such as ECO, green deal and Warm home discount). In particular, whether the schemes could have been designed to allow participation by smaller suppliers, especially when the small supplier exemption excludes them from being the supplier of customers on the scheme as is the case with the Green Deal and Warm Homes Discount. For example, customers of smaller suppliers have to switch to a larger supplier to claim their warm home discount.

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[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/82782/fuel\\_mix\\_disclosure\\_re\\_gs\\_2005.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/82782/fuel_mix_disclosure_re_gs_2005.pdf)

<sup>5</sup> <http://www.goenergysshopping.co.uk/en-gb>

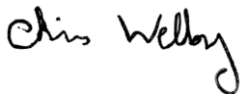
We also agree that the current 250,000 exemption threshold whilst not a barrier to expansion it does create a significant hurdle which needs to be scaled, and can create a temporary competitive disadvantage to suppliers as they prepare to overcome it and for a period of time after they have crossed it.

**Paragraph 65**

Whilst we agree that regulated revenues from network companies should not be investigated, we would encourage the CMA to look at the collateral requirements networks place on users, and the issues the decentralised generators have in connecting the distribution networks, and whether they are constraining competition in generation from small independents.

I hope you find this response useful. If you have any questions or require clarification, please do not hesitate to contact me.

Kind regards,



Chris Welby

Policy & Regulatory Affairs Director