

ENERGY MARKET INVESTIGATION

The Energy Market Investigation (Electricity Transmission Losses) Order 2016

Notice of intention to make an Order under section 165 of, and Schedule 10 to, the Enterprise Act 2002 and public consultation on the proposed Order

Background

1. On 26 June 2014 the Gas and Electricity Markets Authority in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act) (as provided for by section 36A of the Gas Act 1986 (GA86) and section 43 of the Electricity Act 1989 (EA89)), made an ordinary reference to the Chair of the Competition and Markets Authority (CMA) for the constitution of a group under Schedule 4 to the Enterprise and Regulatory Reform Act 2013 for an investigation into the supply and acquisition of energy in Great Britain.¹
2. The CMA investigated the matters referred to it pursuant to sections 131 and 133 of the Act and concluded (a) in accordance with section 134(1) of the Act that there are features of the markets for the supply and acquisition of energy in Great Britain which, either alone or in combination, prevent, restrict or distort competition; and (b) in accordance with section 134(2) of the Act, that there are adverse effects on competition (AECs). The CMA published its findings in a report under section 136 of the Act entitled *Energy market investigation: Final report* published on 24 June 2016 (the Report).
3. In the Report, the CMA found, amongst other things, that the absence of locational pricing for transmission losses is a feature of the wholesale electricity market in Great Britain that gives rise to an AEC (the Locational Pricing AEC), as it is likely to distort competition between generators and is likely to have both short- and long-run effects on generation and demand:
 - (a) In the short run, costs will be higher than would otherwise be the case, because cross-subsidisation will lead to some plants generating when it would be less costly for them not to generate, and other plants, which it

¹ [Energy market investigation terms of reference](#).

would be more efficient to use, not generating. Similarly, cross-subsidies will result in consumption failing to reflect fully the costs of providing the electricity.

- (b) In the long run, the absence of locational pricing may lead to inefficient investment in generation, including inefficient decisions over the extension or closure of plant. There could also be inefficiency in the location of demand, particularly high-consumption industrial demand.
4. The CMA considered, in accordance with section 134(4) of the Act,
 - (a) whether action should be taken by it for the purpose of remedying, mitigating or preventing the AECs or any detrimental effect on consumers;
 - (b) whether it should recommend the taking of action by others for the purpose of remedying, mitigating or preventing the AECs or any detrimental effect on consumers; and
 - (c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.
 5. The CMA decided on a package of remedies to be implemented in order to remedy, mitigate or prevent the Locational Pricing AEC.
 6. By virtue of section 138(3) of the Act, the remedies implemented by the CMA must be consistent with the findings in the Report unless there has been a ‘material change of circumstances’ since preparation of the Report or the CMA otherwise has a ‘special reason’ for deciding differently.
 7. On 11 October 2016, in accordance with section 165 and paragraph 2(1)(a) of Schedule 10 to the Act, the CMA gave notice of its intention to make an Order on the terms attached to the First Notice (the Draft Order) and invited representations on the Draft Order from any interested person or persons by 5pm on 11 November 2016.
 8. Since the publication of the First Notice, further work has been carried out in relation to certain technical details of the Draft Order, in particular within the context of [the modification proposal P350 under the Balancing and Settlement Code](#), which supports the implementation of the CMA’s remedy.
 9. The CMA has also reviewed the proposed legal text for modification proposal P350, as well as the document ‘Assessment Procedure Consultation document’ which discusses, among other things, some interactions between the CMA’s remedy and the government’s scheme Contracts for Difference. Both documents are expected to be published on [Elexon’s website](#) for consultation today.
 10. Reflecting this additional work and the CMA’s assessment of the documents referred to in paragraph 9, and in accordance with section 165 and paragraph

2(4) of Schedule 10 to the Act, the CMA hereby gives notice of its intention to modify the Draft Order on the terms attached to this Notice (the Modified Draft Order).

11. For the avoidance of doubt, the CMA has noted some differences between the proposed legal text for modification proposal P350 and the Modified Draft Order, but currently considers that the proposed legal text is consistent with the Modified Draft Order, and that these differences are justified by the respective nature and purpose of the CMA's and industry code processes. In particular, with respect to the treatment of parts of the transmission system used for the transmission of high voltage direct current, the CMA's approach is set out in paragraphs 49 to 51 of the draft Explanatory Note. The CMA has no objection to the approach taken on this issue provided that it does not jeopardise compliance with the Order by 1 April 2018.
12. The draft Explanatory Note accompanying the Draft Order provides an explanation of how the Modified Draft Order and the associated licence conditions are expected to operate. The CMA has not considered it necessary to modify the draft Explanatory Note in light of the changes made in the Modified Draft Order.
13. This Notice and the Modified Draft Order, including the associated modifications to relevant licence conditions, together with the draft Explanatory Note, have been published on the CMA website.
14. The CMA invites written representations on the proposed Order from any interested person or persons. The CMA will have regard to any representations made in response to the First Notice and to this Notice. The CMA may also make modifications to the proposed Order as a result of any representations. If the CMA considers that any representation necessitates a material change to the proposed Order, the CMA will give notice of the proposed modifications.
15. Representations made in response to the First Notice and to this Notice should reach the CMA by 5pm on 11 November 2016. Representations should be made in writing and should be addressed to:

Project Manager
Energy market investigation
Competition and Markets Authority
Victoria House
Southampton Row
London
WC1B 4AD

or by email to: david.fowlis@cma.gsi.gov.uk and
energymarket@cma.gsi.gov.uk

(signed) ROGER WITCOMB

Group Chair

4 November 2016