

Making it easier for independent suppliers and generators to compete

Ofgem is proposing new rules to open up the wholesale electricity market so that independent suppliers and generators can compete on a more level playing field with the big six suppliers. These rules, together with Ofgem's retail market reforms, will increase competitive pressure on prices for the benefit of consumers.

Creating a more level playing field for independent suppliers and generators

Between them, the big six suppliers (British Gas Centrica, EDF Energy, E.ON, RWE Npower, Scottish Power and SSE) have a 98 per cent share of the household gas and electricity markets. It is harder for smaller, independent suppliers to compete against them as they do not have large power stations of their own. Unlike the big six suppliers and large independent generators, independent suppliers are reliant on buying electricity from the larger market players. This means that their growth depends on the ability to trade with the larger suppliers.

As the big six suppliers all own power stations it is much easier for them to get direct access to the electricity they need for their customers. They do trade some electricity in the wholesale market, but not necessarily in a way that suits small suppliers. For example, the type of products they buy and sell are not always suited to independent suppliers which have fewer customers to serve.

This can make it difficult for independent suppliers and generators to 'hedge' in the forward wholesale electricity markets. Hedging is important so that suppliers can buy power months or years in advance of when it is delivered. Doing this allows them to give their customers longer term security against price increases. Hedging forward is also important for independent generators so they can be certain of the price they will get for selling power.

Ofgem is tackling these issues with new proposals which will create a more level playing field for independent suppliers so they can buy wholesale electricity, especially in the forward markets. The proposed rules will also make it easier for independent generators to sell their power.

Ofgem wants to reform the way wholesale electricity is bought and sold to make the market work in the best interests of consumers. We want to ensure that the wholesale market provides the products that independent firms need to compete effectively. This will increase competitive pressure on the big six suppliers and also encourage them to compete against each other.

In addition, it is very important that investors in new power stations also have confidence in the forward price of electricity. This is because they will use this as the basis of their decisions about when to invest in new power stations, or carry out maintenance on existing ones.

These 'reference prices' show investors the return they will make from a new plant or from efficiently scheduling their maintenance. If the market provides these reference prices effectively, it can help to ensure that consumers have secure electricity supplies. Ofgem's proposals will enable the development of trusted reference prices.

What can be done to increase competition?

Ofgem wants to make the wholesale electricity market more liquid. In this case, liquidity means the ability to buy and sell electricity without causing a significant change in its price and without incurring significant transaction costs.

Last year Ofgem set the industry objectives for improving wholesale electricity liquidity and the regulator put pressure on the big six suppliers and generators to meet these goals. One of the objectives was to create an effective near-term market so that independent suppliers can buy electricity to manage short-term changes in demand. Significant progress has been made as all of the big six suppliers have been auctioning high volumes of electricity in the day ahead market.

However there has been very limited progress by the industry on enabling independent suppliers to buy a range of wholesale electricity products in the forward market. A lack of trading in these products also means that there has been no progress on the development of trusted reference prices.

Ofgem is proposing to introduce new enforceable rules which will ensure that the industry raises its game on making the wholesale power market more liquid. This will be achieved through a 'secure and promote' licence condition which the big six suppliers and the two largest independent power generators (Drax Power Limited and GDF Suez Energy UK) will have to meet.



Supplier market access rules

For the first time Ofgem is proposing a set of rules that require the big six suppliers and the two largest independent generators to trade fairly with independent suppliers that want to buy electricity from them.

The rules mean that these eight companies:

1. Cannot refuse any reasonable requests by independent suppliers to buy electricity. They can also no longer treat these requests to trade as a low priority.
2. Must ensure that they sell electricity to independent suppliers at a fair price and negotiate fairly with them at all times.
3. Must provide the full range of products independent suppliers want to buy in forward markets.
4. Have to set up credit arrangements for trading that are reasonable and clear.

The proposed rules also set strict deadlines and obligations for the eight companies to meet when responding to requests to trade.

For example:

- They will have two days to acknowledge a formal request to trade from an independent supplier, and say whether they need any further information.
- Once they have all the information they need, they will have 15 days to respond to the independent supplier with an offer, or a clear, justifiable reason why they are unable to trade.
- If an agreement cannot be concluded between the two parties within 60 days of a complete request to trade being acknowledged, they must offer to meet the smaller supplier to discuss areas of disagreement.

A market making obligation

Ofgem is proposing that the big six suppliers become 'market makers' for a range of products in forward electricity markets which will be suitable for independent suppliers to buy. This will ensure that trusted reference prices are developed through increased trading.

Mandatory market making means that the big six suppliers will have to post the prices at which they will buy and sell wholesale electricity on power trading platforms.

The benefits of this are that:

- It will provide clear wholesale prices up to two years in advance together with continuous opportunities to trade for the independent generators and suppliers.
- It allows independent generators and suppliers to compete more effectively as they can hedge in the forward wholesale market. As a result they can give their customers more protection against wholesale price fluctuations. The products provided by the market makers will also make it easier for the big six to compete with each other.

- Independent generators will be able to secure a market place for their output.
- Continuous trading will result in trusted reference prices being developed which will benefit all market participants.
- Market making occurs in a variety of commodity markets. It has also been used successfully in electricity markets in other countries such as Norway and Germany, where the electricity markets are much more liquid compared to Britain.

When will the reforms be in place?

Following this consultation on our final proposals Ofgem will publish a formal statutory consultation on the legal wording for the reforms before the end of 2013, ensuring that the licence condition comes into effect in early 2014. These reforms can be implemented much more quickly and with less cost to the consumer than a fundamental reorganisation of the structure of the market.

How will Ofgem check that liquidity is improving?

The regulations are enforceable, meaning that Ofgem could fine companies which are not compliant. Ofgem has a strong record on enforcement and expects the industry to raise its game by adhering to these rules and improving liquidity. We will closely monitor progress by, for example, requiring the eight companies to provide quarterly progress reports to Ofgem.

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