



Making a positive difference
for energy consumers

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Ofgem Response to CMA Issues Statement

Ofgem made its Initial Submission¹ to the CMA on 21 July 2014. That document sets out the issues that we think should be the focus of the investigation and those which should not be the focus.

Based on your Issues Statement published on 24 July 2014, our views are broadly aligned. The theories of harm set out in your Issues Statement have a stronger focus on the wholesale electricity market compared to the issues described in Ofgem and OFT's State of the Market Assessment and Ofgem's Initial Submission. However the CMA's approach of looking at all relevant factors will ensure that any market features harming competition are thoroughly investigated.

Given the focus on wholesale electricity markets implied by these theories of harm, the purpose of this letter is to highlight major policy and monitoring activities undertaken by Ofgem in relation to wholesale electricity markets which will be relevant to the CMA's independent investigation. We set out our activities relating to:

- General wholesale market monitoring
- REMIT (regulation on energy market integrity and transparency) and TCLC (Transmission Constraint Licence Condition)
- Future Trading Arrangements and Market Design

General Wholesale Market Monitoring

We have staff closely monitoring and assessing the performance of the wholesale gas and electricity markets in real time by reviewing price and fundamental market data, and scanning the markets for future issues. We draw on a wide range of data sources including information from the system operator and expertise throughout Ofgem. We disseminate this information to the market and consumers in a variety of ways, including through our annual National Report and Capacity Assessment publications.

¹ <https://www.ofgem.gov.uk/ofgem-publications/88901/submissiontocmafinafinalpdf.pdf>

REMIT and TCLC

In addition to our general monitoring of the market, set out above, our active monitoring of the markets means that we are vigilant against potential market abuse and market manipulation. Key activities include monitoring for potential infringements of REMIT, TCLC and competition law.

Among other things, REMIT improves transparency in wholesale gas and electricity markets, by requiring market participants to publish inside information relating to these markets before they trade based on that information. REMIT also prohibits market abuse in the form of insider trading and market manipulation in those markets. Those professionally arranging transactions in wholesale energy products are required to report suspicious transactions to Ofgem. From the first half of 2015 (subject to European Commission legislation) market participants across Europe will be required to report wholesale market transaction data (bids and offers, not just completed trades) to ACER (the Agency for the Cooperation of Energy Regulators). Ofgem will have access to this data as it relates to the GB wholesale market.

The TCLC is a 5 year licence condition (with the possibility of a 2 year extension) which prohibits generators from obtaining excessive benefit from electricity generation during transmission constraints². At Ofgem we have had concerns that transmission constraints can lead to firms having significant temporal market power in the 'Balancing Mechanism'³. Our analysis suggests the implementation of the TCLC has altered behaviour and brought down the costs of transmission constraints. For example, average payments to onshore wind farms in Scotland have fallen from around £200/MWh pre TCLC to around £85/MWh since the TCLC came into force. We have continued to observe falling bid prices from these generators.

It is hoped that future network investment upgrades to the transmission network should increase the capacity for electricity to flow between regions and reduce the frequency of transmission constraints. Therefore this would reduce the likelihood of firms having temporal market power and may remove the need for the TCLC. Future policy development, eg European Network Codes, could potentially also impact on the need for the TCLC.⁴

When considering the application of the TCLC and REMIT Ofgem also considers the possible application of competition law and whether proceeding with an investigation and potential enforcement action under competition law would be more appropriate.

Future Trading Arrangements and Market Design

As well as our ongoing monitoring responsibilities the third policy area it is important to highlight is our ongoing work looking at the Future Trading Arrangements (FTA)⁵. The electricity market is in transition. The government's Electricity Market Reform (EMR) is driving a significant shift in the generation mix towards more renewables and is introducing a new capacity mechanism. In addition European reforms including the Third Package and European Network Codes are working towards the creation of a single European electricity

² Transmission constraints occur when there is temporarily insufficient capacity to transmit electricity from where it is generated to where the demand is. This can lead to parties in some locations having market power during the period of the constraint – 'temporal market power'

³ The Balancing Mechanism is the principal tool used by the system operator (SO) to balance the electricity system on a second-by-second basis. Generators and consumers with spare flexibility in their portfolios submit offers (to increase generation or decrease demand) and bids (to decrease generation or increase demand) to the SO via the Balancing Mechanism.

⁴ For example the CACM European Network Code obliges Transportation System Operators to consider whether national markets should be split into different bidding zones. This would mean that different zones would have wholesale prices that better reflect the transmission costs and would probably remove the need for the TCLC.

⁵ <https://www.ofgem.gov.uk/electricity/wholesale-market/forums-seminars-and-working-groups/future-trading-arrangements-fta-process>

market and technological developments such as smart meters and storage are being introduced.

Ofgem has been assessing the potential impact of these developments on the effectiveness of current market arrangements through the Future Trading Arrangements Forum.

The FTA Forum brings together informed and influential industry players to identify emerging issues for GB trading arrangements and build consensus around necessary and desirable changes to current arrangements. The CMA's investigation will aid the FTA work by highlighting areas where policy and regulation may have an impact on competition.

Through the FTA project Ofgem is also considering alternative future market designs that may improve market performance and consumer outcomes in a low-carbon, pan-European integrated electricity system. This work will assess the fundamentals of the GB market design and also consider the potential applicability of existing, well-regarded overseas arrangements in the GB context. We recognise that this work will be relevant to the CMA if an adverse effect on competition (AEC) is identified in relation to this area. We will keep the CMA informed as our work progresses in this area.

Benefits of CMA's Investigation on Consumers

Ofgem and the CMA are both keen to ensure that this investigation has a real positive impact for consumers. We agree that the operation of the wholesale gas market should not be the focus of this investigation. At the same time we have both recognised that there may be features of the retail energy supply market that prevent the benefits of a competitive wholesale gas market flowing through to consumers. As set out in the State of Market Report and your Issues Statement this could be due to a number of factors, including weak consumer response, potential tacit coordination and barriers to entry and expansion. The CMA's investigation will help identify whether or not these factors are having an adverse effect on competition and help to restore public confidence in the energy market.

We are committed to playing a full part in the investigation and will continue to assist the CMA by providing information, data and expertise wherever it can be helpful and in line with our statutory functions⁶. With this in mind Ofgem would be happy to meet with the CMA panel and staff to explain developments and Ofgem's ongoing work in the energy markets in more detail.

Yours Sincerely

Emma Kelso
Acting Partner, Markets

⁶ Section 43(5) of the Electricity Act 1989 and Section 36A(6) of the Gas Act 1986. S.36A(6) of the Gas Act 1986 and S.43(5) of the Electricity Act 1989 require the Authority to give the CMA any information which is in the Authority's possession and which relates to matters falling within the scope of the CMA's investigation if (a) the information is requested by the CMA; or (b) the Authority is of the opinion that it would be appropriate to give the information to the CMA.