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The Renewable Energy Company Ltd (Ecotricity) response to Competition & Markets Authority Statement of Issues

Ecotricity is an independent British renewable energy generator and supplier with over 130,000 customer accounts and 61.5MW of renewable capacity. We are partially vertically integrated and we also trade on the electricity wholesale market. We employ some 400 staff across our supply and generation businesses. The power we supply is 100% renewable and we pride ourselves in the professional, transparent and personalised customer service that we offer, which is consistently recognised by customers and third party surveys.

We acknowledge receipt of the CMA's Issues Statement setting out the background to the investigation, the theories of harm which will provide a framework for the CMA's investigation and the issues which the CMA is not minded to investigate.

We note that CMA invites comment on the:

- Theories of harm identified;
- Key characteristics of energy market which may affect competition; and
- Elements of the regulatory framework and supply & demand characteristics which are already subject to change in the near future and how their analysis should be take into account these elements.

We agree that the theories of harm identified by CMA are those that warrant investigation; however, we strongly disagree with the decision not to investigate distribution networks and the gas wholesale market.

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

   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.

   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.

We agree that this theory of harm gives adequate scope for CMA to investigate wholesale pricing within electricity markets. It is our experience that problems with wholesale pricing may have significant impacts on customers. Insufficient churn means that prices do not have sufficient depth and are therefore not reliable indicators; this is particularly true of the forwards market. High transaction costs, high hedging cost, manipulability of prices in thinly traded and/or opaque markets and a lack of transparency leading to public mistrust are also important factors particularly in bilateral trades. We consider that this is primarily a result of the majority of electricity being generated by the Big 6, Drax and GDF Suez rather than a result of market rules.

We recognise that the vertical integration of energy companies presents complexities for the CMA. We believe that of itself vertical integration is not a problem rather it is a valuable feature of energy markets; allowing for accurate forecasting, promoting security of supply and facilitating control of revenue streams. In addition, for intermittent generators it reduces exposure to lack of liquidity and opacity of prices in energy markets.

There are, however, 3 aspects to vertical integration which we consider the CMA will want to investigate:

- Market Power - the greater the size of the company, the more likely its vertical integration will have an adverse affect on competition;
- The UK/overseas ownership split – intra-group transfer pricing activities between UK and foreign arms of the same group of companies can influence wholesale pricing and therefore have an adverse affect on competition. Accordingly, declared profit of the UK arm may not be an accurate reflection of actual margin achieved; profits can be hidden; and
- The type of generation– large baseload generation linked to a supply arm can distort competition in the market. A vertically integrated operation with only intermittent generation will need to be prepared to balance and therefore trade on the wholesale market. The same balancing need is not there for an operation with baseload generation.

We believe it is important for the CMA to recognise and uphold vertical integration in the market to the extent to which it yields competitive benefits. However, we are concerned that wholesale electricity markets do not operate effectively as a result of so much generation capacity being held by a few, large electricity generators who are also active on the supply market. It is this rather than the vertical integration per se that is the problem. We strongly urge CMA to investigate these matters in depth and take steps to control those which have an adverse effect on competition.

2. **Vertically-integrated 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**

We agree that vertical integration, where large baseload generation capacity is linked to a supply arm, can harm the competitive position of non-integrated firms. We strongly question, however, whether the same could be argued to be true for small-scale intermittent vertically integrated companies. As we describe above, Ecotricity is, to some extent, vertically integrated. The CMA must make a distinction in its review (and in any remedies resulting from it) between those vertically integrated suppliers with market power and those without. As with our response to hypothesis 1b, the harm or benefits will depend on the detail of the companies in question rather than vertical integration being a problem per se. We welcome the CMA's investigation into both sides of vertical integration argument.

3. **Market power in electricity generation leads to higher prices**

We agree that this theory should be investigated and concur with the hypotheses suggested:

- One relating to the exercise of unilateral market power is that certain generators may have power in the Great Britain generation market at particular times; and

- A second that certain generators may have local market power at particular times, created by transmission constraints and that given the limited numbers of options available to the System operator, the potential exists in some cases for generators to charge high prices for balancing services.

We have no direct evidence over co-ordination of prices by generators; however, we can see that it is a possibility. Market power is in the hands of a small number of companies and increasing the number of generators in the market, would we believe have a positive effect.

4. **Energy suppliers face weak incentives to compete on price and non-price factors in retail markets, owing to inactive customers, supplier behaviour and/ or regulatory interventions.**

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

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

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

We agree that the hypotheses proposed should be investigated by CMA. We agree that customer trust and confidence in the market and the market regulator is low, and that the ability of recent RMR reforms to adequately build trust and improve consumer engagement is limited.

We welcome Ofgem's recent proposals for next day switching as a mechanism for increasing customer activity in the energy market, but suggest that this may not go far enough to improve customer response. In addition we support CMA's proposals to investigate the recent RMR tariff reforms which, despite having been introduced to improve consumer engagement, restrict the ability for suppliers to differentiate their offering to customers and therefore are likely to have a negative impact on consumer engagement.

With regard to the size threshold of 250,000 accounts below which a supplier is not required to meet certain obligations, we agree that this is a consideration for smaller suppliers as the extra commitments beyond that threshold are not insignificant. We consider, however, that a threshold is better than no exemptions whatsoever – without the economies of scale of the Big Six, smaller suppliers would find it near impossible to enter the market if they had these commitments from the outset. We support the tapered approach for the Energy Company Obligation, as spreading the impact evenly helps minimise the burden of the associated obligations, and that is important.

Issues/parts of the market that the CMA are not minded to investigate:

1. Wholesale gas markets

We challenge the CMA's proposal not to investigate the wholesale gas market. Whilst the market is not as vertically integrated and does show higher levels of liquidity than the electricity wholesale market, we suggest that it form part of the CMA's investigation. This is because:

- Gas prices have a significant effect on electricity generation; 33% of electricity is generated by gas power stations;
- Wholesale gas prices usually change with electricity prices and suggesting that they are subject to the same influences;
- Impact of gas prices on consumers is significant; an average consumer uses 4 times more gas than electricity in their home; and
- There have been incidences of market manipulation in the gas market such as the St Fergus & Bacton Scandal in 1999.
- We would suggest that the presence or absence of vertical integration within the gas wholesale market is not, of itself, an indicator of efficient market. The lack of vertical integration is more likely for structural reasons which have no bearing on the efficiency or competitiveness of that market or on the consumers' experiences of the same.

2. Transmission and distribution networks

Distribution networks operate as privately owned monopolies. They report substantial profits annually and are allowed by Ofgem to impose price rises on suppliers which have historically been well above inflation.

Whilst price control is regulated by Ofgem, who only recently have announced savings and upgrades to the networks, visibility of such price control is low; suppliers are unable to ascertain whether prices are an accurate reflection of costs. In our view it is imperative that the price control of distribution networks is investigated by the CMA.

Finally, we consider that the non-contestable elements of grid connection costs merit the CMA's investigation. Non-contestable costs can be disproportionately high and there is little visibility for the generator of the make-up of such costs and which can ultimately impact the viability projects.

3. Credit and collateral arrangements

The energy industry is highly collateralised and suppliers are required to lodge large amounts of credit with Elexon, electricity distributors, gas transporters and counterparties. This can be millions of pounds at peak winter; a problem that is only set to increase with the introduction of Contracts for Difference (CfDs). Collateral and credit requirements are a particular problem for independent suppliers as, unlike the Big 6 who can rely on a credit rating, we must generally lodge this in the form of cash. Not only does this expose us to risk, it also reduces the amount of cash we have available for business growth and development: in our case increasing renewable deployment. Lack of available credit also inhibits an independent supplier's ability to trade effectively and therefore reduces its own liquidity. In order to increase competition and ensure a level playing field, we strongly urge CMA to consider alternatives to credit lodging.

Government programmes such as EMR will significantly increase the collateralisation of the market. This is a feature of the programme's design, which will require additional forms of collateral for a variable levy and to allow participation in the Offtaker of Last Resort. However, this need not be the case; for example, the current Renewables Obligation does not require suppliers to put up collateral and they have over a year between when the Obligation is announced and when final payment is required.

Conclusion

We support CMA's investigation and agree with the theories of harm proposed. In particular we welcome CMA's investigation into both sides of the vertical integration argument and we urge CMA to include within its investigation the wholesale gas market and the transmission and distribution networks.

We note that the CMA emphasises throughout its draft Statement the changes in the relevant markets that have either recently taken place (for example, RMR, Secure & Promote, reforms to electricity imbalance pricing) and those that are due in the future (for example, EMR, introduction of CfD contracts, Smart Metering and Time of Use tariffs). The CMA clearly identifies the challenge it faces in assessing the likely impacts of these changes. However, we would urge it to consider critically whether these measures will actually remedy any Adverse Effect on Competition that it identifies rather than to adopt a "wait and see" approach when considering remedies.

Ecotricity welcomes the opportunity to respond and hope you take our comments on board. We also welcome any further contact in response to this submission. Please contact Melanie Durston on 01453 769307 or melanie.durston@ecotricity.co.uk

Yours sincerely

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