Consumer Focus
Campaigning for a fair deal

Consumer Focus response to Ofgem's consultation on Project Discovery policy options

March 2010

Summary

We provide responses to the individual questions posed in your consultation later in this document. We first set out some high level views on the project's findings to date – and how it should be progressed.

Moving from concepts to evidence

We welcome Project Discovery. While we do not agree with some of the conclusions reached thus far, we think that it is a valuable and timely exercise.

The British energy sector is in a transitional period as we seek to decarbonise and replace generation assets that are reaching the end of their economic lives. Decisions made now will be reflected in consumers' bills for several generations, and it is imperative that policy-makers get the big judgement calls right. To do this, bold thinking backed up by good evidence will be crucial. The ideas in Discovery display considerable boldness, but it still appears to us to be a conceptual piece – you have much further to go before you can make a decision on which model should be preferred.

The light at the end of the tunnel may not be a train coming the other way

Discovery paints an extremely bleak picture of the prospect of GB delivering secure, sustainable energy at an acceptable cost to consumers. It suggests the need for considerable intervention to underwrite energy investments through some form of price support (for example, minimum carbon prices) or central direction (for example, tenders for capacity or a central buyer). The majority of the policy options identified involve some kind of additional explicit or implicit subsidy flowing from consumers to an energy industry already making record profits.

It is undeniable that our electricity generation fleet is aging, but we do not share your pessimism on gas supply prospects[1]. It must be noted that the gas markets delivered well during the recent extremely cold winter. Despite National Grid recording the highest demand day on record in January, no firm customers were cut off, nor did this ever appear a realistic possibility. 1.1 billion cubic meters (bcm) of new gas storage[2] is due to come on line by 2014 – upping GB gas storage capacity by over a quarter. A massive 43bcm of further capacity[3] is under construction or proposed.

The global gas market is suffering from acute over supply, from diverse sources, with every prospect that this situation will continue well in to the coming decade. This sustained downward pressure on gas wholesale costs needs to be fully reflected in consumers' bills if they are to be sold the pain of decarbonising our electricity generation fleet. Discovery seems to view increased interdependence with global gas markets as a challenge to be mitigated, rather than an opportunity to be exploited. This seems short-sighted.

[1] We note that the Treasury and DECC do not appear to either, with last week's Energy Market Assessment stating that *'the risks of the gas market being unable to meet demand are very low, even in extreme scenarios and that there are no scenarios where there are any involuntary interruptions to supplies'*. The assessment was similarly bullish on electricity security of supply during the coming decade

[2] Aldbrough, Holford, Caythorpe and Stublach facilities

[3] BBL expansion, South Hook 2, Dragon 2, Isle of Grain 3, Isle of Grain 4, ConocoPhillips Teeside, Canvey LNG, Port Meridian and other facilities

The situation in electricity is challenging and may justify intervention – the key will be to make sure that any intervention is proportionate, well evidenced and avoids unintended consequences. Before any kind of intervention is enacted, policy-makers must be fully confident that the outcome it seeks to achieve would not have occurred anyway – consumers should not be underwriting the costs of projects that are already viable.

Finding the right balance between sustainability, security and affordability

Energy policy-makers find themselves in the unenviable position of trying to balance three frequently contradictory core policy aspirations: sustainability; security of supply; and affordability.

It is not clear to us that Discovery has yet found the right balance. Sustainability and security of supply appear to have primacy in its thinking, with affordability taking a back seat. We estimate that there are over 6.6 million people living in fuel poverty in the UK and retail profit margins are at historic highs. Affordability is already a major issue in 2010 – a path to 2020 that does not give it higher priority will only make this worse.

There is a compelling need for measures that put pressure on the industry to manage its costs better and to pass these through to consumers more effectively. This is only likely to come with an injection of healthy competition in to the market – but some of the interventions set out in the consultation are likely to do the opposite, further sedating an already comatose market.

Two of the proposed remedies cause us particular anxiety because they would increase the already formidable barriers to entry that small suppliers face.

Firstly, the suggestion that electricity imbalance signals should be sharpened – implicitly, through a move to fully marginal pricing – but without any commitment to sort out the dismal state of wholesale market liquidity first. Sharpened price signals are only an incentive when the person(s) exposed to them can modify their behaviour in response. It is hard to see how small suppliers can respond to imbalance price signals when traded volumes are so thin. This proposal may kill off what little competitive fringe exists, to the detriment of all consumers.

Secondly, the proposal that suppliers' should be mandated to purchase significant volumes of capacity three to five years out, increasing the upfront costs of participation.

Careful thought will need to be given to ensure that any policy interventions do not simply create problems as large as the ones they replace – for example, improving security of supply through a permanent dilution of affordability.

The need for evidence-based policy-making

Discovery has been, thus far, strong on concept but weak on detail.

None of the options in the consultation document has been subject to any public cost benefit analysis, even at a cursory level.

We would caution you against reading too much in to the responses you receive at this stage. Pragmatism is invariably more of a virtue than ideology, and it is likely that views will change as to the relative merits of different options as the evidence emerges.

We therefore encourage you to use this consultation stage to filter out those options that are not viable, rather than trying to reach a 'minded to' decision on which to be progress – you are still some distance short of having built a compelling case for any option on the table.

Views on consultation questions

Chapter Three

Question 1: Do you agree with our assessment of the current arrangements?

Only in part. We set out our views below, using the same thematic headings that were used in the consultation document.

Financing

We agree that if there is a lack of certainty on future energy policy this will drive up the risk premia that consumers pay for future energy infrastructure. Clear, coherent energy policy will help to protect consumers' interests.

However, we do not share your pessimism that the GB energy sector is a risky or unattractive investment environment. It is a sector in which those companies that are highly efficient and best in class make lots of money – but where those that are highly inefficient and worst in class also make lots of money.

We note that in your own characterisation of the current arrangements[4] you highlight that there is relatively little evidence of the major players attempting to out compete each other on wholesale costs – by far the biggest single component in end user bills – and that they operate in a market with relatively little fear of predation by new players:

> *'Ofgem's energy supply probe into retail gas and electricity markets noted that companies sought to benchmark their procurement and hedging strategies against each other in order to minimise the risk of their energy costs deviating materially from the average. Such behaviour is a consequence of the market structure and the lack of threat from new entry in supply'.*

Five of the 'Big Six' have now reported their results for 2009. All reported healthy profits, and we see no reason to expect that Scottish and Southern Energy will have fallen off this gravy train when it is the last to report in May.

2009 was not a freak year, and there is sustained evidence from a wide variety of sources on the long-term profitability of the sector[5]. With a licence to print money and little fear of predation it is hard to see why the major players would not invest in the UK.

Market structure

We recognise the issues you identify regarding industry's 'ownership' of the market codes and their subsequent ability to frustrate positive changes.

We continue[6] to support the introduction of the Major Policy Review proposals that you developed during the Code Governance Review to tackle that problem.

The problem of industry holding the whip hand in the regulatory relationship is not constrained to the industry codes and is also a problem that blights the licensing regime, as a result of ridiculously low blocking thresholds for collective licence modifications.

[4] Page 17 of your consultation

[5] Including (but not limited to) market participants' statutory financial accounts, broker analysis, Ofgem's quarterly wholesale/retail price reports and the periodic reports of the National Right to Fuel campaign

[6] Please see our September 2009 consultation response on the Code Governance Review for fuller details

We strongly support reform of the collective licence modification thresholds[7] and the raising of the blocking threshold to a level that acts to protect consumer interests, and not simply those of the 'Big Six' (collectively or individually).

There is a wide range of defects in current market structures that need tackling. Principal among these are the desperately poor liquidity of the wholesale power markets and the absence of any discernible pressure on the (allegedly) competitive market participants to compete on price and customer service.

Uncertain price of carbon

More certainty on carbon prices will clearly help investment certainty, but the effectiveness of such a policy would depend greatly on how it was designed. Your proposals in this area are so short on detail that we have no further comment at this time.

Investment signals in generation

We agree that the comparatively lower capital cost and development time of gas plants, coupled with their lower carbon emissions, may make Combined Cycle Gas Turbines (CCGTs) more attractive investment options than other fossil fuel plant – and an appropriate bridging option to get us through the mid-decade capacity margin squeeze.

Wholesale gas prices are currently at historic lows and some commentators think they are likely to remain so for the foreseeable future[8]. This should help to support reasonable CCGT investments.

We note the arguments around capacity payments as a means to support new investments. We comment more on this idea in a later answer.

Issues with current market rules

The economic arguments for stronger imbalance signals as a means to incentivise investment in peaking plant and ensure security of supply are well known[9], understood and logical.

That said, we think consideration of stronger imbalance signals in electricity should be deferred until such time that the utterly dismal state of liquidity in the GB wholesale electricity markets has been addressed, for the simple reason that there is very little point in sending out stronger imbalance signals until such time that market participants can actually act on those signals. Implementing fully marginal cash-out in advance of liquid trading markets may simply kill off what little competitive fringe exists in electricity supply. We need more competition with the 'Big Six', not less.

Liquidity in gas markets appears to be adequate for the purpose of forward contracting, and commencing work on improved pricing signals in that sector may be appropriate.

Enabling demand side response and distributed generation

We strongly agree with the need to facilitate demand side response and distributed generation.

We would caution against overestimating the potential contribution of demand side response in the short term. Many batch or continuous industrial production processes are

[7] Indeed, we challenged parliament to tackle this defect during its consideration of the recent Energy Bill. We welcome the subsequent commitment from the Government to consider whether these thresholds should be changed

[8] For example, the International Energy Agency's 'World Energy Outlook 2009' suggests that gas supply growth is likely to outstrip demand in the next few years. It notes, '*This glut could have far-reaching consequences for the structure of gas markets, with suppliers to Europe and Asia-Pacific coming under pressure to modify pricing terms under long-term contracts, to de-link gas prices from oil prices, sell more gas on a spot basis and to cut prices to stimulate demand*'. BP's Statistical Review of World Energy is similarly bullish on supply volumes
http://www.bp.com/subsection.do?categoryId=9023762&contentId=7044550

[9] Ofgem has been reviewing the cash-out arrangements continuously since May 2004

difficult to interrupt and it may be inherently difficult to encourage some large-scale consumers to provide demand response[10]. In principle, smart grids should greatly facilitate demand side response, but it is unlikely these could be in place in time for the mid-decade pinch-point identified in your scenarios.

Risk management

We have no comment on this section.

Costs to consumers

We agree that three of the key drivers of costs to consumers will be investors' perception of risk; levels of subsidy for environmental initiatives; and any volatility in supply. Regarding the last of these, we would however note that many gas market analysts suggest that over-supply is much more likely to be an issue than under-supply in the short to medium term.

We think there are additional drivers that you have not identified.

One of these is the effectiveness of competition in driving down costs. You will be aware of our concerns that the market is not working effectively in the interests of consumers. The 'soft' competition that characterises the GB energy markets is not conducive to adequate downward pressure on consumers' bills. Indeed, your last quarterly wholesale/retail report suggested retail profitability is at an historic high – despite significant demand destruction as a result of the recession and energy efficiency measures.

A second additional driver is expectation management. Since the publication of your consultation document it is notable that the £200 billion investment projection for your green transition scenario – only an estimate, and only relevant to one scenario – is being presented as a hard fact by the industry in order to argue that price cuts are not merited[11].

It is rather ironic that the main ammunition being used by the industry to fight against price cuts (which are overdue, and in consumers' interests) are the reports of the regulator (which is supposed to be protecting consumers' interests). We urge you to be careful in how you present any estimates going forward so that you do not talk-up end-user prices.

Interaction with interconnected markets

We think your concerns on the security of gas supplies are overly pessimistic.

The market coped reasonably well during the extremely cold weather this winter[12]. The Gas Balancing Alerts (GBAs) prompted the release of significant volumes of gas in to the market – to the point where National Grid Gas ended up having to sell back surpluses on some affected days.

The threat of shortfalls is being used to argue that consumers should fund expensive new storage assets – either in the form of gas storage or new interconnections.

Priority consideration should be given to improving European market rules. We note the implication in paragraph 3.42 that the market did not follow price signals when withdrawing gas from GB storage rather than continental storage during the Russia-

[10] These concerns have been raised on several occasions by industrial consumers at your Demand Side Working Group.
[11] For example, in press releases and other media work by the communication arm of the 'Big Six', Energy UK **http://www.energy-retail.org.uk/media/press/Whichresponse.html** The AEP has scheduled a seminar called 'The £200bn generation game' for April
[12] Indeed, this view is also commonly held by the industry itself. For example, see Tony Hayward's speech to the London Business School on 24 February: **http://www.bp.com/genericarticle.do?categoryId=98&contentId=7059562**

Ukraine dispute in January 2009. Building new assets in already irrational markets brings the risk of unintended consequences.

We have responded separately to your consultation on electricity interconnector policy. See that document for a fuller explanation of our views; we favour a fully merchant, or 'pseudo-merchant', approach to funding these assets that does not involve consumers materially underwriting the risk of building stranded assets.

We have no problem with the building of either additional interconnectors or additional gas storage where these are fully funded by the private sector. But we do not agree that a public policy case has been made that these assets should be underwritten by consumers – the case for consumers to pay yet more subsidy to an already bloated sector simply has not been made.

We agree that it would seem sensible to look at ways to tackle the issues around 'out of spec' gas that you identify in paragraph 3.44.

Interactions with networks

We oppose the 'connect and manage' approach to transmission access reform.

Encouraging new generation assets in constrained areas before the transmission network has been reinforced sufficiently to cope with them is an ill-conceived idea. It raises the very real prospect that the system operator will frequently have to constrain renewable generation off and put conventional thermal generation back on at significant cost.

We encourage you to look at ways to reduce the costs, and lead times, of network strengthening to cope with new generation assets.

We will be responding separately on RPI-X@20 in the coming days.

Non-financial barriers

We agree with the non-financial barriers you have identified.

We think that two further barriers are likely to be the complexity of the industry codes and the interaction between the rules surrounding electricity cash-out and the dismal state of liquidity in the electricity wholesale market.

There are a multitude of codes governing participation in the energy industry. These are bulky documents, that each typically contain hundreds (if not thousands) of obligations on market participants. The Balancing and Settlement Code alone has roughly a hundred subsidiary documents, all of which are binding on code signatories. Signing up to these codes is generally obligated by licence conditions. The volume of regulation may well be deterring new market entry.

Electricity cash-out rules are intended to incentivise market participants to manage their imbalance positions and (by extension) to invest accordingly. In theory, this investment could take one of two forms: asset based (ie building generation) or commodity based (ie procuring energy either bilaterally or from the wholesale markets).

The problem is that the forward electricity wholesale market is frozen. Larger suppliers can get around this problem by either building generation assets or exercising their massive purchasing power to contract bilaterally. They also own much of the flexible plant. These balancing options are far less viable for smaller suppliers, who are disproportionately exposed to imbalance prices as a consequence.

An incentive is only an incentive when the person exposed to it can change their behaviour in response. The electricity wholesale markets are so illiquid, we do not think that behavioural change will result from sharpening imbalance signals – those exposed to them will not be encouraged to 'go to market' for the simple reason that there is no market for them to go to.

You need to sort out electricity wholesale market liquidity before tackling imbalance signals. The former is a stepping stone to the latter – not vice versa. Strengthening imbalance signals in isolation may simply kill what little competitive fringe we have.

Question 2: Are there other aspects of the current arrangements which could have a negative impact on secure and sustainable energy supplies, or costs to customers?

The state of liquidity in the wholesale power markets is dismal, and is not conducive to new market entry. Given the primacy of dual fuel as a customer offering, it may also be constraining entry into the domestic gas market too. Effective competition is a key factor in driving down customer costs, and is – despite your rhetoric – not a feature of the GB energy markets. You need to be doing more to ease market entry.

The current arrangements also lack adequate scrutiny mechanisms to ensure that costs to consumers are minimised. The introduction of separate financial reporting for the 'Big Six' as one of the Energy Supply Probe remedies is a major step forward, but we think further steps can be made. Article 40 of the EU Third Package significantly increases your information gathering, and dissemination, powers as they relate to wholesale markets. You need to act on these powers – we would welcome a clear commitment to do so.

Question 3: Do you agree that the five issues we have highlighted are the most important?

We agree that the fifth issue (affordability) and the second issue (carbon price uncertainty) are highly important issues. With over six million people in fuel poverty and retail margins running at record levels, affordability is a very real issue in 2010 – let alone 2020.

We agree that the third issue (incentivising peaking plant) is important, but consider that fully marginal imbalance pricing should not be introduced into the electricity side of the market until the woeful state of wholesale market liquidity has been sorted out.

We have mixed views on the first issue (unprecedented levels of investment and poor investor confidence). We agree that levels of investment are likely to be high, but note that there is considerable diversity of views on how high these costs may be – even the four scenarios modelled in Discovery show extremely wide variance (between £95 billion and £200 billion). We are sceptical that investors will lack confidence to invest in the UK energy markets. These are markets that have offered sustained high levels of profitability – it would appear acutely foolish to walk away from them.

We do not agree that the fourth issue (increasing interdependence with international markets) is important – or at least not in the way that you envisage. The whole presumption behind this issue appears to be that these markets are in a state of crisis, and that we run the risk of being cut off due to political instability or competition for resources. While feasible, we do not think this is particularly likely. If anything, we see a glut of gas on the global markets for the foreseeable future. International interdependence at a time of likely sustained global surplus is more likely to be a benefit that should be exploited, than a risk that should be mitigated.

Question 4: Do you have any comments on our description of what might happen if no changes are made to the current arrangements?

We agree that it is likely that conventional thermal plant may be built, or that existing thermal plant may see its life extended, to address capacity issues in the middle of this decade.

We also agree that it is possible that there may not be incentives on the gas industry to build seasonal storage. We do not find this particularly concerning though – as previously noted, we expect the global market to be awash with gas for the next few years and the current arrangements coped well with the severe winter we just experienced.

Chapter Four

Question 5: Do you believe that our policy packages cover a sufficient range of possible policy measures?

Yes, though they lack sufficient detail to make a judgement on their relative merits appropriate at this stage.

Question 6: Do you have suggestions for variants to these policy packages?

For the reasons set out in our answer to question 1, we see sorting out electricity wholesale market liquidity as an essential precursor to tackling imbalance pricing.

We are conscious that Ofgem is running a separate project on liquidity. These projects could be usefully combined – or, if this is not possible, we would strongly favour your prioritising the liquidity project. We agree with DECC and the Treasury that the primary barrier to entry in to British energy markets is low wholesale market liquidity[13].

Question 7: What other policy measures do you believe should be considered, and why?

We do not wish to suggest any additional policy measures at this stage – we would rather that more flesh was put on those already on the table, so that their implications can be better understood.

Chapter Five

Question 8: Do you agree with the assessment criteria that we have used to evaluate the policy packages?

They look broadly reasonable.

Going forward, it may be useful to broaden the fourth criteria to consider input subsidy as well as output cost, as consumers will pick up the bill for both. Many of the options on the table are at least in part dependent on consumers underwriting the risk or cost of new investment (ie through carbon price floors, or capacity payments).

Questions 9 and 10: Do you have any comments on our initial assessment of each of the packages? Do you agree with our summary of the key benefits and key risks of each policy package?

These questions are very similar, so we answer them together.

Very little information has been provided on the scheme parameters for any of the options and none of them has been subject to any form of robust cost/benefit analysis. You will need to conduct robust analysis on any option that you develop further.

[13] See page 15 of their joint Energy Market Assessment, March 2010.

Many of the policy interventions identified are common to several of the packages. To avoid repetition, we therefore present our views in relation to individual interventions rather than overall packages.

Minimum carbon price (a feature of packages A to C)

We can understand the logic behind this kind of policy intervention, but it is hard to reach any kind of view on whether it would be effective based on the limited information available.

To reach any kind of view on whether this intervention would work we would need more detail on basic points of scheme design, such as:

- What technologies would qualify?
- Whether the price would be fixed or sculpted?
    - If fixed, at what level?
    - If sculpted, how would it interact with the wholesale market price that was set by marginal plant?
- How long would this price support be guaranteed for?
- Would this price support be restricted to new build, or would it also include existing plant?
- Would we implement such a scheme unilaterally in the UK or would we only go ahead if we could get international agreement?

Improved ability for demand side to respond (packages A to D)

Facilitating demand side response would certainly be beneficial, but is likely to be a relatively small piece in the puzzle given that the major 'pinch point' in capacity appears to be around 2015/16.

Household demand response is likely to be limited in the short term. Smart tariffs and automated energy management goods ('smart fridges' etc) may be able to play a part but those tariffs and products have not yet hit the mass market.

Industrial demand response is more credible in the shorter term. Interruptible contracts are an existing feature in that sector and major commercial users are likely to be more responsive to price signals than smaller non-commercial users are.

That said, it must be noted that some industrial production facilities will never wish to participate in demand side response because their 'batch' or 'continuous' nature means they cannot be safely and/or economically shut down in the middle of a production run.

Improved price signals (packages A to D)

We see logic in the desire to strengthen price signals to encourage investment in peaking plant. The benefits of this are obvious, although the impact of changes to market rules on the competitive dynamic should be taken in to account.

As noted on several occasions in this response, we consider that liquid wholesale markets are an essential companion to strengthened price signals. There is no point sending out stronger signals on market participants to forward contract if there is no mechanism through which they can do this.

The state of liquidity in the gas wholesale markets is adequate for the purpose of forward contracting. In electricity, it is dismal. We would encourage you to prioritise consideration of price signals in gas before you look at electricity. Sharpened price signals in electricity should only be considered when you have come up with a credible solution to the

illiquidity in that wholesale market. If the former is tackled without the latter, you may simply end up killing off what little competitive fringe exists in that market.

Enhanced obligations on suppliers and system operator (packages B and C)

It is unfortunate that two essentially different concepts have been bundled together under a single option because their merits greatly differ.

Enhancing obligations on the system operator to ensure that there is adequate capacity to meet demand seems broadly sensible. This could probably be achieved through sharpening the System Operator (SO) incentive regime, an existing mechanism.

The alternative approach – putting these obligations on suppliers instead – strikes us as highly undesirable and ill conceived.

The consultation suggests, 'we believe that obligations of duration between three and five years may strike the right balance between future visibility of provisions and market contestability'. We are extremely surprised by this view. We do not have a contestable market in 2010: the energy market is characterised by soft competition and there has been no scale new entry for many years now. Expecting new entrants to fund capacity up to five years out – assuming they can even adequately forecast the volumes they would need – would only increase the already formidable (impassable?) barriers to entry.

We would be surprised if the supplier driven approach were compatible with competition law and your statutory duties. Further sedating an already comatose market is not an attractive prospect for consumers and we urge you to reject this thoroughly toxic idea.

Centralised renewable market (packages B to D)

The explanation of cash out price risk to intermittent generation is not clear and gives no sense of its materiality.

Unless the risk is very significant, it would seem preferable to avoid having parallel markets for differing technologies. There is a risk that excessive price support for intermittent technology may undermine the financial case for building other generation assets, and we will continue to need some thermal plant to deal with intermittency.

Replace RO with renewable tenders (package C)

We have no observations on this model at this time.

Tenders for all capacity (package D)

This is an interesting concept and we agree with the strengths and weaknesses you identify.

Such a model would be strong on long-term certainty – both for markets in terms of underwriting the risk and revenue streams of investment, and for consumers in terms of securing supply and an appropriate generation mix.

As with any centrally planned model there is a risk that these planners will get things wrong or over procure – with consumers picking up the tab if they do.

Before any kind of intervention to guarantee capacity were enacted, policy makers must be fully confident that the outcome it seeks to achieve would not have occurred anyway – consumers should not be underwriting the costs of projects that are already viable.

Notwithstanding this anxiety, this is an idea worthy of further consideration.

Central buyer for energy and capacity (package E)

This model has many of the same conceptual strengths and weaknesses as tendering for all capacity – greater certainty on generation mix and cost, but with the risk of over procurement and the stifling of innovation in the upstream sector.

The principal policy driver for this proposal is to ensure security of supply, but it could have very significant unintended consequences for the competitive landscape – and it is not entirely clear whether these would be positive or negative.

In principle, the creation of a central energy market with a single cleared price fundamentally unwinds many of the drivers for vertical integration by creating a functional and financial separation between the upstream and downstream sectors of the industry. It could solve entrenched problems with liquidity and provide a level playing field for new suppliers – because they could gain access to the same product at the same terms as the major players.

That said, the benefits of opening up the market to genuine retail competition could be reduced, or reversed, if poor purchasing decisions by the central buyer significantly inflated the costs of the energy and capacity it was purchasing on behalf of all suppliers.

The Energy Market Assessment clearly signals that the Treasury and DECC do not favour this market model. We can understand why – this package is certainly the riskiest of all the policy interventions on the table. That said, in the continuing absence of liquid wholesale markets, it is not entirely without attractions – it might actually open up the GB retail market to genuine competition by reducing barriers to entry.

Question 11: Do you have a view on which package is preferable, or alternative policy measures or packages that you would advocate?

We have no preferred model among those put forward.

It is simply too early to say which should be preferred. None of the measures or packages has been subject to adequate (indeed, any) cost benefit analysis at this stage.

If we are not in a position to suggest which options should be taken forward, we can at least provide a view on which options definitely should not.

We consider that two of the measures proposed are fundamentally toxic to consumer interests. We strongly advise you to reject these two concepts, but propose mitigating measures that you must consider if you are determined to take them forward.

Firstly, we cannot express strongly enough our view that fully marginal imbalance pricing should not be introduced in to the electricity market at this time. The wholesale power market is extremely illiquid, with the consequence that smaller suppliers are highly exposed to imbalance. Without improvements to liquidity, sharper cash out signals are likely to completely – and permanently – kill off what little competitive fringe we have in electricity. If you are determined to pursue this measure you must take steps to dramatically improve the liquidity of the power markets first.

Secondly, we similarly think that putting obligations on suppliers to purchase capacity volumes at least three to five years out is going to make market entry even harder than it already is. This is a dreadful prospect for consumers – we need an injection of competitive pressure in to the market, not its further dilution. If you are determined to pursue this measure, you should consider whether suppliers below a certain size should be exempted from these obligations. Ultimately, with 99 per cent of the domestic energy supply market in the hands of the ‘Big Six’, smaller suppliers are not going to be materially affecting GB security of supply any time soon.

Chapter Six

Question 12: Do you agree with our assessment of the timing for important investment decisions?

We have no observations on your assessment.

Question 13: Do you believe that early actions should be considered?

It is fairly hard to answer this question in the abstract. None of the options on the table are sufficiently well evidenced or costed at this moment in time to justify a 'leap of faith' that they should be brought further forward. But as the evidence emerges, there will almost certainly be a case for prioritising some actions over others.

Question 14: Do you think that the issues are such that policy measures should be considered as a package or should they be considered on a case by case basis?

The five packages on the table vary in how radical they are, but all would appear to require some form of legislative change. As such, none could be implemented in its entirety without parliamentarians taking a view on their preferred shape of the future market.

Where a proposal, taken in isolation, may benefit consumers and could be implemented by Ofgem without legislative changes, there may be a case for it to be taken forward by you on a case by case basis. In considering any such proposal you would need to be mindful of the risk of early redundancy if it were to prove incompatible with the direction of future government policy.

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