Will Fletcher
Project Manager
Competition and Markets Authority
Victoria House
Southampton Row
London
WC1B 4AD

Sent by email to: energymarket@cma.gsi.gov.uk

5th August 2015

Dear Mr Fletcher,

InterGen UK welcomes this opportunity to respond to the CMA's provisional findings and potential remedies.

InterGen is one of the UK's largest independent generators, operating a portfolio of three high efficiency, low emissions producing, flexible gas-fired power stations (totalling 2,490 MW; an investment of some £2.1bn in today's money). We have operated in the UK since 1996 and actively market and trade our generating capacity through long term contracts or in the prompt and forward wholesale power, carbon, and gas markets. Our power stations are located at Rocksavage (Cheshire), Spalding (Lincolnshire), and Coryton (Essex).

InterGen is also ready to build new CCGT (combined cycle gas turbine) projects at two sites, Spalding (Lincolnshire) and Gateway Energy (Essex). The new stations, which are "spade ready", will cost around £1billion to construct.

Key points

- The CMA's conclusion that **vertical integration** is not likely to have a detrimental impact on competition for independent suppliers and generators is wrong and its analysis is both flawed and narrow. Remedies aimed at improving liquidity and increasing transparency (particularly full reporting of internal trades among group entities) should be urgently re-considered.

- We welcome the CMA's conclusions regarding recent reforms, namely **EMR** and **cash-out reform**. These policies will enhance competition in the wholesale markets encouraging new entry and a level playing field for different thermal and renewable technologies.

We comment below on specific aspects of the provisional findings report.

Access to long-term products

The CMA recognises the extensive work that has been done to provide routes to market for independent renewable generators under Energy Market Reform.

However, whilst acknowledging InterGen's own submission stating that independent gas-fired generators need access to market (as well as Capacity Market revenues) to support investment decisions, the CMA appears to have undertaken little further analysis into this issue concluding that "continued investment in independent generation suggests that this is not a concern".

We can categorically state that this is a concern; not just for InterGen but for many other independent thermal developers. The Government has itself acknowledged this potential barrier to entry in its 2012 Gas Generation Strategy.

Access to short-medium term products

We remain deeply concerned that the volume of peak product transactions for forward seasons remains low despite tightening system margins and the introduction of Secure & Promote market making obligations.

Whilst we recognise that there is no simple single reason for this but in our view credit requirements imposed by large suppliers and substantial regulatory uncertainty are major contributing factors. Although the report findings suggest that hedging strategies of VIUs did not lend them an unfair competitive advantage we believe their natural hedge still stifles effective market competition and impairs market liquidity.

The CMA found evidence that the Big 6 hedge "more volume further ahead than independent operators". InterGen, as an independent generator with no natural hedge, finds the cost of trading well in advance (on the curve) to be prohibitive and faces a significant barrier in the form of cost of credit to be able to adopt similar trading strategies to the Big 6. We are disappointed that the CMA has not conducted any thorough analysis of the role of credit as a major barrier to entry and participation in the wholesale markets

High credit costs mean that independent generators need to be selective when choosing who best to lodge credit with, which is inevitably members of the Big 6, as these parties are the obligated market-makers under S&P. Sleeves (where counterparty has not lodged credit) mean Big 6 members are aware of who is transacting what, meaning they have greater visibility of trading activity than other participants.

InterGen note that improved liquidity and in particular price discovery has resulted from the Secure and Promote obligations. Without this regulatory stimulus, InterGen fear that liquidity and our ability to hedge beyond the prompt markets would be severely compromised. Thus, we would prefer the CMA to endorse Secure and Promote as an enduring market reform enshrined in legislation and liquidity not merely, "currently protected"[1] but a cornerstone of a functioning energy market that needs to remain stimulated by mandate.

Vertical Integration

Whilst the CMA acknowledges all of the areas where VIUs enjoy an advantage it concludes there is little tangible proof of material gains to be made over non-VI competitors, "while such benefits do exist, in practice they are likely to be relatively modest". Such a trite observation appears somewhat contradictory and certainly unsatisfactory. If such a conclusion is to be drawn, then surely further empirical evidence must follow by way of support for this. It is certainly unclear from the report's findings whether internal tolling arrangements were operated by utilities on an arm's length basis; whether their pricing levels were investigated and whether in fact the withholding of this capacity from wholesale markets distorts wholesale prices.

We acknowledge the importance of establishing standardised reporting methods in as many areas as possible for large VIUs. We have highlighted to the CMA the opaque nature of some reporting and in particular the lack of clarity regarding which costs and risks are passed through from VIU generating businesses to their trading or retail businesses. In light of this, standardised reporting structures would provide greater transparency to other market participants and ultimately to consumers.

At a minimum, we would expect remedies that impose far more onerous reporting requirements on intra-group transactions between generating and trading/supply businesses. For example, in our view, it would be highly desirable to introduce requirements on vertically integrated utilities to report all trades executed including those done intra-group and this could relatively easily be introduced through extending existing market reporting requirements.

Capacity Market

InterGen supports the CMA's endorsement of the Capacity Market. However, without access to a 'guaranteed return' as established under the contracts for differences for new renewable generation, the Capacity Market will not be a panacea for investors in new flexible thermal generation. Long-term security of supply and the lowest costs for consumers can only be delivered if a truly competitive, liquid, rational and transparent wholesale market also exists that provides a bankable route to market for independent generators.

Cash out reform

InterGen supports the changes proposed through a 'single cash-out price' and a reduction of PAR. Cash-out changes will increase the value of flexibility in the market. Price spikes at times of system stress offer an opportunity for flexible capacity providers to earn additional revenues in the near-term market. The prospect of earning significant revenues during these periods will ultimately help to stimulate investment in plant efficiency and flexibility.

[1] CMA full report 6.103 (Vertical Integration)

Whilst addressing a known market failing, whether or not cash-out reform provides pure and efficient feedback of capacity scarcity into market prices requires monitoring. If this policy change does not adequately address market price signals to solve the 'missing money' issue then additional changes should be explored.

Locational Transmission Loss Factor

We agree that locational adjustments to the Transmission Loss Factor (TLF) will help to correctly incentivise future investment decisions that will aid the balancing of the transmission system. In the short term, however, these changes could be interpreted as a windfall gain/tax on existing generating assets with some winners and losers.

InterGen would add that in arriving at a suitable methodology for setting the TLF the CMA/Ofgem should consider some of the possible consequences including:

1. If TLF is to be set seasonally, then the factor is unlikely to be dynamic enough to reflect the balancing challenges faced by NGC with the increasing level of intermittent renewable generation (much of it embedded) located away from the demand centres and requiring conventional thermal generation to run to support system voltage and inertia; and

2. If the TLF is to be calculated per settlement period, then it will become an uncertain contributor to the variable cost of generation. It can be assumed that the volatility of TLM/TLF in any location will increase as the charge will not be smoothed by a national averaging that currently occurs. For a generator already exposed to heightened and increasingly volatile BSUoS costs, primarily caused by the rapidly increasing portion of intermittent generation in the UK fuel mix, this is not an attractive prospect. Dispatch decisions made by the marginal plant (currently CCGT) will be proven economic or uneconomic retrospectively as BSUOs and now TLF become values only known at settlement stage well after the event.

This proposed change is in keeping with the locational aspects of Project TransmiT and could in theory be implemented very quickly by the CMA itself (TLF is part of the existing TLM calculation but currently set at zero). We would urge the CMA to allow for industry participants to contribute to this market alteration in a collaborative fashion via a consultation so that the most informed outcome is arrived at.

Role of Ofgem

Ofgem's referral of the energy market for investigation by the CMA in itself suggested that it does not not possess sufficient powers to intervene themselves and/or are not the correct body to be policing and promoting competition in the energy market.

As it stands, Ofgem are able to monitor participant behaviour and flag potentially anti-competitive behaviour but hold no powers no intervene in the market to create heightened competition should any adverse effect on the consumer be anticipated. This omission conflicts with Ofgem's over-arching remit to deliver value for end consumers. Competition is the key to unlocking efficiency in markets. We agree with the CMA that Ofgem's statutory objectives can constrain its ability to promote competition.

Yours sincerely,

Chris Elder
Commercial Director
InterGen