

ENERGY MARKET INVESTIGATION

The Energy Market Investigation (Electricity Transmission Losses) Order 2016

Notice of making an Order under section 161 of the Enterprise Act 2002 issued under section 165 of, and Schedule 10 to, the Enterprise Act 2002

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 (the First Notice) of its intention to make an Order on the terms attached to the First Notice (the Draft Order). The First Notice, the Draft Order, and a draft explanatory note, were published on the CMA website for consultation (the First Consultation).
8. Following the publication of the First Notice, further work was 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. The CMA 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.
9. Reflecting this additional work and the CMA's assessment of the documents referred to in paragraph 8, and in accordance with section 165 and paragraph 2(4) of Schedule 10 to the Act, the CMA gave notice (the Second Notice) of its intention to modify the Draft Order on the terms attached to the Second Notice (the Modified Draft Order). The Second Notice and the Modified Draft Order

were published on the CMA website for consultation (the Second Consultation).

10. Having considered the representations received in response to the First Consultation and Second Consultation, the CMA has made some further minor modifications which it included in the Order. The CMA did not, however, consider any of these further modifications to be material so as to require further consultation.²
11. The CMA now gives notice of the making of the attached Order. The Order is made in accordance with sections 138 and 138A and in exercise of the powers conferred by section 161 of and Schedule 8 to the Act. The Order is made for the purpose of remedying, mitigating or preventing the Locational Pricing AEC identified in the Report and for the purpose of remedying, mitigating or preventing detrimental effects on customers in so far as they have resulted from or may be expected to result from the Locational Pricing AEC. The Order will come into force on 15 December 2016 except Articles 3, 4 and 7, which shall come into force on 1 April 2018.
12. The Explanatory Note accompanying the Order provides an explanation of how the Order and the associated licence conditions are expected to operate.
13. This Notice, the Order, including the associated modifications to relevant licence conditions, and the representations received in response to the First Consultation and Second Consultation, have been published on the CMA website.

(signed) ROGER WITCOMB

Group Chair

14 December 2016

² In light of the representations made in response to the First Consultation and Second Consultation, some further minor modifications were also made to the draft Explanatory Note.