

# COMPETITION AND MARKETS AUTHORITY ENERGY MARKET INVESTIGATION



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Response to the Statement of Issues

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14 August 2014

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## 1. Executive Summary

- 1.1 This submission is made by EDF Energy plc ("EDF Energy") on behalf of EDF Group companies. EDF Energy is a key player in the UK energy sector. It is an integrated energy company with over 15,000 employees and is part of the EDF Group, a leading global energy company which began investing in the UK in 1998. Safety is critical to the EDF Energy business; our day-to-day activity strives to embed a culture of safety throughout the business. Our ambition is to be a successful and responsible long-term energy business, trusted by customers and powering a thriving society and a healthy environment. The aim to be a force for good runs through everything EDF Energy does.
- 1.2 From a customer's perspective, the experience of the past decade has been that the prices they pay for gas and electricity have risen substantially and are widely expected to rise further. This has been due to a combination of factors: rising fossil fuel costs, rising network costs, increasing policy costs and the costs associated with renewal of infrastructure which is focussed largely on decarbonising the electricity generation sector. Customers naturally look to their energy supplier to help them understand the reasons behind rising bills, including these wider factors that are largely beyond the direct control of energy companies.
- 1.3 EDF Energy therefore welcomes the investigation into the supply and acquisition of energy in GB by the Competition and Markets Authority ("CMA"). It is EDF Energy's expectation that the investigation will identify where the market already works well for customers and strengthen areas where it can work better. The investigation will therefore help rebuild trust. We want to operate in enhanced, dynamic and transparent retail markets while, at the same time, ensuring the regulatory framework and climate is stable and suitable for the necessary long-term investments.
- 1.4 EDF Energy's business model is to have a customer-generation business. We believe this delivers material benefits for customers and the UK. For example, the £12.5 billion acquisition of British Energy in 2009 reflected EDF Energy's commitment to the UK market and gave the previously standalone British Energy business a suitable and more appropriate platform on which to thrive. This is being followed up with investment in our people and our plant. This will help deliver improved reliability and, where possible, extensions of the lifetimes of existing plant. We are also committed to investment in new generation capacity, including at Hinkley Point C.
- 1.5 Today, at the retail level, EDF Energy supplies around 5.8 million customer accounts in the UK, both residential and business. EDF Energy is also the UK's largest producer of low-carbon electricity, producing around one-fifth of the nation's electricity from its nuclear power stations, wind farms, coal and gas power stations.
- 1.6 EDF Energy is a major investor in GB infrastructure. In 2013 EDF Energy invested £1.1 billion in the UK, which was greater than its total profit. This investment trend is likely to continue as EDF Energy seeks to develop nuclear new build in the UK.
- 1.7 Given this, it is imperative that the retail markets - in gas and electricity (and the interplay between the two) - are looked at closely. Hence, EDF Energy is of the view that all of the theories of harm identified by the CMA should be investigated - but that the key starting point should be the customer experience and that appropriate weight should be given to the examination of the retail markets. We recognise that the Statement of Issues is consistent with such an approach and have no doubt that the CMA will be focused on consumer welfare.
- 1.8 In terms of the stated theories of harm, some echo concerns that EDF Energy has long identified; others do not appear to reflect our experience but should be carefully considered. For the investigation to be able to clear the air, it is important that all major aspects around the supply and sourcing of electricity and gas are looked at – including fuel sourcing, differing market structures and linked energy services.

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- 1.9 In EDF Energy's view the market overall is competitive. There are a number of larger suppliers of differing types competing strongly both against each other and against a number of growing independent suppliers. On its face, this should deliver effective competition. However, there are certain features which, in EDF Energy's view, may give rise to an adverse effect on competition ("AEC") within the meaning of the Enterprise Act and should be investigated under one or more theories of harm.
- 1.10 In particular, the following features, individually and collectively, warrant detailed investigation to confirm whether or not they give rise to an AEC:

*Lack of customer engagement*

- (a) Suppliers face strong incentives to compete on price. However, the number of inactive, disengaged, or "sticky" customers is a concern to us. Certain suppliers have a very large cohort of such customers. EDF Energy has done a considerable amount of work to identify and understand the drivers of customer decisions - and also the reasons for the lack of engagement. Understanding the dynamics that contribute or amount to barriers to consumer participation and addressing these would, in EDF Energy's view, greatly enhance competition as the potential for more customers making informed decisions to switch supplier would be increased.
- (b) Historically-driven market structures may have a considerable impact on the dynamics of competition in the market overall, including due to customer stickiness and brand loyalty and the resulting pricing strategies.
- (c) It is also important that the role of brokers, third party intermediaries ("TPIs") and switching sites should be investigated, including for small and medium sized enterprises ("SMEs"): commission charges are not always transparent; further, a full comparison and choice is not always presented to customers.

*The impact of the regulatory framework*

- (a) The energy sector is by its nature heavily regulated and subject to continuous regulatory, political, government and EU influence. There is constant regulatory change. The degree of regulatory intervention has increased in recent years. Key issues include whether customers trust the existing regulatory framework is in their best interest and whether the current framework is optimal. There is a great need for the regulator to adopt a balanced approach. In order to achieve this, the intensity of the political focus relating to the sector needs to be appropriate. The market investigation is an opportunity for the CMA to take an objective and holistic view of regulation and help establish an appropriate foundation for the sector going forward.
- (b) EDF Energy also believes that there are specific aspects of the current regulatory environment that may constitute features giving rise to an AEC. EDF Energy has raised a variety of concerns in this regard. For example:
  - (i) In EDF Energy's view, existing Tariff Price structures make accurate comparison difficult.
  - (ii) There are also material issues relating to credit and collateral that may act as a barrier to entry and/or expansion for smaller suppliers, albeit a number of other factors have to be considered. In our view, whatever the source of the requirements for collateral, these should result in arrangements at an efficient level; it is also important to recognise that credit and collateral arrangements exist to mitigate a real risk of potential default.
  - (iii) Likewise, small supplier exemptions may affect competition. The nature of the exemptions should be considered to ensure they are appropriately targeted and proportionate, and do not create distortions.

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1.11 In contrast to those areas where we believe there may be an AEC, there are certain features which, although warranting consideration, are in EDF Energy's view unlikely to give rise to substantive concerns:

*Vertical integration*

- (a) 'Vertical integration' (being present upstream and downstream in the energy supply sector) can take many different forms. Our customers-generation model brings benefits to consumers and does not prevent other business models succeeding. There are many other different entities in the market that pursue varying competitive strategies. In EDF Energy's view, vertical integration does not give rise to the issues of concern such as perverse incentives, tacit coordination and foreclosure.

*Liquidity*

- (b) Given its generation portfolio and business model, EDF Energy is dependent on transparent and liquid wholesale markets. Our experience is that the level of transparency and liquidity is adequate for industry participants.

*Electricity Market Reform ("EMR")*

1.12 EDF Energy agrees with the CMA that EMR should be "context" and also agrees with DECC that EMR should not be an area of focus. In addition to the need for investment certainty at this critical time, the CMA will note that the UK Government's EMR package has been subject to separate and close scrutiny by the European Commission (under the State aid competition rules), with the key mechanisms, feed-in tariffs with Contracts for Difference ("CfDs") and the Capacity Market, having already been approved.

*Wholesale gas*

1.13 With respect to wholesale gas, EDF Energy notes the CMA Panel Chair's response to Tim Yeo MP and welcomes the approach set out.

*Conclusion*

1.14 Overall, the theories of harm set an appropriate framework within which to consider the relevant issues. EDF Energy looks forward to engaging further on the substance and hopes to bring to bear its experience in order to assist the CMA. More detailed comments are set out in the sections that follow.

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## 2. EDF's structure and business model in the UK

### *Introduction*

- 2.1 When considering EDF Energy's comments, it is helpful to understand our structure and some of our history.
- 2.2 EDF Group's main operations in the UK are through EDF Energy. EDF Trading, a global energy commodity trading company (wholly owned by EDF SA) is also active in the UK in the wholesale energy market. EDF Group began investing in the UK in 1998.
- 2.3 EDF Energy's activities are organised into three 'Business Units', namely 'Customers', 'Generation' and 'Nuclear New Build' ("NNB").<sup>1</sup> 'Customers' is responsible for supplying energy to our business ("B2B") and residential customer ("B2C") accounts. 'Generation' encompasses EDF Energy's generation activities, comprising nuclear (9 GW<sup>2</sup>), coal (4 GW), gas (1 GW); EDF Energy Renewables operates over 500MW of renewables. NNB is tasked with the delivery of the new generation of nuclear plants in line with EDF's global programme.
- 2.4 EDF Energy aspires to be a safe, successful and responsible long-term energy business and to stand on the side of customers.
- 2.5 At the retail level, EDF Energy is proud to supply electricity and gas to 5.8 million customer accounts. This spans residential as well as non-domestic customers, including small businesses and larger industrial and commercial ("I&C") companies.
- 2.6 EDF Energy has an established ambition of becoming the best and most trusted supplier for customers in the UK. We have a clear ambition to grow our customer base. Many of our pricing initiatives reflect this (see Section 12 below). At the same time, EDF Energy has a focus on reducing costs and providing excellent customer service.
- 2.7 Pursuant to this, EDF Energy generates around one-fifth of the UK's electricity from its portfolio of nuclear, coal, gas and renewable assets<sup>3</sup>. EDF Energy operates 8 of the UK's 9 nuclear power stations, two coal stations and one new CCGT station, while the EDF Energy Renewables joint venture (a joint venture between EDF Energy and EDF Energies Nouvelles, within the EDF Group structure) builds and operates onshore and offshore wind farms. This makes EDF Energy the largest UK generator of electricity (in terms of terawatt hours produced), and also the largest UK producer of low-carbon electricity. EDF Energy is the only UK business operating across all the main generation technologies but its main generating capability is nuclear. This reflects the commitment made by EDF Group to nuclear generation - and the energy supply sector in general - through the £12.5 billion acquisition of British Energy in 2009. This is by far the EDF Group's single largest international investment to date and a clear example of the EDF Group's long-term commitment to the UK.
- 2.8 EDF Group's rationale<sup>4</sup> for the acquisition of British Energy included the following:
- (a) To bring together the expertise of EDF Group and British Energy in the operation of nuclear generating plants and related sectors, and to deploy such engineering expertise in the operation of both parties' existing nuclear plants and in the construction and operation of new nuclear plants in GB;
  - (b) To enable EDF Group to play a proactive role in the early construction of new nuclear plants in Great Britain ("GB"), by acquiring ownership of some of the sites likely to be suitable for use in

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<sup>1</sup> The Business Units are supported by Corporate Finance, Corporate Human Resources and Strategy & Corporate Affairs teams.

<sup>2</sup> This figure is 100% of the nuclear generation business (of which Centrica owns 20%).

<sup>3</sup> This includes 80% of the nuclear generation output and 50% of EDF Energy Renewables Joint Venture output.

<sup>4</sup> Source: Form CO submitted to the European Commission in Case No. Comp/M.5224 - EDF / British Energy.

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the "first wave" of NNB - British Energy faced a number of issues that prevented it being able to do this as a standalone company; and

- (c) To combine EDF Group's GB employees, the vast majority of whom were engaged in customer service and distribution network operation, with those of British Energy who were primarily involved in generation to create the opportunity for the exchange of best practice and cost synergies.

2.9 In summary, it was sensible for British Energy to be acquired by a bidder that had the expertise, experience, financial resources and long term vested interest in the GB market required to play an active role in NNB.

2.10 The transaction thereby gave the GB nuclear business an appropriate long-term platform from which to operate. This transaction was also reflective of the EDF Group and EDF Energy view that being a large supplier and large generator<sup>5</sup> is good for customers, through (i) best meeting their needs in both the short and long-term and (ii) allowing us to think across the board about issues in the industry. We believe that companies that have this wider perspective are best placed to advocate effective and sustainable solutions on behalf of customers.

2.11 EDF Energy believes that this nuclear expertise provides a competitive advantage in nuclear generation. It is for this reason, and the fact that we believe the regulatory framework for investment will remain sufficiently stable to allow a reasonable return if we perform well, that EDF Energy is committed to projects such as Hinkley Point C. EDF Energy is also currently engaged in programmes to extend the life of its existing power stations.

2.12 In addition to preparing for the UK's first new nuclear power station in a generation at Hinkley Point C, EDF Energy's recent and ongoing investments in the UK also include:

- (a) a new integrated customer billing system;
- (b) significant investment in the training and development of our employees, including a £15 million training centre in Somerset;
- (c) a UK based Research & Development ("R&D") centre, unique in this sector, which could be a blueprint to help accelerate low carbon innovation and contribute to wider economic growth;
- (d) a new gas fired power station at West Burton, Nottinghamshire; and
- (e) a UK renewable portfolio in development and operation of approximately 1000MW through EDF Energy Renewables.

### *EDF Trading*

2.13 EDF Trading is a separate wholly owned subsidiary of EDF Group that operates across international wholesale energy markets including the UK. It provides the route to wholesale markets for EDF Energy. EDF Trading is a leading participant in the European and North American wholesale energy markets and fulfils three core activities: market access for EDF Group companies and third parties, optimisation and hedging of EDF Group assets, and provision of risk management services. Less than 2% of its revenues relate to the GB market.

2.14 In brief, the interface between EDF Energy and EDF Trading operates as follows:

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<sup>5</sup> EDF Energy divested its networks business to Cheung Kong Group in 2010 and has no remaining ownership interest in energy distribution in the UK.

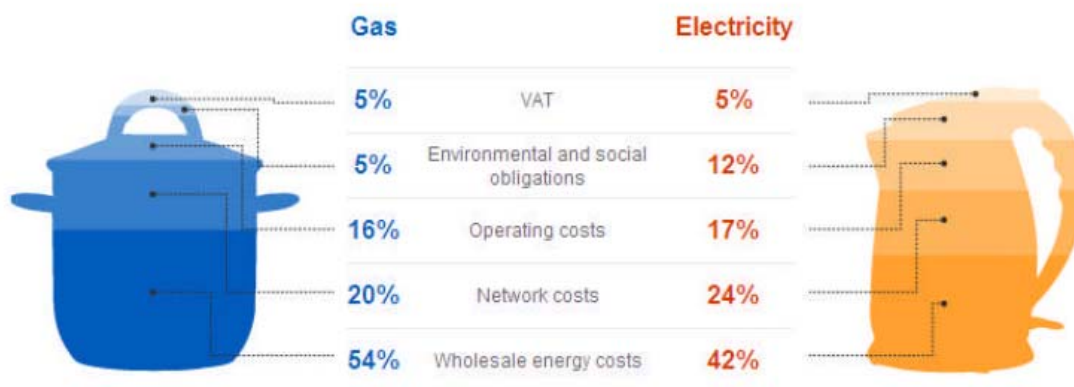
- 
- (a) EDF Energy is responsible for managing customers and upstream assets through its Customers and Generation business units, respectively.
  - (b) EDF Trading is an international market participant in energy commodity markets (including coal, gas, oil, power, biomass and carbon). It is the primary interface to the wholesale forward electricity markets for the EDF Group.
  - (c) Optimisation, which sits within EDF Energy's Customers business unit, serves both EDF Energy's Customers and Generation business units. Its role is to minimise the impact of market price volatility and volume uncertainty by instructing EDF Trading to execute purchases and sales transactions on the forward market. EDF Energy does not take speculative positions, due to the EDF Group's risk policy. Thus, any risk associated with speculative activity does not arise.
  - (d) Optimisation is also responsible for balancing portfolio positions and maximising value in the UK prompt market.
  - (e) All trades between EDF Energy and EDF Trading are undertaken at market prices and at arm's length.
  - (f) Any internal netting within EDF Energy is carried out at market prices, with any benefit of transfers (netting) shared between the Generation and Customers business units.
- 2.15 Due to the nature of the market, externally traded volumes on the wholesale electricity market are many times the size of either EDF Energy's generation or supply volumes (see also section 5 below).
- 2.16 This structure, and the reliance on transparent market prices and adequate liquidity, informs our comments on the CMA's theories of harm.

### **3. EDF Energy's comments on market characteristics**

- 3.1 The Statement of Issues sets out a number of key features that are relevant to the CMA's assessment. While EDF Energy broadly agrees with the CMA in this regard, EDF Energy would like to also highlight the following market characteristics as critical:
- (a) From the consumer's perspective, electricity and gas are commodity products. No active decision by customers is needed in order to connect. As a result, there is no requirement for customers to engage with the market if they do not wish to.
  - (b) The energy sector is part of a global commodities market. Commodity prices can be volatile. Changes in one part of the world have implications in another (e.g. the discovery of large volumes of shale gas in the US caused coal prices to fall in Europe). This is relevant to assessing risks affecting earnings of generation and supply activities.
  - (c) A large proportion of costs are exogenous and not under the direct control of the supplier. The result of this is that retail suppliers of energy are only able to directly control around 20% of the costs that go to make up the final customer bill: see Figure 1.

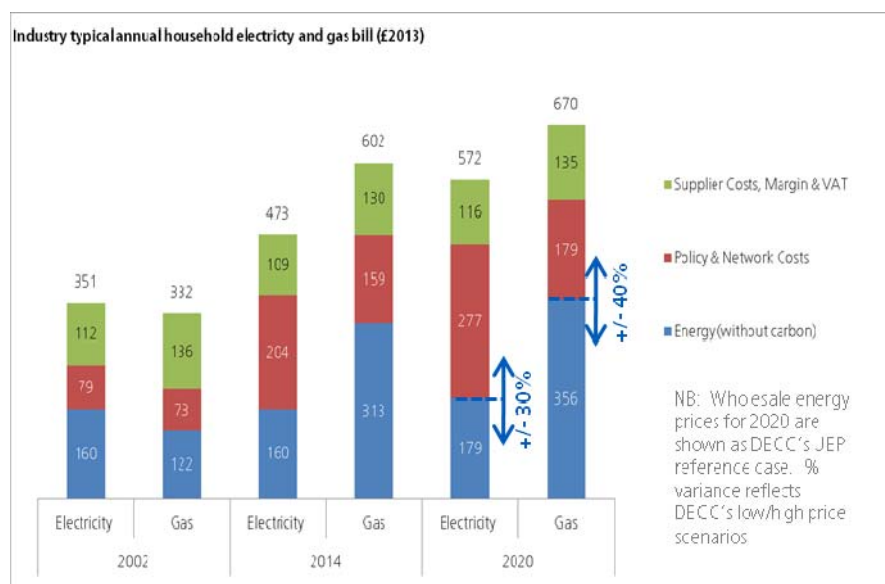


**Figure 1 EDF Energy's breakdown of cost for supplying energy to domestic customers<sup>6</sup>**



(d) As the CMA seeks to understand retail price levels, it is important that the evolution of these costs over time and their impact on prices is taken into account. Indeed, EDF Energy's analysis (based on Government data) forecasts a significant growth in wholesale energy costs and shows the increasing impact of policy and network costs on customer bills between 2014-2020. During this period, we forecast policy and network costs to account for over half of all bill increases: see Figure 2.<sup>7</sup> The growth in the total customer bill attributable to gas prices is also notable.

**Figure 2 Industry typical annual household electricity and gas bill<sup>8</sup>**



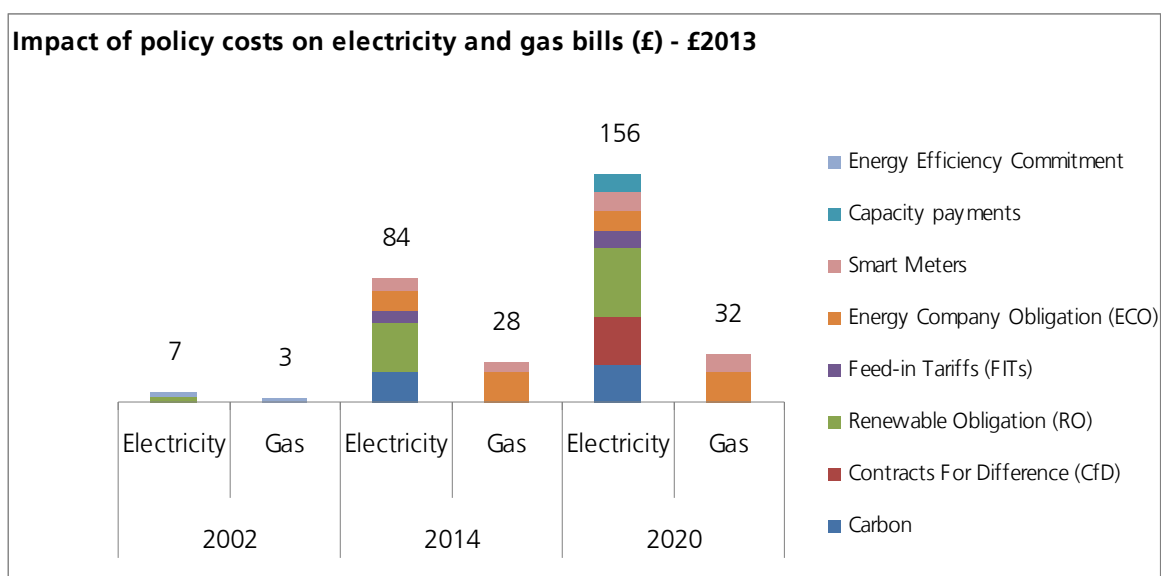
(e) The majority of policy costs are levied on electricity bills – by 2020, policy costs are expected to be (based on DECC projections) around five times higher on electricity bills than on gas bills: see Figure 3.

<sup>6</sup> Breakdown based on our residential supply business for 2013 as per our Ofgem consolidated segmental statements. It is an average of all payment types, based on the average usage of EDF Energy customers.

<sup>7</sup> As indicated previously, there are a number of assumptions that are critical to any such calculation.

<sup>8</sup> Source: Historic and future customer bill data based on DECC 2013 UEP data and ICIS Heren. Note: Graph assumes average household gas and electricity demand of 13.5MWh & 3.2MWh p.a. levels kept constant across years to allow comparisons. Bills are weighted average of payment types.

**Figure 3 Impact of policy costs on electricity and gas bills <sup>9</sup>**



3.2 The CMA may wish to consider whether this itself impacts on competition, prices, and/or usage of energy. EDF Energy supports a fair distribution of costs as a means of supporting the UK's goal of decarbonisation. Equitable distribution of policy costs between gas and electricity could help strengthen the signal for decarbonisation.

<sup>9</sup> Source: Historic and future customer bill data based on based on DECC 2013 updated energy projections (UEP) data and ICIS Heren. Note: Graph assumes average household gas and electricity demand of 13.5MWh & 3.2MWh p.a. levels kept constant across years to allow comparisons. Bills are weighted average of payment types.

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## 4. Comments on current and forthcoming changes in the regulatory framework

The degree of regulatory intervention has increased in recent years.

There is a great need for the regulator to adopt a balanced and proportionate approach. In order to achieve this, the intensity of the political focus relating to the sector needs to be appropriate. The market investigation is an opportunity for the CMA to take an objective and holistic view of regulation and help establish an appropriate foundation for the sector going forward.

- 4.1 EDF Energy notes that the CMA, in its Statement of Issues, recognises the changing nature of the regulatory framework over the next few years. EDF Energy agrees that significant changes are taking place. The CMA will have to take these changes into account when carrying out its market investigation, and when considering any remedies which may be required. The CMA will also wish to consider more holistically the impact of the regulatory changes in the market. EDF Energy notes with interest the letter of five former regulators dated 7 August 2014.<sup>10</sup>
- 4.2 The energy sector is by its nature heavily regulated and subject to continuous regulatory, political, government and EU influence. There is constant regulatory change. The degree of regulatory intervention has increased in recent years. There is a great need for the regulator to adopt a balanced approach. In order to achieve this, the intensity of the political focus relating to the sector needs to be appropriate. The market investigation is an opportunity for the CMA to take an objective and holistic view of regulation and help establish an appropriate foundation for the sector going forward. For further comments, please see the observations made in relation to theory of harm 4c.
- 4.3 In addition, EDF Energy has the following specific comments.
- The roll-out of smart meters for gas and electricity supply to all households and businesses by 2020*
- 4.4 The roll-out of smart meters for gas and electricity supply has the potential to deliver a transformation in the way consumers understand their energy use and engage with suppliers. However, the technology alone does not guarantee this; other developments (tariff changes, and changes in consumer behaviour etc.) will also be required to change demand dynamics in this way.
- 4.5 In particular, the £12 billion cost of smart-metering<sup>11</sup> will be borne by customers nationally and will primarily fall on the electricity supply side. The cost will not be offset unless £6 billion consumption savings are achieved by customers in addition to the operational savings by suppliers and distribution network operators. This fact is not currently widely acknowledged by Government or other stakeholders. Customer engagement will be a key factor in achieving savings; persistent consumption savings are therefore not guaranteed and there are only very limited insights into the persistency of savings behaviours over time. A failure to recognise this could undermine the benefits arising from this market investigation - or create the need for a further review in the not too distant future.

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<sup>10</sup> [https://assets.digital.cabinet-office.gov.uk/media/53e38996e5274a261f000001/Stephen\\_Littlechild\\_et\\_al\\_submission\\_to\\_CMA\\_7\\_Aug\\_2014.pdf](https://assets.digital.cabinet-office.gov.uk/media/53e38996e5274a261f000001/Stephen_Littlechild_et_al_submission_to_CMA_7_Aug_2014.pdf)

<sup>11</sup> NPV 3.5% real. Note, EDF Energy identified a package of savings for the smart-metering programme, which, if implemented, could have reduced the overall roll-out cost by £1.8bn while preserving the core benefits of the scheme and reducing bill impacts for customers. Though DECC has offered support for some elements of our package, we have not been able to secure support from DECC or Ofgem for the adoption of a form of centralised procurement of smart-meters with a regulated rate of return, which made up £1.2bn of the total savings package.

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*The reforms arising from Ofgem's Retail Market Review ("RMR")*

- 4.6 The RMR resulted in a package of reforms which has yet to be fully implemented and 'experienced' in full by customers. EDF Energy supported the RMR and believes that it has been partially successful in addressing a number of barriers to consumer engagement.
- 4.7 EDF Energy has implemented the Mandatory Market Making ("MMM") licence obligation through EDF Trading. We are supportive of this initiative to support a robust reference price along the forward curve, although it is too early to fully assess its impact on market liquidity and bid-offer spreads. EDF Energy is also supportive of the obligation to provide market access to suppliers; in practice, EDF Energy has already provided such market access to some small suppliers and so, from our perspective, the obligation had no little impact other than to formalise existing practices.
- 4.8 However, legitimate concerns about certain aspects of the RMR, such as the Tariff Comparison Rate ("TCR"), remain. EDF Energy considers the TCR to be potentially misleading for customers as it assumes a typical annual electricity consumption of 3.2MWh or a typical annual gas consumption of 13.5MWh rather than the customer's actual consumption. Therefore the tariff with the lowest TCR may not be the cheapest tariff for a customer's actual consumption.
- 4.9 The TCR is also calculated for each region. Many sales channels and the national media still refer to the national average bill value at typical consumption rather than the TCR. We believe national average prices can be misleading for customers as relative prices in any region vary, with the cheapest national average tariff frequently not constituting the cheapest prices in all regions.
- 4.10 EDF Energy has been advocating the introduction of national unit rate pricing (and the withdrawal of the TCR) to help make price comparisons as easy as possible and, hence, improve engagement. This would provide customers with the absolute confidence that the tariff with the lowest national unit rate was the cheapest option irrespective of their consumption or which region they live in. A national unit rate could then be presented consistently in sales channels, national media and on a customer's bill.
- 4.11 EDF Energy notes the comments of the House of Commons Energy and Climate Change Committee in Volume I of their 5th Report on "Energy Prices, Profits and Poverty" and in particular the fact that Which? submitted that national unit rate pricing should be introduced for energy tariffs.<sup>12</sup> Research conducted by Which? has shown that in 81% of cases consumers can accurately identify the best deal for them when comparing tariffs using national unit rate pricing, versus just 35% using the TCR<sup>13</sup>. These results are also borne out by our own customer research.<sup>14</sup> Such an approach would not constrain price competition.

*Design of certain policies – Electricity Market Reform ("EMR")*

- 4.12 The CMA states in its Statement of Issues: "For clarity, overarching government targets and objectives (such as targets for emissions reductions) will be treated as context for our investigation. It is not for the CMA to take a view on the costs and benefits of such targets for energy customers. However, we may review the design of certain policies that have been put in place to meet these targets, to assess their impact on competition in energy markets and, potentially, consider alternative approaches to achieving the targets if we feel these are likely to lead to better outcomes for energy customers."<sup>15</sup>
- 4.13 EDF Energy strongly believes that, while EMR should be taken into account for the purposes of the market investigation, it should not be an area of focus and the CMA should not seek to challenge it. In adopting this view, EDF Energy notes the following:

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<sup>12</sup> Ev 120, paragraph 3.3

<sup>13</sup> Which?, April 2014

<sup>14</sup> EDF Energy recognises this sacrifices cost reflectivity in the interests of simplicity. We believe this is appropriate.

<sup>15</sup> CMA Statement of Issues, paragraph 20.

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- (a) The design and implementation of EMR has been the subject of a long and detailed process between Government and relevant stakeholders. Any ambiguity at this stage could inadvertently introduce investor uncertainty and undermine the much-needed investment in low carbon generation.
  - (b) We believe that the EMR package provides the right framework for the low carbon investment that the country needs, while keeping costs affordable for consumers. Reform of the existing electricity market arrangements is necessary to ensure that investment comes forward to deliver the reliable diverse energy mix required to achieve the UK's energy policy objectives.
  - (c) EDF Energy therefore agrees with the Government that Feed-in tariffs with Contracts for Difference ("CfDs"), in conjunction with the carbon price floor, are capable of working for all low carbon technologies (including renewables, nuclear and fossil fuels with carbon capture and storage) and, indeed, are designed to do so. They will give all such projects access to the long-term, stable and reliable revenue they need to justify the large upfront investment required. The mechanism will therefore provide a vital underpin to enable financing of low carbon projects.
  - (d) The CfDs will be a key component of ensuring value for money for customers by shielding them from the damaging impacts of high and volatile fossil fuel prices. Offering a fixed price (via the "strike price") will ensure that consumers pay no more than is necessary when the underlying power price is high.
  - (e) This is because the CfD is designed to be two-way. When the market price is above the agreed strike price, the generator will be required to pay back the difference to electricity suppliers (via the counterparty body). If the reverse is true then generators will receive the price they achieve in the electricity market (the market reference price) plus a 'top up' to the agreed strike price from the reference price.
  - (f) While the strike price will be a fixed price, it is not a guaranteed return or risk-free, as the operators of CfD plant will still be required to (a) construct the plant to budget (b) generate to receive the strike price (and hence will continue to face operational risk) and (c) participate in the wholesale market to achieve the market reference price (and not just the 'top up'). Therefore under the CfD mechanism, the generator will still be exposed to wholesale market price signals and will be required to efficiently schedule and maintain its plant accordingly.
  - (g) The CfD mechanism will expose the relative cost positions of generation technologies. It therefore creates an incentive for least cost low carbon generation to the benefit of customers.
- 4.14 The CMA will of course be aware that several aspects of EMR are subject to separate approval by the European Commission. The European Commission's decisions<sup>16</sup> reached thus far in relation to EMR have emphasised the consumer benefits of the proposals: "The UK Capacity Market embraces the principles of technology neutrality and competitive bidding to ensure generation adequacy at the lowest possible cost for consumers, in line with state aid rules."<sup>17</sup>
- 4.15 In addition, in its recent decision to grant state aid approval for a number of renewable electricity generation projects, Commissioner Almunia stated: "The UK Contracts for Difference encourage all renewable energy technologies producing electricity to compete against each other for support beyond

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<sup>16</sup> In relation to the UK Capacity Market electricity generation scheme and in relation to the UK aid package for renewable energy production (Formal decisions not yet public).

<sup>17</sup> Commissioner Almunia, as quoted in European Commission Press Release of 23 July 2014: "State aid: Commission authorises UK Capacity Market electricity generation scheme", IP/14/865.

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2016. It is a fine example of how to promote the decarbonisation of the economy with market-based support mechanisms, at the lowest possible cost for consumers".<sup>18</sup>

- 4.16 Hence, EDF Energy agrees with DECC's submission to the CMA that: "EMR will provide important context to the CMA investigation in relation to the shape of the future market, but we do not think the design of the programme should be an area of focus. It is for Government to deliver EMR, an important step in strengthening investor confidence and providing the framework for investment. We would expect the CMA to consider how the wider market can deliver better outcomes for consumers given the framework Government has established".<sup>19</sup> Investigating or reconsidering EMR would also be problematic as it could destabilise much-needed investment in the UK energy sector.

*Third party intermediaries ("TPIs") / brokers*

- 4.17 Another relevant issue relates to the role of TPIs / brokers. Switching sites should be a driver of optimal consumer choice but, currently, do not show all tariff options equally and hence do not give "perfect" information. For example, if you are an existing EDF Energy customer, such sites do not show customers the available EDF Energy tariffs, as they are unable to charge commission for existing customers signing up through their website. There are additional factors in respect of non-domestic customers, as set out further below.
- 4.18 More generally, there is little transparency of broker / TPI commission charges.
- 4.19 The CMA will no doubt wish to investigate the role and conduct of TPIs and switching sites in the energy market, and the current regulatory framework.<sup>20</sup> We note that Ofgem is currently consulting on this issue.

*Other regulatory issues - Distributed generation*

- 4.20 EDF Energy recognises that an increased penetration of distributed generation will pose new technical and forecasting challenges for both distribution and transmission networks and that these challenges may lead to additional costs. The regulatory framework should ensure that these costs do not lead to market distortions through being inappropriately allocated and create an unnecessary burden on customers.
- 4.21 We consider that the development of distributed generation and micro-generation has an important role to play. It can contribute to the decarbonisation of the UK's electricity supply, encourage innovation and support new entry to the market. Therefore, it is important that distributed generation is not disadvantaged by the regulatory framework.<sup>21</sup>

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<sup>18</sup> Commissioner Almunia, as quoted in European Commission Press Release of 23 July 2014: "State aid: Commission authorises UK aid package for renewable electricity production", IP/14/866.

<sup>19</sup> DECC, Letter to Roger Witcomb of the CMA, 21 July 2014: [https://assets.digital.cabinet-office.gov.uk/media/53d8cae9ed915d560900000b/Department\\_of\\_Energy\\_Climate\\_Change.pdf](https://assets.digital.cabinet-office.gov.uk/media/53d8cae9ed915d560900000b/Department_of_Energy_Climate_Change.pdf)

<sup>20</sup> House of Commons Energy and Climate Change Committee in Volume I of their 5th Report on "Energy Prices, Profits and Poverty" at para. 25 supports increased standardisation of bills to improve the use of price comparison websites.

<sup>21</sup> Good Energy, in its market investigation reference consultation response, argues that the investigation must look at how the market can support the emerging decentralised generation model. See submission of 16 May 2014.

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## 5. Vertical integration and scale

**'Vertical integration' can, and does, take many different forms.**

**Our customers-generation model brings benefits to consumers and does not prevent other business models succeeding.**

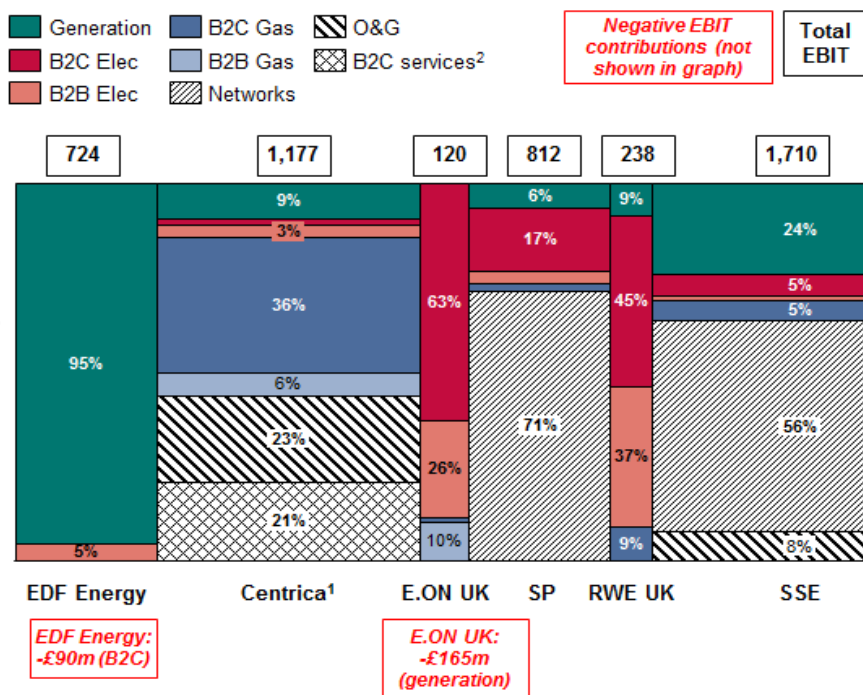
**There are many other different entities in the market that pursue varying competitive strategies.**

**In EDF Energy's view, vertical integration does not give rise to the issues of concern such as perverse incentives, tacit coordination and foreclosure.**

- 5.1 A key element relevant to the various theories of harm is an assessment of the benefits of business models or businesses that have both generation and supply operations. As it is a common theme, EDF Energy groups relevant comments together here.
- 5.2 It will be for the CMA to consider the different forms of vertical integration that exist in the market, of course, and how widespread vertical integration actually is. As discussed in EDF Energy's Response of 23 May 2014 to Ofgem's State of the Market Assessment, the term 'vertical integration' is used to cover many very different structural models.
- 5.3 EDF Energy notes the broad and varying range of corporate structures of each of the other major suppliers in the GB energy market. EDF Energy rejects the term "the Big Six" as it implies a homogeneity that is not there. There are material differences both at the generation level (e.g. nuclear position) and retail level. For example, some businesses have distribution networks whereas others, such as EDF Energy, do not. See also section 13 below. Such variety leads to materially different outcomes. As a result, we generate our profits in significant different ways: see Figure 4.

**Figure 4 EDF Energy's indicative view of EBIT of main suppliers, 2013<sup>22</sup>**

**UK EBIT generated by business area 2013 (inc. also O&G, networks, services)<sup>1</sup>**  
 (only positive EBIT contributions, £m)



The chart is based on Ofgem segmental accounts and other publically available information

<sup>1</sup> Centrica's UK EBIT from Oil and Gas ("O&G") estimated based on the UK's share of Centrica's global O&G production volumes. Networks and B2C services figures are from annual reports. Excludes (relatively small) UK O&G assets of EDF, E.ON and RWE; Centrica's storage business; further UK renewables of EDF Group and RWE Group.

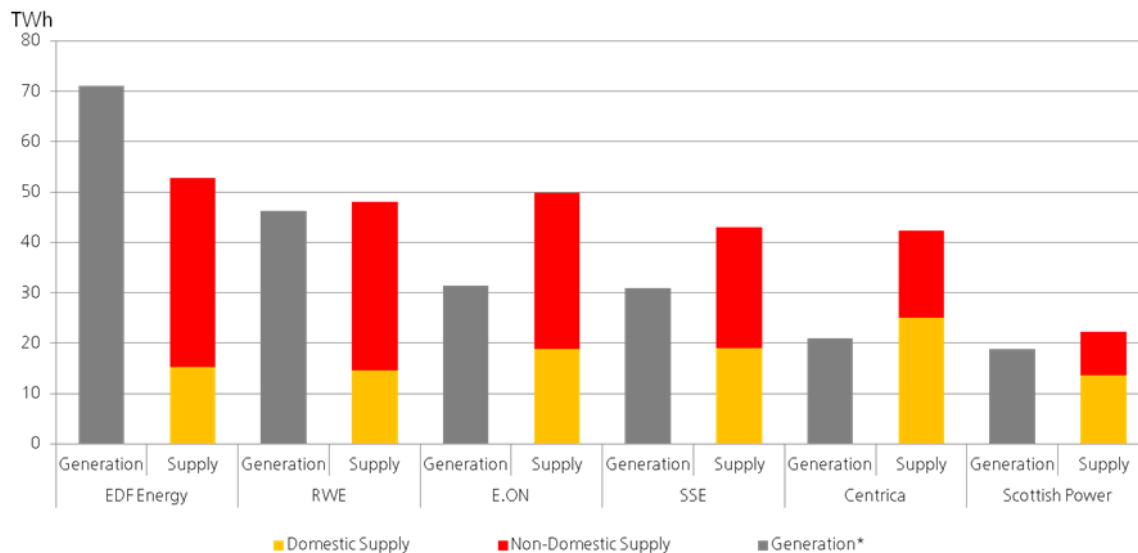
<sup>2</sup> Services is largely boiler and central heating installation and repair

5.4 Further, Figure 5 below illustrates the balance between supply and generation for each of the six largest suppliers in 2013. It shows that with the exception of Centrica, all six companies have an excess of generation over their supply to domestic customers. EDF Energy is unique in having an excess of generation over all supply. Even assuming balancing was a target, this provides energy companies with an incentive to trade. The reality, however, is that EDF Energy (and we assume other parties) would trade even if it had a balance between generation and supply in order to manage market risk

<sup>22</sup> Chart based on Ofgem segmental accounts of main retail energy suppliers also present in generation, combined with indicative estimates of other large profit sources. Note that the hatched segments (networks, oil and gas, and services) are not included in the Ofgem segmental accounts.

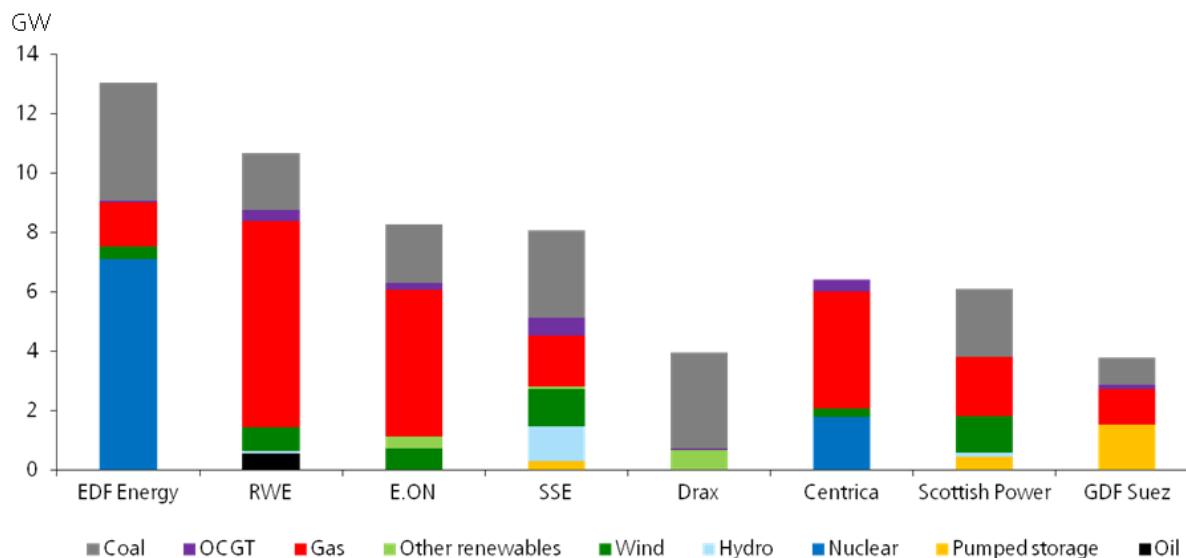


**Figure 5 Electricity Generation v Supply of the largest domestic suppliers (2013)**<sup>23</sup>



5.5 There are also other large vertically integrated suppliers, such as Drax and GDF Suez, and both operate in the I&C retail market. There are also smaller suppliers in the residential supply market with renewable generation assets (e.g. Good Energy), which may operate very differently to undertakings integrated across generation and business energy supply. An overview of the capacity mix in GB is set out below in Figure 6:

**Figure 6 GB capacity mix by major players as of August 2014 (GW)**<sup>24</sup>



<sup>23</sup> Source: EDF Energy commercial analysis (Generation); Ofgem 2013 segmental accounts (Supply). Notes: 20% of nuclear capacity operated by EDF Energy allocated to Centrica. \*As metered at station gate.

<sup>24</sup> Source - EDF Energy commercial analysis. Capacity mix: 20% of EDF Energy's nuclear capacity allocated to Centrica. Wind, hydro and other renewables values are EDF Energy's best view based on publically available data. All capacities are non-derated.

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5.6 While it is important that CMA considers the impact of the differing business models, EDF Energy believes that vertical integration, diversification of portfolio and/or scale are all factors that bring significant benefits to customers without adversely impacting on smaller players. The evidence available to EDF Energy is that our customer-generation model brings benefits to customers and, we believe, to the UK generally and does not prevent other business models from succeeding.

5.7 Such benefits include:

- (a) *An improved ability to make long-term commitments within the market and better withstand challenging market conditions - reducing the potential for disruptive business failures.* Companies present in supply and generation build expertise, enabling them to manage the complex electricity system, including exposure to international markets, intermittency and regulatory requirements, such as the impact of smart-meters. Indeed, such companies are well placed to understand the full system implications of such measures and can help to roll out/deliver policies. This helps to ensure stable supply for customers. Reliable players with a long-term view can also help the country to prepare for the future through R&D and the ability to implement new policy measures. Presence in both supply and generation allows companies to take a long-term view across the value chain in customers' interests, rather than promoting silo interests. Further, reliable, long-term players can also act as suppliers of last resort.
- (b) *A material reduction in capital costs to fund collateral requirements due to both a reduction in the cost of capital and a reduction in the volume of collateral postings required:*
- *lower cost of capital:* a vertically integrated undertaking will often benefit from a stronger balance sheet and have more risk diversification resulting in a higher credit rating than a non-vertically integrated or smaller undertaking. This is a 'scale'/diversification factor rather than vertical integration per se. The resulting significant working capital savings are shared with customers; and
  - *lower volume of collateral postings:* a vertically integrated undertaking would generally trade on both sides of the market, hence reducing collateral requirements whenever positions match. In addition, a vertically integrated undertaking will also not be exposed to collateral requirements when transferring power from its generation to supply arm, generating efficiency savings.
- (c) *Reduced costs due to removal of duplication of people and systems.* An undertaking that can share back office, corporate and IT support (among numerous other potential efficiencies) will naturally be able to operate more efficiently than it would if these functions needed to be duplicated; and
- (d) Of course, vertical integration can also benefit small players, including in relation to collateral requirements.

*The benefits of scale more generally, particularly in the nuclear arena*

5.8 It is also important to have large, creditworthy players in the energy sector (whether vertically integrated or not):

- (a) Large players are needed to develop large scale projects, particularly in the nuclear arena. The renewal of assets requires significant long-term investment and complicated financing, which may not be available if the markets are concerned about a company's creditworthiness.
- (b) Scale is important not only for investment but also to develop operational excellence, in particular in relation to nuclear safety - EDF Energy's overriding priority. At EDF Energy, operational decisions are driven far more by safety and technical considerations than by other factors. As noted above, a key part of EDF Energy's rationale for acquiring British Energy was the

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possibility of bringing together the expertise of EDF and British Energy in the operation of nuclear generating plants and related sectors.

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**6. Theory of harm 1: Opaque prices and/or low levels of liquidity in wholesale electricity markets create barriers to entry in retail and generation, perverse incentives for generators and/or other inefficiencies in market functioning.**

**EDF Energy is fully committed to a market which is liquid and has relevant price signals.**

**In general, EDF Energy finds that the wholesale market functions adequately.**

**EDF Energy is of the view that the real barriers to entry for smaller suppliers are credit and collateral constraints. The minimum collateral necessary that can be provided efficiently should be the aim.**

**It is important to recognise that credit and collateral arrangements exist to mitigate a real risk of potential default.**

*EDF Energy preliminary comments*

- 6.1 EDF Energy considers that the CMA's alternative hypotheses are appropriate theories of harm to consider. It is important to assess the operation of the market in the light of the concerns raised and the ongoing regulatory interventions.
- 6.2 As indicated in the Sections above, EDF Energy has itself not experienced difficulty due to liquidity or opaque prices in the wholesale markets with horizons to the three year period.<sup>25</sup> Given the size and nature of our portfolio, EDF Energy relies heavily on the wholesale market. In particular, as a nuclear generator, we are exposed to wholesale electricity prices (rather than the spread to a fuel price faced by a thermal generator), increasing our incentive to hedge in advance to manage earnings uncertainty. In addition, EDF Energy's business model and transfer pricing approach are built on the concept that the wholesale market is the most relevant reference for pricing decisions. Therefore, we are fully committed to a market which is liquid and has relevant price signals. In general, we find that the wholesale market functions adequately, both in terms of available liquidity and the robustness of transparent price signals.
- 6.3 EDF Energy has for a long time been of the view that the real barriers to entry for smaller suppliers are credit and collateral constraints and has previously submitted its observations to Ofgem.<sup>26</sup>
- 6.4 This potential barrier to entry and/or expansion has been more generally recognised and initiatives to reduce its impact have been implemented or are under consideration. The Secure and Promote licence condition requires that credit terms and collateral arrangements must be a reasonable reflection of the risks of trading with the eligible supplier. In addition, we note that DECC has commissioned Cornwall Energy to examine the impact of credit and collateral arrangements on market participants including those associated with balance and settlement.
- 6.5 EDF Energy is supportive of both these initiatives and alternative arrangements which could further reduce the collateral burden. However, when considering alternatives we believe it is important to recognise that credit and collateral arrangements exist to mitigate a real risk of potential default. As a result, any changes should not create a moral hazard scenario, where participants are not exposed to the impact of their behaviour.
- 6.6 In this regard, important factors to consider when assessing liquidity in this context include:

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<sup>25</sup> Levels of liquidity in wholesale electricity may be impacted by positions adopted in the closely related wholesale gas market.

<sup>26</sup> See for example the report B.7.Opt\_A\_Liquidity\_Paper\_Nov\_2012, which EDF Energy submitted as part of its response to the Commission's First Day Letter.

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- (a) The main factors to have had an effect on liquidity are counterparty credit, counterparty risk appetite and government driven regulatory intervention;
  - (b) Counterparty credit impacts liquidity because of the cost of credit and credit restrictions: this is a long-term and consistent factor;
  - (c) Reduced counterparty risk appetite impacts liquidity through availability of risk capital for UK trading power;<sup>27</sup> and
  - (d) Regulatory intervention impacts liquidity because regulatory uncertainty affects risk appetite. For example, with reference to the UK, increased capital requirements following the introduction of MiFID/EMIR impacted counterparty risk appetite.

6.7 When examining such issues, there is a balance to be struck. Some regulation is necessary to safeguard business operations and in the interests of customers, to ensure the efficient operation of the market. The risks and responsibilities that undertakings of different sizes bear also have to be taken into account. EDF Energy's view is that, given the critical nature of gas and electricity supply, it is in the best interests of customers that energy companies should be capable of sustaining operations into the longer term. Nevertheless, the above issues should be considered.

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<sup>27</sup> This has been evidenced by the reduced risk appetite in the banking sector following the legislative changes during the last five years as a direct result of the financial crisis. The withdrawal of previously major players in the UK power market, such as Barclays, Deutsche Bank, BNP and Citigroup is also likely to have contributed to reduced levels of liquidity.

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## 7. Hypothesis 1a: The market rules lead to opaque prices and low liquidity in wholesale electricity markets, creating barriers to entry in retail and generation, perverse incentives for generators and/or other inefficiencies in market functioning

EDF Energy considers that the current market rules provide an appropriate framework.

Opaque prices and/or a lack of liquidity would create issues for the EDF Energy business model. In practice, such concerns have not arisen.

- 7.1 The CMA will be aware that certain of the issues raised under the individual theories of harm are broader points; EDF Energy's views set out above at Sections 3-5 are relevant to considering each theory of harm.
- 7.2 While EDF Energy agrees that this hypothesis should be investigated, it is our view that the market rules provide a framework which allows for parties to hedge against relevant risks and for efficient dispatch. As noted above, opaque prices and/or a lack of liquidity would create issues for the EDF Energy business model. In practice, such concerns have not arisen.
- 7.3 When considering this hypothesis it is useful to understand the motivations of market participants to trade forward. Paragraph 29 of the Statement of Issues is based on the premise that the primary reason for trading in the forward markets is to avoid expensive energy imbalances. However, this is not the experience of EDF Energy.
- 7.4 Our primary motivation to hedge several years ahead is to manage the uncertainty around earnings due to the volatility of energy market prices. This volatility is driven by a large number of factors, particularly supply and demand of global commodities such as coal and gas, with the market rules contributing to volatility of forward prices to a lesser extent.
- 7.5 As noted, the earnings uncertainty is substantial for the EDF Energy portfolio. To illustrate the magnitude of the uncertainty, in 2013 the EDF Energy portfolio had 60 TWh of nuclear generation<sup>28</sup>. If none of this volume was hedged forward, a change in the forward electricity price of £1/MWh would result in a change in forecast earnings of £60m. By hedging forward we reduce the variability of earnings but we do not guarantee to have higher earnings than if we did not hedge.
- 7.6 It is only as we approach real time that the risk of imbalance becomes a significant factor in our hedging decisions. Due to the size and nature of its portfolio, EDF Energy faces significant imbalance risk. As a result, it is an active participant in the spot market, both to manage unexpected changes in position, for example due to outages, and to refine the shape of our contracted position as more granular products become available closer to delivery.
- 7.7 It is in this context that we discuss the transparency, liquidity and robustness of reference prices.

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<sup>28</sup> Includes 100% of generation assets; does not exclude, therefore, Centrica's interest.

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### *Transparency*

- 7.8 UK energy market rules create one of the most transparent markets in the world. The current trading arrangements and licence obligations mean that licenced parties publish comprehensive data. This includes:
- (a) Intended and actual generation production under the Grid code for all obligated generators;
  - (b) Data on energy prices for products via the exchanges who offer free near real-time data to non obligated parties;
  - (c) Reporting under European obligations, in particular unexpected outages (under REMIT reporting requirements);
  - (d) Comprehensive settlement data from Balancing Mechanism ("BM") reports;
  - (e) Information on input costs (coal and gas prices) from reporting services such as Heren or Platts; and
  - (f) The obligation to file regulated accounts with the regulatory objective to disclose margins to encourage entry.

### *Spot Market Liquidity and Reference Price*

- 7.9 EDF Energy has found liquidity in the spot market sufficient for its needs. The introduction of a day-ahead auction has further improved price signals in the spot market. EDF Energy is active in such auctions and is committed to continue working with the industry to increase the robustness of the auction as a reference price.

### *Forward Market Liquidity and Reference Price*

- 7.10 EDF Energy has found liquidity in the forward market sufficient for its needs. MMM has been introduced to address the perceived lack of liquidity in the forward electricity markets. This is intended to ensure that trade volumes are available to all market participants at a transparent price with regulated bid-offer spreads that are comparable with other liquid markets.
- 7.11 It is still too early to say if MMM has increased market liquidity. The CMA will, of course, want to consider whether this measure is sufficient in terms of providing pricing transparency and whether excluding the independent generators from any requirement to trade on the market is the most efficient way to increase liquidity. EDF Energy similarly invites the CMA to consider the impact of the 'Supplier Market Access' rules (part of the same package of reforms), which oblige the larger undertakings to ensure fair and reasonable terms in trading and credit arrangements with smaller undertakings.
- 7.12 EDF Energy observes that, even with the introduction of MMM and Supplier Market Access, the significant barrier to entry of collateral requirements facing small suppliers with weak credit ratings remains. This may prevent them from hedging forward even when there are transparent prices and narrow bid-offer spreads available in the market. The requirement to post collateral is a reflection of the real risks faced by counterparties trading with each other in the market. The degree of collateral posted by a small player is reflective of its credit rating and is not impacted, for instance, by other parties being vertically integrated.

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- 7.13 Although the presence of vertical integration does not impact the credit rating of a small supplier, it can significantly reduce the collateral postings required by a vertically integrated company as described in Section 5 above.



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## 8. Hypothesis 1b: Vertical integration leads to opaque prices and low liquidity in wholesale electricity markets, creating barriers to entry in retail and generation, perverse incentives for generators and/or other inefficiencies in market functioning

Given its generation portfolio and business model, EDF Energy is dependent on transparent and liquid wholesale markets. Our experience is that the level of transparency and liquidity is adequate for industry participants.

- 8.1 EDF Energy agrees that hypothesis 1b is an appropriate theory of harm to consider. However, our own experience suggests that vertical integration is not a cause of low liquidity in wholesale electricity markets (see above) or that vertical integration has acted as a barrier to entry or otherwise created any perverse incentives or inefficiencies. Our comments on transparency of prices are set out above.
- 8.2 EDF Energy's Optimisation team manages its hedging at a portfolio level which means that when deciding on volumes to trade externally (via EDF Trading) the ability to net buys and sells across the various business units, including generation and B2C/B2B internally is considered. However, due to the different timeframes over which the assets are hedged, these netting opportunities are in reality relatively limited. In addition, the forecast output of assets changes over time. As a result, EDF Energy trades many multiples of its net portfolio position on the wholesale market (largely via EDF Trading). In turn, EDF Trading transacted a further multiple of the volumes notified by EDF Energy.
- 8.3 Regarding the specific hypothesis that vertical integration may give rise to the potential for wholesale price manipulation, foreclosing non-vertically integrated suppliers, EDF Energy has neither the incentive nor the ability to withdraw capacity so as to raise wholesale prices. Due to its particular characteristics, nuclear power is incapable of being withdrawn strategically and EDF Energy's mid-merit plant are not pivotal. Moreover, there are legal, regulatory and market rules requirements that prevent the adoption of such a strategy.
- 8.4 Any concerns based on the presumed need for generation and supply activities to be fully balanced are misconceived. No perverse incentives or other inefficiencies arise as a result. EDF Energy observes that its own generation output significantly exceeds its supply activities - i.e. EDF Energy itself has not sought/achieved such a balance between generation and supply: see Figure 5 above. EDF Energy is seeking to invest in further nuclear generation capacity as well as other generation capacity and take investment decisions on an asset by asset basis. In any event, even if balanced, EDF Energy would still need to trade: see comments in relation to hypothesis 1a.
- 8.5 As noted above, EDF Energy only nets its supply and generation hedge volumes where this meets the needs of the hedging strategy and does not therefore systematically balance generation and supply volumes. Additionally, all pricing decisions are made by the relevant areas (e.g. B2C and B2B), based on their own cost base, which in turn is based on a market reflective transfer price. EDF Energy believes that this model is effective as it ensures that EDF Energy's management can fully understand the contribution of the differing parts of the business to the whole, while activities are incentivised to focus on their drivers (e.g. availability for generation assets, cost and quality of customer service for the retail businesses).
- 8.6 EDF Energy notes the CMA's concern that companies might be able to influence the CfD market reference price improperly. However, we would highlight that the CfD terms contain safeguards to ensure that the market reference price accurately reflects the market. Furthermore, we would normally

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expect a generator to manage risk by hedging against the reference price; to the extent that they do so, there would be no benefit in seeking to lower the reference price as they would receive the same total amount of revenue from the combination of wholesale market and CfD difference payments.

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**9. Theory of harm 2: Vertically integrated electricity companies harm the competitive position of non-integrated firms to the detriment of customers, either by increasing the costs of non-integrated energy suppliers or reducing the sales of non-integrated generating companies.**

**While there are a variety of factors that impact the costs and sales of non-integrated energy suppliers or generating companies, these are not due the actions of vertically integrated companies.**

- 9.1 EDF Energy agrees that this theory of harm should be investigated but does not believe that vertical integration has had the impact set out in the hypothesis. As noted above:
- (a) EDF Energy's experience and business model depends on liquid wholesale markets at robust prices. These are equally accessible to non-integrated firms.
  - (b) Moreover, EDF Energy has supported small suppliers through trading services, even before this was made mandatory through the Secure and Promote licence condition.
  - (c) Collateral requirements may increase the cost of certain suppliers but it is not the product of vertical integration by other market participants.
- 9.2 More generally, please see the comments above.

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## 10. Theory of harm 3: Market power in generation leads to higher prices

**We agree the CMA should look at the issue of market power in generation.**

**EDF Energy has raised concerns on a number of occasions in relation to transmission constraints.**

- 10.1 EDF Energy agrees that the CMA should consider as part of its investigation whether a generator may have the opportunity or incentive to exert market power.
- 10.2 As stated in paragraph 8.3, EDF Energy has neither the incentive nor the ability to withdraw capacity so as to raise prices. As the UK's largest generator, with a portfolio of baseload and flexible generation that has been involved in a number of regulatory matters, we have considered the issue of how our generation fleet can have an impact on wholesale prices on previous occasions. For example, we considered the issue during the acquisition of British Energy in 2009. In response to the European Commission's concern that the transaction could make it easier for the merged entity to withdraw electricity supplies from the market in order to increase the price, we analysed both the entity's ability and theoretical incentive to engage in capacity withdrawal gaming strategies and found neither to be compelling. However, to address the Commission's "serious doubts" and obtain a Phase 1 clearance, EDF Energy agreed to divest power generation plant at Eggborough and Sutton Bridge.
- 10.3 In addition, participation in the forthcoming capacity market under EMR will reduce the incentive and ability of successful generators to withhold temporary flexible capacity to influence spot prices, to the extent such ability exists at all. EDF Energy's nuclear and fossil fuel assets are eligible to participate in the forthcoming capacity auction, and thus may potentially benefit from capacity payments. If successful in the auctions, such plant will be subject to the obligations of the capacity market, which includes an obligation of electricity delivery and not only an obligation to be available. This means that withholding capacity during a period of system stress would expose the plant to significant penalty risks.<sup>29</sup>

### *Transmission constraints*

- 10.4 Issues regarding the ability to influence price could arise due to transmission constraints. The possibility of generators, such as those located in Scotland, benefitting from transmission constraints when they are behind an export constraint exists in theory, and is an issue that has previously been looked at by Ofgem and DECC.<sup>30</sup>
- 10.5 EDF Energy launched a formal complaint to the regulator about this behaviour in December 2007. Ofgem decided to use its licensing powers to solve the problem, developing what became known as the

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<sup>29</sup> There are regulatory provisions in place to prevent operators from engaging in capacity withdrawal. For example, the introduction of the EU regulation on energy market integrity and transparency (REMIT), and enforced by Ofgem, provides a consistent EU-wide regulatory framework specific to wholesale energy markets that defines and prohibits market abuse such as market manipulation and insider trading. In addition to the civil regime to implement REMIT, we note that the Government is proposing to create two new criminal offences of energy market manipulation and insider trading (<https://www.gov.uk/government/consultations/strengthening-the-regulation-of-wholesale-energy-markets-through-new-criminal-offences>).

<sup>30</sup> Ofgem consultation paper "Addressing Market Power Concerns in the Electricity Wholesale Sector – Initial Policy Proposals", March 2009, available at <http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/Documents/1/Market%20Power%20Concerns-%20Initial%20Policy%20Proposals.pdf>.

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transmission constraint licence condition ("TCLC"). EDF Energy was active in the development of the condition itself.

10.6 EDF Energy's dispatch behaviour in the BM is not influenced by transmission constraints, although it is unclear whether this is true for all operators. The following points are relevant in this regard:

- (a) With respect to wind generators and their offtake contracts, it is our view these were not set up with flexible generation in mind. EDF Energy believes that the expectation would have been, and still is, to run such plant at full available output whenever possible in order to secure renewables subsidies. The high bid prices that were submitted by such generators in the past were likely to have been intended simply to ensure that the plant were not constrained-off rather than to be exploitative. However, we note that this issue increasingly began to come to the fore from April 2011 as it became necessary for the System Operator to constrain-off some wind plant on warm, windy spring and autumn nights.
- (b) This resulted in the introduction of the TCLC in October 2012. This regulatory change has been successful, together with other educational initiatives by the System Operator, in changing generator behaviour. In EDF Energy's view, this has resulted in lower, more cost-reflective bid prices being submitted by wind generators.
- (c) EDF Energy would highlight that the bid prices that it submits into the BM with respect to its existing advanced gas-cooled reactor ("AGR") nuclear fleet reflect the technical operating constraints of such plant. Our desire not to be constrained-off is, unlike other plant, driven by unique safety and technical reasons rather than solely commercial ones. This is because our existing nuclear plant (as described above) are not designed to be flexible in the way that the BM envisages, and reducing load increases the risk of trip activity and may permanently reduce output. Hence, EDF Energy's bid prices are TCLC compliant and reflect this increased technical risk. However, we recognise the potential need for NNB to play a role in helping to balance the system in the future.
- (d) The CMA will also note that upgrades are currently planned for the transmission network, including in and out of Scotland. This will increase the capacity for electricity to flow between regions. As a consequence, this will reduce the frequency of transmission constraints and therefore the occasions when the System Operator has limited options to balance the system.

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**11. Theory of harm 4: Energy suppliers face weak incentives to compete on price and non-price factors in retail markets, due in particular to inactive customers, supplier behaviour and/or regulatory interventions**

It is imperative that the retail markets - in gas and electricity (and the interplay between the two) - are looked at closely.

The key starting point must be the customer - appropriate weight should be given to the examination of the retail markets.

Understanding the dynamics that contribute or amount to barriers to consumer participation and addressing these would, in EDF Energy's view, greatly enhance competition as the potential for more customers making informed decisions to switch supplier would be increased.

EDF Energy agrees that the CMA should examine the drivers of competition in the domestic and SME (microbusiness) retail energy markets, but that it should be extended to look at whether energy suppliers face weak incentives to compete due to the market design or other market features, such as the way that prices are displayed by industry to customers.

Low levels of customer trust is a major concern. It is not only suppliers that can help to rebuild trust - the actions of the regulator and other stakeholders all contribute, as will this investigation.

11.1 We have indicated our main comments in the sections that follow.

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## 12. Hypothesis 4a: Inactive customers reduce the incentives of energy suppliers to compete

**Suppliers face strong incentives to compete on price. However, the number of inactive, disengaged, or "sticky" customers is a concern to us. Certain suppliers have a very large cohort of such customers. This is important for domestic customers and SMEs.**

**Historically-driven market structures may have a considerable impact on the dynamics of competition in the market overall, including due to customer stickiness, brand loyalty and the resulting pricing strategies.**

### *EDF Energy faces strong competition*

12.1 EDF Energy has recognised the challenges in the residential market and the competitive dynamics. Our response has included the following:

- (a) We have publically committed to providing customers with fair value, better service and simplicity.
- (b) We operate on the basis that we have a responsibility to do everything we can to keep costs down for our customers.
- (c) In the residential market we have a long track record of offering competitive prices on our fixed price and standard variable tariffs.
- (d) EDF Energy has offered the cheapest standard variable dual fuel tariff for 49 out of the last 52 weeks<sup>31</sup> compared to the other major suppliers. We have attempted to differentiate ourselves in this segment of the market e.g. by freezing prices over winter whilst other suppliers increased theirs.
- (e) EDF Energy has demonstrated both price and non-price competition through the development of Blue+Price Promise tariffs, which have been competitively priced and are backed by a unique commitment to tell customers when and where they could save £1 per week at typical consumption, even if it is with a competitor. Since the start of 2014 EDF Energy has sent over 8 million price alerts to customers as a result of this commitment. In fact, churn rate on this product has been very low - perhaps reflective of the increased trust and confidence that customers have as a result.
- (f) EDF Energy also introduced a simpler bill in 2012 and a clearer annual statement in 2013. The latter included the display of personal savings available for each customer by switching to an alternative EDF Energy tariff and pre-empted similar changes under the RMR.
- (g) EDF Energy has been successful in engaging with its customers, with significant levels of EDF Energy's customers moving from standard variable to fixed price/term tariffs. Over 40% of EDF Energy's domestic customers' accounts are on fixed price tariffs. EDF Energy believes that this is evidence that many customers engage when they can see significant and easy to access savings.

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<sup>31</sup> Assuming Ofgem typical consumption, and payment by Direct Debit with paper bills.

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A change of tariff on EDF Energy's systems is instantly available and EDF Energy does not have termination fees on any of its tariffs, unlike most of its competitors, so customers can move between tariffs at will.

- (h) EDF Energy does not retain the same levels of incumbent evergreen tariff share of supply as seen for some other major suppliers. Note, the high level of active tariff choices being made by EDF Energy customers in selecting fixed price tariffs is not reflected in DECC's switching figures, which include only external switches between energy suppliers. The CMA will be aware of the differences between internal switching, often disregarded or not fully taken into account, and external switching. The former is highly relevant.

12.2 In terms of other aspects of non-price competition, it is relevant to note that:

- (a) In 2013, EDF Energy was ranked joint first in the National Customer Satisfaction Index (NCSI), which represented a significant improvement from the last place position at the start of 2012. EDF Energy was in last place due to material issues that it has worked to overcome when it migrated customers to a new billing system during 2011.
- (b) EDF Energy achieved a consistent reduction in the level of customer complaints throughout 2013. The aim is to achieve the lowest level of customer complaints of the major energy suppliers by 2015.

12.3 EDF Energy would observe that the number of complaints is not necessarily an accurate measure of quality. Active, engaged customers may be more likely to raise issues than inactive customers. There is currently no official alternative benchmark.

12.4 Despite the above, there are clear issues in the market with a number of factors relevant for consideration.

*The residential market*

12.5 Considerable savings are available to customers and yet many have not taken action despite high general levels of customer awareness about the ability to switch. EDF Energy therefore believes that it is important for the CMA to examine this sub-hypothesis. It is relevant to note the following:

*Consumer engagement and price competition*

12.6 EDF Energy believes that the level of engagement by consumers is mixed, with a large number of consumers being highly engaged. However, a sizable proportion of consumers appear to remain disengaged despite sustained regulatory and supplier led attempts to engage them. For example,

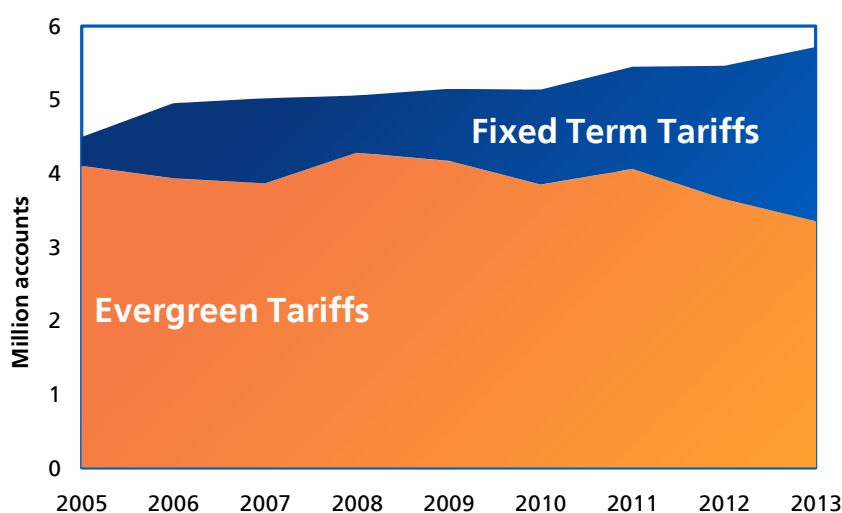
- (a) Ofgem's July 2014 research indicated that 88% of consumers are aware that they can switch supplier.
- (b) Ofgem's own analysis indicates that 85% of customers who have never switched supplier would switch for a saving of £200.
- (c) EDF Energy's research shows that the majority of customers typically demand a saving of £100 before switching.



(d) Such levels of saving are available in the market today, yet many customers are not taking advantage of the savings on offer.

12.7 Hence, some customers do not switch despite the savings available. The cheapest prices in the market have historically been offered as fixed term tariffs, which have therefore attracted more engaged customers. Amongst these cheapest tariffs, relatively small differences in price can result in significant differences in the numbers of new customers won. In addition, when a customer is renewing a fixed term tariff, relatively small differences in price between a supplier's offer and the cheapest alternative will substantially affect the number of customers lost to competitors. This is not the case for standard variable pricing – for long periods we have had the lowest standard variable price without material gains in standard variable customers as a result. However, we do recognise that this sets an important benchmark in terms of brand building.

**Figure 7 EDF Energy customer migration to fixed term tariffs**



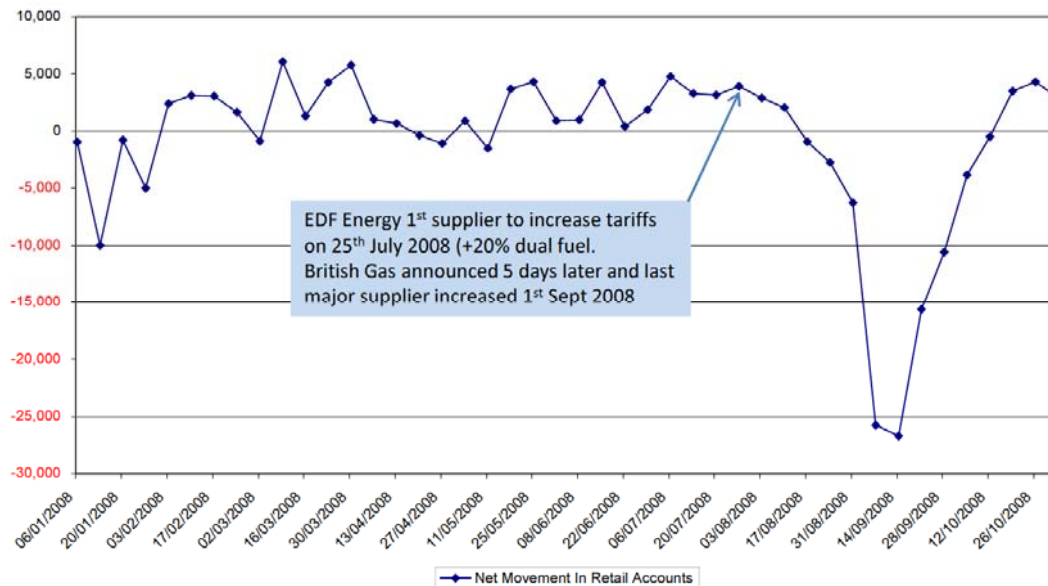
12.8 Less engaged customers, by definition, will be supplied on a default evergreen standard variable or deemed tariff. The level of engagement for these consumers tends to vary, with the greatest engagement for many being around the time of a published price change announcement. This is particularly the case should the timing, or size, of a supplier's change be significantly out of line with those of competitors, primarily because price changes typically attract significant media attention providing a call to action for many consumers: see Figure 8. Prepayment meter customers have, historically, not had many options outside of standard variable tariffs, so may exhibit a different level of engagement to cash/cheque and Direct Debit customers on standard variable tariffs.

12.9 The high level of media attention around a standard variable price change can have a material impact on consumer switching and acts as a strong disincentive to be the first supplier to raise prices, even with cost pressure building significantly.<sup>32</sup> The regulatory requirements for changing standard variable prices mean that such changes are likely to happen irregularly, normally only once or twice a year, due to the requirement to notify all customers in advance of the change and the cost of making the change. The

<sup>32</sup> Over 40% of EDF Energy's domestic customers are on fixed term and price contracts, and so are not included in price change announcements.

graphic below illustrates the material adverse impact EDF Energy suffered in 2008 when it was the first supplier to increase prices.

**Figure 8** *Weekly net movement in EDF Energy customer accounts 2008*



- 12.10 There are incentives for suppliers to differentiate themselves through delaying price increases and/or changing prices by a smaller amount, even once other suppliers have announced increases. The benefits derived are typically consumer and political stakeholder support for a differentiation strategy. EDF Energy does not believe that there would be a direct advantage in terms of new customer gains onto the evergreen tariff, but there may be an indirect advantage in terms of gains onto other tariffs.
- 12.11 Suppliers have an incentive to be the first to reduce prices as stakeholders tend to react with positive comments that will enhance a supplier's brand. Media and other stakeholder pressure for other suppliers to follow suit is generally high once any supplier has announced a reduction.
- 12.12 This lack of engagement by some customers is a feature of the market that deserves close scrutiny and has long been a concern for EDF Energy.
- 12.13 EDF Energy believes that it is important for the CMA to explore the reasons why customers do not engage, in order to aid the design of any structural changes that may be determined if the outcome of the investigation concludes changes are necessary.
- 12.14 The way prices are presented is key to encouraging engagement, as the nature of competition between suppliers is governed by this. We wish to see a thriving market with high levels of actively engaged consumers and, therefore, wish to see any barriers to engagement being minimised. We believe that it is of vital importance to provide consumers with the ability to compare offers available in the market as simply as possible, in order for them to make the right personal decision and by making the switching process as quick and easy as possible. However, EDF Energy understands that some customers may wish to remain disengaged and this right needs to be respected.

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12.15 EDF Energy recognises that some customers will be unable to engage regardless of how simple market pricing is, due to reasons of vulnerability, which may be temporary or permanent. It will be important to consider the impact of competition on these consumers and determine the appropriate level of protection they require and how this can be facilitated. EDF Energy's research shows that the relationship between engagement and vulnerability is complex. It is not the case, for example, that being inactive necessarily equates to being vulnerable, nor that all vulnerable customers are inactive.

*Incentives to compete on non-price factors*

12.16 Suppliers have a strong incentive to compete on non-price factors in order to attempt to engage the sizable proportion of consumers that remain disengaged, or to differentiate themselves from competitors when competing for engaged customers. There is evidence of suppliers developing various tariffs and features in order to fulfil these aims (for example, EDF Energy's Price Promise - here we are competing on trust and relationship).

12.17 EDF Energy notes that the Terms of Reference explicitly encompass the provision of ancillary services. Ancillary services do appear to impact on levels of customer engagement and levels of switching or inactivity. In EDF Energy's view, certain ancillary services (such as boiler maintenance services) increase barriers to switching through materially increasing levels of customer stickiness in the retail supply market. Customers are often unaware that such services are standalone and hence assume that they are tied in, not helped by some advertising campaigns.

*Impact of supplier behaviour*

12.18 EDF Energy believes that the low level of trust in suppliers is a major concern and impacts the ability of suppliers to engage consumers. The causes of the low level of trust in suppliers are manifold and EDF Energy has already expressed a desire to do all it can to rebuild trust and hopes that the CMA investigation will help in this respect.

12.19 EDF Energy believes that this lack of trust does, in some way, influence the level of engagement in the market. However, it is not only suppliers that can help to rebuild consumer trust. It is incumbent upon all stakeholders to improve the current situation. The actions of the regulator, media, politicians and consumer groups all contribute to the overall perception of suppliers' trustworthiness by consumers.

*Customer engagement in respect of Microbusinesses (SMEs)*

12.20 The CMA, when considering customer engagement, will wish to consider certain characteristics of the SME market, which differ from the domestic supply market.

12.21 Unlike domestic customers (subject to the caveats discussed elsewhere in this response), SME customers are not able to easily access all the prices that are available to them.

12.22 This is particularly true for smaller SMEs, who may not find it as easy to access brokers/TPIs, or be actively targeted by brokers/TPIs as larger SMEs are likely to be. Even where a customer does engage through a broker/TPI, they may not be given the full range of prices, either because prices are not available through that channel (for example a direct online price) or because the broker/TPI chooses not to make that price available to that customer (e.g. due to commission levels being higher elsewhere).

12.23 EDF Energy has also observed that attractive prices or savings messages that are advertised may not apply to all customers. In this context, it is likely to be lower-consuming SMEs which are disadvantaged, either

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because they do not earn the broker/TPI enough commission for certain prices, or because the offers are only available above certain thresholds or to certain customer types. In addition to a general lack of transparency of pricing, there are two common pricing practices that could give rise to concerns:

- (a) "Not on contract" prices - these can often be significantly higher than contract prices, by amounts that do not appear to be justifiable in terms of increased cost or risk borne by suppliers. Customers are also often unaware that they are on these prices, which can include standing charges of over £1 / day and unit rate prices more than twice that of contract prices. This applies to both Deemed prices (that customers are charged when they move into a property) and also Default prices (that they move on to at the end of a contract). Such pricing practices clearly have a disproportionate impact on SMEs which are less engaged in the market.
- (b) The "acquire low / renew high" model - this is still prevalent across suppliers, with acquisition prices at very low or even negative margins, and costs being recovered by charging higher prices at renewal. Automatic contract renewals will be relevant in this regard. Whilst this model is prevalent in many industries, and also to a certain extent for domestic customers, the lack of price transparency in the non-domestic energy market means the differentials can be quite large. They are also not generally expressed as introductory offers but as different prices available to new and existing customers, with those available to new customers being significantly lower. EDF Energy does not have any restrictions on contract prices available to new and existing customers with the exception of our "New Start" product, which is only available to customers who are not currently in contract with us or another supplier.

12.24 Further, due to high churn rates in this segment, combined with lack of information about the customers available to suppliers and the inability to object for debt at change of supply, there is a significant amount of bad debt. This ultimately ends up creating higher prices for all customers, which may be considered an unfair burden on those customers. EDF Energy would welcome a focus on the impact that change of tenancies in general and "Deemed customers" specifically have in this regard to see how this is impacting on the nature of competition in the segment.

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### 13. Hypothesis 4b: Tacit coordination between energy suppliers reduces their incentives to compete

It is vital, in order to restore trust in the market, that a full and objective factual analysis of this hypothesis is undertaken by the CMA.

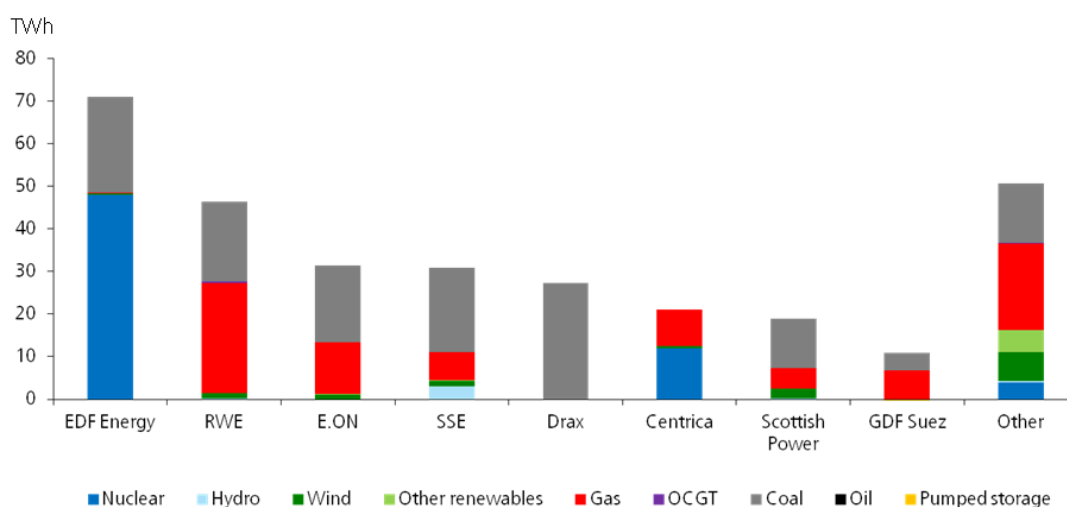
There is a tension between increasing transparency (a legitimate desire of stakeholders) and, to the extent there is a concern, facilitating tacit coordination. The CMA will wish to consider this issue closely.

13.1 EDF Energy understands the concerns that have give rise to this sub-hypothesis and supports its inclusion in the Statement of Issues. It is vital, in order to restore trust in the market, that a full and objective factual analysis of this hypothesis is undertaken by the CMA.

13.2 Currently, EDF Energy has the following observations:

- (a) There are certain factors that mean that particular behaviour may occur in parallel. In particular, there are similar drivers such as weather; a similar cost base within the residential supply market only (with about 20% under direct control - see Figure 1); financial year end (apart from SSE) being the same; and the material disincentive to be the first to announce a price rise in standard variable such that there is a domino effect when the first announcement is made - see paras 12.8-11 above.
- (b) Otherwise no significant levels of symmetry can be observed in the positions or commercial strategies of the large suppliers.
- (c) As noted above, EDF Energy has a strong history of taking standard variable pricing decisions independently (e.g. the Winter Price Freeze). We have also been innovative in our other price and non-price strategies e.g. Blue Price Promise.
- (d) EDF Energy is unique in having a very significant exposure to low-carbon, low-marginal-cost, baseload nuclear generation (see Figure 9 below).

**Figure 9 GB generation mix by supplier in 2013<sup>33</sup>**



- (e) Profit levels in both generation and supply are not unreasonable across the market, but with varying levels within that. Indeed, EDF Energy's retail B2C business has made a loss in recent years, reporting EBIT losses of around £90 million (3%) in each of the last two years, as seen in our consolidated segmental statements. This is in contrast to other suppliers: see Figure 4 above, illustrating that 2013 EBIT for the main energy suppliers was derived in different ways. In short, the main ways were:
- (i) EDF Energy: Electricity generation.
  - (ii) Centrica: Gas supply, residential services and gas production.
  - (iii) Scottish Power: Networks.
  - (iv) E.ON UK and RWE UK: Electricity supply (B2C + B2B). While E.ON UK in 2013 generated the majority of its EBIT from B2C electricity, this was not true in prior years and reflects the movement of its generation business from profit to loss.
  - (v) SSE: Networks and electricity generation.
- (f) There are clear differences in market shares.
- (g) There are considerable entry levels into the domestic market with a number of entrants growing beyond the 250,000 exemption thresholds.<sup>34</sup>

<sup>33</sup> Source: EDF Energy commercial analysis. Note: Data on output from renewables is taken from Ofgem's Renewables Obligation Certificate (ROC) register which has a delay of approx 3-4 months, therefore the missing months have been estimated. 20% of nuclear capacity operated by EDF Energy allocated to Centrica. 50% of EDF Energy Renewables assets reflected for EDF Energy. Excludes generation which is not metered (e.g., used on-site by industrial processes).

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13.3 There are, however, strong pressures from many stakeholders for increased transparency in the energy supply market.<sup>35</sup> There is a tension between increasing transparency - a legitimate desire of stakeholders - and, to the extent there is a concern, facilitating tacit coordination. The CMA will wish to consider this issue closely.

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<sup>34</sup> As of April 2014, Ovo Energy had increased to 470,000 customer accounts and First Utility to 790,000 customer accounts. Both are likely to have grown further since.

<sup>35</sup> This has led to a situation where there is a large amount of information publicly available, which enables high levels of competitor analysis: (i) Profit forecasts (as well as information on commercial strategy etc.) from publically quoted companies; (ii) Segmental accounts, as required by Ofgem; (iii) A requirement to notify consumers of price changes in advance (as required under Standard Licence Condition 23.4a); (iv) Itemised cost movements supporting price change announcements (as required under Standard Licence Condition 23.4j).

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## 14. Hypothesis 4c: Regulatory interventions reduce the incentives for energy suppliers to compete

The regulatory framework fundamentally shapes the competitive response and may impact where and how competition takes place.

The extent of regulatory intervention and the pace of change has materially increased in recent years and may constitute a barrier to entry.

Key issues include whether customers can trust that the existing regulatory framework is in their best interest and whether the current framework is optimal.

There is a great need for the regulator to take a balanced approach.

The market investigation is an opportunity for the CMA to take a holistic approach and establish a suitable framework going forward.

- 14.1 EDF Energy believes that the regulatory framework fundamentally shapes the competitive response of energy suppliers. It is therefore important for the CMA to review the regulatory framework to see if the various interventions in the market have produced the best outcomes for consumers. EDF Energy supports the inclusion of this sub-hypothesis in general terms but also refers the CMA to its specific comments on EMR.
- 14.2 Regulatory interventions can take a number of forms. Direct intervention changes the rules that combine to form the market framework. These rules are typically enacted through licence conditions, codes, primary and/or secondary legislation. Ofgem has also moved to a principles-based regulation (i.e. Standards of Conduct) which applies throughout a licensee's activities and has widened the scope and depth of regulation. The CMA should consider whether this form of intervention is consistent with best regulatory practice.
- 14.3 The regulator can also have a profound impact on the market by indirect means, for example through activities which impact consumer trust and engagement.
- 14.4 EDF Energy notes, alongside other commentators, that Ofgem has significantly increased the number and depth of its interventions since the launch of the Energy Supply Probe in 2008. In parallel to these developments, energy suppliers have been required to participate in a range of social and environmental schemes, further adding to the growing regulatory burden.
- 14.5 While supportive of many of these interventions, EDF Energy believes that Ofgem's 2009 prohibitions on price discrimination did not have a positive effect on the market. Under this initiative, Ofgem sought to limit what it saw as undesirable differences in prices between relatively inactive home area customers (i.e. with the ex-Public Electricity Supply company areas) and customers in other regions. However, suppliers responded by increasing prices to non-home-area customers in order to comply with the requirement. Ofgem's rules therefore reduced incentives to switch for these customers. The CMA will



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note the work by Professor Waddams<sup>36</sup> (and others) that demonstrates reduced switching between suppliers following the introduction of the non-discrimination requirement.

- 14.6 EDF Energy is concerned that Ofgem's approach to media interaction has at times been unhelpful in terms of its impact on consumer trust. For example:
- (a) Ofgem publishes estimated retail profits (the Supply Market Indicator) that overstate profits when compared with the segmental accounts;
  - (b) Ofgem uses the term "Big Six" despite its inaccurate suggestion of homogeneity; and
  - (c) Ofgem's press releases have, at times, been unhelpful in terms of the language used. For example its statement on 12 June 2013 stated: "Ofgem's proposals will break the stranglehold of the big six in the retail market".
- 14.7 EDF Energy recognises that the decline in trust has many drivers, including the behaviour of energy companies themselves. Nevertheless, many stakeholders assume that Ofgem has an authoritative command of the facts and as a result many are likely to pay particular attention to Ofgem's statements and data.
- 14.8 Ofgem's recent RMR process has resulted in a number of very significant interventions in the retail market, particularly in terms of limitations on the number and structure of tariffs. EDF Energy agreed with Ofgem regarding the difficulty that many customers were having in terms of comparing tariffs containing multiple and non-standard components. EDF Energy recognised that there was a trade-off between interventions and dampening innovation (which may lead to a lessening of competition). In the context of low engagement, we supported moves to simplify tariffs in the hope of securing improvements. In fact, we suggested to Ofgem that it go further and introduce unit only pricing.

*Particular regulatory interventions which the CMA should investigate closely*

- 14.9 EDF Energy believes that it will be particularly important for the CMA to reach its own view of the success or otherwise of recent regulatory interventions, as well as the robustness of the framework and institutions that gave rise to them. EDF Energy is looking forward to contributing to the development of Government's first Strategy and Policy Statement which will clarify the roles and responsibilities of DECC and the independent regulator, which will come into force in 2015.
- 14.10 Further, EDF Energy believes that it is imperative that consumers are able to access robust (wherever possible based on reported numbers rather than estimates) and impartial information on energy costs and supplier profits. EDF Energy believes that an independent regulator should be best placed to do so, and should be at the heart of such information provision.

*Areas for Consideration*

- 14.11 EDF Energy considers that there are three areas which the CMA should consider closely to determine whether they are either limiting or distorting competition in the domestic energy market in GB:
- (a) Price structures and comparisons;

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<sup>36</sup> See for example, Hviid, M. and Price, C. W. (2012), Non-Discrimination Clauses in the Retail Energy Sector. The Economic Journal, 122: F236–F252.

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- (b) Provision of accurate cost and profitability data;
  - (c) Exemptions from obligations or licence conditions.

#### *Price Comparisons*

- 14.12 EDF Energy recognises that there is a potentially important trade-off between tariff complexity (which is what “innovation” in energy pricing has created in the past) and customer accessibility (including the ability of consumers to make robust tariff/product choices). How customers actually behave when faced with tariff complexity needs to be taken into account, particularly for those consumers who are currently less engaged. In EDF Energy’s view, this will be an important area of consideration for the CMA in the course of its market investigation.
- 14.13 The current comparison of suppliers’ tariff prices on a national average dual fuel Direct Debit typical consumption basis may be causing consumers not to engage or potentially make the wrong personal choice. Comparing tariffs in this way may incentivise behaviours that lead to outcomes that, whilst minimising the average price that will appear in national media, are not truly available to the majority of customers.
- 14.14 There is also an incentive, when increasing prices, for suppliers to choose the metric that creates the lowest percentage change for prices, for use in media announcements, whilst creating the highest revenue difference for the supplier, because there is no standard way of expressing the change in prices for a standard variable price change. The fact that the media concentrate on percentage movements rather than prices and potential savings does not aid engagement.
- 14.15 In principle, EDF Energy supports Government’s midata initiative to allow suppliers/intermediaries access to electronic files of consumption data to enable robust and bespoke tariff/product comparisons. The CMA should, in EDF Energy’s view, assess the role that automated tools, of the type envisaged by midata, could play in encouraging engagement. These should be seen as additional to the simplicity of unit rate pricing relevant for the majority of customers, rather than substitutional, in the same way as more complex investments sit alongside fixed and variable interest rates for savers.

#### *Provision of Accurate Cost and Profitability Data*

- 14.16 EDF Energy believes that consumer trust and consequently engagement, is impacted by profitability data that infers suppliers are making excess profits.
- 14.17 Ofgem’s Supply Market Indicators (SMI) are meant to provide an independent view of supplier profitability. However, they have provided significantly inaccurate figures implying supplier profitability over three times the actual average profitability reported in suppliers’ segmental accounts. The methodology was improved in Q1 2014, but there still appear to be significant differences between the more recent profits estimated by Ofgem and the forecasts of the companies, as well as by financial analysts. Recent statements by British Gas and SSE highlight this problem.<sup>37</sup>
- 14.18 EDF Energy considers the provision of accurate cost movement and profitability data by influential stakeholders to be of vital importance in rebuilding trust and ensuring that consumers can and will engage with confidence. It would like the CMA to consider how the imposition of rules governing the

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<sup>37</sup> For instance <http://britishgas.presscentre.com/Press-releases/Setting-the-record-straight-on-Ofgem-profit-figures-473.aspx> and <http://sse.com/newsandviews/allarticles/2014/07/will-morris-snapshots-fail-to-give-proper-results/>

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provision and communication of cost and profitability data, both historic and future, could improve engagement and competition.

*Exemptions from Obligations or Licence Conditions*

- 14.19 EDF Energy believes that the drafting of exemptions from obligations or licence conditions is an area where it is easy to introduce competitive distortions and particular care needs to be taken with their introduction or amendment. There are two areas where EDF Energy believes competition is currently being distorted.
- 14.20 EDF Energy believes that the current white label exemption is distorting competition through the provision of an advantage to suppliers that had white labels at the time of the RMR cut-off. The key advantage these suppliers have is an ability to have more tariffs in the market without notifying all customers on the supply licence of the cheapest tariff available through that supply licence. This provides an incentive to keep prices higher than they would otherwise be between the brands and alternate competitive priced offerings to limit margin cannibalisation.
- 14.21 EDF Energy also believes that the current small supplier exemptions from Government obligations are distorting competition and confer an unfair advantage on small suppliers. This is because the exemptions are larger than the cost disadvantage relating to the fixed costs of compliance compared to a larger supplier that would benefit from economies of scale. This creates an associated issue whereby the cost of obligations is avoided by engaged consumers but paid by the less engaged.
- 14.22 EDF Energy believes that there would be significant value in the CMA considering how future exemptions could be designed and reviewed to ensure that they do not distort competition.

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## 15. Wholesale gas markets

- 15.1 Tim Yeo MP has urged the CMA to reconsider its approach in this regard due to the importance of the wholesale gas market.<sup>38</sup> EDF Energy also notes the views of Ed Davey MP, who urged Ofgem and the CMA to look at the gas market closely, in the context of the State of the Market Assessment.<sup>39</sup>
- 15.2 EDF Energy understands the views expressed, given the importance of wholesale gas, and notes the Panel Chair, Roger Witcomb, has responded in writing to Tim Yeo MP.
- 15.3 EDF Energy does not have a concern with respect to the wholesale gas market in and of itself. Clearly, EDF Energy is concerned about retail gas and how wholesale gas prices translate into the cost base for a rival's supply business. EDF Energy notes that wholesale gas and wholesale electricity are closely related, not least due to gas generation plant's role in setting wholesale electricity prices. Liquidity in wholesale electricity is therefore impacted (i.e. reduced) due to positions taken in wholesale gas.
- 15.4 As such, EDF Energy welcomes the CMA Panel Chair's response that relevant issues will be considered.

### EDF Energy

August 2014

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<sup>38</sup> Letter from Tim Yeo MP to the CMA - <http://www.parliament.uk/documents/commons-committees/energy-and-climate-change/Lord-Currie-300714.pdf>

<sup>39</sup> Letter from Ed Davey MP to the CMA and Ofgem - <http://www.bbc.co.uk/news/business-26114324>