



State of the market team
Ofgem
9 Millbank
London
SW1P 3GE

Email to: stateofthemarket@ofgem.gov.uk

23 May 2014

Consultation on a proposal to make a market investigation reference in respect of the supply and acquisition of energy in Great Britain

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy welcomes the proposal for an investigation of the energy market by the Competition and Markets Authority (CMA). A thorough, objective, transparent and evidence-based investigation by the CMA will help to rebuild trust in energy markets, identify areas where there is room for improvement in the interests of customers and set the basis for a period of stability in the market, which is vital in the context of the unprecedented level of investment that needs to be made in energy infrastructure over the coming years.

Our detailed response is set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact me on 0207 752 2200.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Angela Pearce'.

Angela Pearce
Director of Corporate Policy and Regulation

EDF Energy
40 Grosvenor Place, Victoria
London SW1X 7EN
Tel +44 (0) 20 7752 2200

edfenergy.com
*EDF Energy plc.
Registered in England and Wales.
Registered No. 2366852.
Registered office: 40 Grosvenor Place,
Victoria, London SW1X 7EN*

Attachment

Consultation on a proposal to make a market investigation reference in respect of the supply and acquisition of energy in Great Britain

EDF Energy's response

EDF Energy welcomes the proposal for an investigation of the energy market by the Competition and Markets Authority (CMA). We have been calling for an investigation of this kind for over two years. Assuming the investigation proceeds, EDF Energy looks forward to working constructively with the CMA towards the shared outcome of ensuring the market is working for everyone.

EDF Energy believes that the market investigation will be an opportunity to:

- Take a thorough, objective, evidence-based look at the energy market, and identify areas where there is room for improvement in the interests of customers;
- Conduct an open and transparent investigation into the sector, which will help to rebuild customer trust; and
- Set the basis for a period of stability in the market, which is vitally important for the unprecedented level of investment that needs to be made.

With these objectives in mind, EDF Energy has set out below some suggestions to inform the focus of the investigation. EDF Energy is of the view that the current scope is sufficiently wide so as to enable the CMA to consider in depth all the issues identified, subject to the suggested amendments to the terms of reference set out in the Annex.

An objective examination to identify areas for improvement in the interest of customers

EDF Energy recognises that a thorough examination of the energy market is necessary to "clear the air" and address misconceptions about the energy market (played out largely in the media and in political debate). We believe its aim should be to find areas where there is real room for improvement in the interests of customers.

In order to inform the focus of the proposed CMA investigation, EDF Energy has set out below its suggestions for areas that should be subject to further examination by the CMA. Many of these were also identified in the *State of the Market Assessment* report from Ofgem, the Office of Fair Trading (OFT) and the CMA. EDF Energy will be pleased to share

its understanding of the market and evidence base with the CMA as well as its ideas about what is working well and where there is room for improvement.

Suggested areas for further examination by the CMA

We recommend that in undertaking any investigation, the CMA should take account of the significant changes made recently and in train in the market. These are most notably as a result of Ofgem's Retail Market Review (RMR), measures to enhance liquidity, the introduction of smart meters and the Government's Electricity Market Reform (EMR) programme. EDF Energy recognises that some of these fall within the scope of the reference and the regulatory framework itself may be a 'feature' that raises issues and can be improved¹.

Similarly, EDF Energy believes that it is appropriate for the CMA to take account of the fact that the energy sector has been subject to continuous and continuing regulatory, political, government and EU intervention, which has been instrumental in shaping the energy market of today and tomorrow. The energy market is designed to deliver a variety of objectives, including notably the UK's energy policy objectives of security of supply, decarbonisation and affordability.

1. Weak customer response

The Consultation has identified switching as a primary indicator of customer engagement and hence competition in the market. To properly understand the market dynamics relating to switching, EDF Energy believes it is necessary to get beyond the headline figures and understand what drives customer behaviour, and the different dimensions of customer response. For example, we suggest that the CMA considers:

- Switching between products but staying with a particular supplier – this demonstrates customer engagement.
- Some customers may choose not to switch, i.e. they are satisfied with their supplier.

¹ EDF Energy understands the EMR itself is outside the scope of the terms of reference.

- Some customers may face barriers, e.g. lack of internet access. The CMA needs to understand all the barriers and how to address them in a proportionate manner.
- Some customers may consider that the savings available are limited and therefore switching is not worthwhile.

We encourage the CMA to look for ways to make it easier for customers to compare prices and products in the market. For example, EDF Energy strongly advocates the introduction of a unit only price for electricity and gas for domestic customers, which we believe would facilitate engagement further.

EDF Energy agrees with the *State of the Market Assessment* report that there needs to be a focus on making sure that vulnerable domestic consumers are able to access the market, and ensuring they have adequate protection where necessary. The relationship between vulnerability and disengagement in the retail market is a complex one. Customers can be disengaged for a number of reasons, which are not necessarily related to vulnerability. Therefore, the issue of engagement needs to be considered for all customer groups, not only the vulnerable. Equally, there may be specific issues around vulnerability that should be examined, not only in relation to their engagement with the market but also wider issues they may face.

We also suggest that the CMA examines the role and conduct of intermediaries, including switching sites. An amendment to the current terms of reference may be required to achieve this, which we have set out in the Annex.

The issue of weak customer response is one where we encourage the CMA to pay particular attention to the impacts of developments already underway in the market, including RMR, the smart meter programme and moves to speed up switching.

2. Incumbency

The *State of the Market Assessment* report raises concerns about the implications of incumbency. EDF Energy agrees that the CMA should look at this issue during the course of its investigation. In doing so, EDF Energy supports consideration by the CMA of all the dimensions, including fuel type and fuel mix, by region, market position and other influential factors, e.g. brand.

In addition, we recommend that the CMA considers the costs of responsibilities borne by incumbents (express and implied) as well as the advantages of incumbency. There are

notably significant costs related to debt recovery and bad debt write-off that result from an incumbent customer base that other suppliers may otherwise regard as high risk.

3. Tacit coordination

The *State of the Market Assessment* report does not identify any evidence of collusion, but notes that there are similarities in the way that companies have behaved that warrant further investigation, to see if they could be evidence of tacit coordination.

We suggest that the CMA undertakes a thorough examination of the drivers of company behaviour to understand the motivation for the observed behaviours. There are many causes of these behaviours, including competition and the current regulatory framework. EDF Energy looks forward to the opportunity to discuss this issue in more detail with the CMA during the investigation.

We expect the CMA will look for examples of companies acting independently in response to the competitive market environment. We will be happy to share examples with the CMA, for example the products we offer to SMEs and our decision in November 2013 to announce a price rise for domestic customers that was significantly less than the majority of our major competitors.

4. “Vertical Integration”

The term “Vertical Integration” is used to cover very different structural models. We recommend that the CMA drills down into the specifics of the business models adopted by companies, and assesses their implications, both individually and collectively.

There are multiple models of conducting business in different segments of the market which can be interpreted as integrated models, for example smaller suppliers in the residential supply market with renewable generation assets and market players integrated across generation and business energy supply. The adoption of such models (including by smaller suppliers) may well shed light on the causes and effects of integrated business models.

EDF Energy is a business that both generates and supplies electricity, and also supplies gas. We carry out these activities in a way that we believe best meets the needs of customers, both in the short and long-term.

The *State of the Market Assessment* report acknowledges that there may be benefits attributable to generation-supply business models. EDF Energy supports this view, and believes such benefits include:

- Companies present through the value chain can take a view across the entire energy system, advocate solutions on behalf of customers rather than based on silo business interests and contribute to a quality debate on energy policy.
- Companies present in supply and generation build expertise, enabling them to manage the complex electricity system, including exposure to international markets, intermittency and impacts of smart meters. This helps to ensure stable supply for customers.
- Internally, these first two points are also useful for skills building and employee motivation.
- Reliable players with a long-term view can help the country to prepare for the future through R&D and the ability to implement new policy measures.
- The presence of reliable integrated businesses with a long-term commitment protects against business failures under challenging market conditions. The history of energy markets includes many examples of small and/or undiversified players going into administration, with costs falling on customers. Reliable, long-term players can also act as suppliers of last resort.

We look forward to sharing these ideas further with the CMA during the investigation.

We suggest that the CMA tests some of the questions commonly raised about generation-supply business models, often in the media and during political debate. These questions include, for example:

- The robustness of segmental accounts;
- The impact on liquidity in the market; and
- The reliability of wholesale prices and transparency of internal transactions.

In looking at these commonly raised questions, we hope the CMA will establish whether an integrated business model really is the root cause of some of the issues identified, or whether there are other factors at play.

We also suggest that the CMA looks at the bundling of other products and services with energy retail, and considers the impact this may have on the market, in particular bundling that may adversely impact customer engagement.

Finally, EDF Energy strongly encourages the CMA to look at both electricity and gas, recognising that there are different issues in each and that an appropriate balance is required between the two during the investigation.

5. Barriers to entry

EDF Energy agrees that the CMA should consider the factors listed in the *State of the Market Assessment* report as potential barriers to entry, including liquidity, credit and collateral, pricing strategies, regulatory barriers and reputational risks.

When examining the question of barriers to entry, EDF Energy advises the CMA to consider in particular:

- Requirements in order to do business in the energy sector, for example relating to credit and collateral.
- Regulation necessary to safeguard business operations and in the interests of customers, to ensure the efficient operation of the market.
- The risks and responsibilities that players of different sizes bear. Given the critical nature of gas and electricity supply, it is in the best interests of customers that energy companies should be capable of sustaining operations into the longer term so as to provide security of supply.
- Whether the support given to small companies should be proportionate to any disadvantage of scale relating to fixed costs that they face.
- Regulation in the energy market, namely whether the nature and extent of regulation is the most appropriate to promote competition, and whether it is really in the best interests of customers.
- The reasons why few major players (both large non-energy players, for instance from the wider retail sector, and large energy players operating in different areas of the market, e.g. business energy supply) have entered the domestic energy supply market in recent years. For example, established businesses might have been expected to diversify into this market. We invite the CMA to consider the kind of regulatory, commercial, and reputational barriers that might be preventing this.

6. Profits

The *State of the Market Assessment* report points to evidence of increasing average profitability amongst the six larger suppliers over the last four years. However, the report

does not form any conclusions as to whether excess profits are being made and notes differences in the profitability of the large suppliers. EDF Energy welcomes the opportunity for the CMA to further investigate the facts about profitability, and suggests that the following are considered:

- Levels of profitability in the context of the risks faced and the investments made.
- A detailed view of profits at supply business level, including notably by customer segment, e.g. by tariff type.
- Profits in both electricity and gas, and the interaction between them.
- The extent to which scale contributes to higher profits as well as profit distribution amongst all suppliers.

Additionally, EDF Energy believes that it is important to bring more transparency to the costs of supplying electricity and gas and for this to be communicated clearly to consumers. In particular, we think that clarity is needed on what has been happening to policy costs, and the way in which they are allocated between electricity and gas, and between customer groups. Network and other regulated costs are clearly a strong driver in recent increases in bills. All stakeholders, including the CMA, will need to understand the drivers behind these increases and their justification.

Helping to restore trust

There is no doubt that trust in the energy market has declined, and this is noted within the *State of the Market Assessment* report.

EDF Energy believes that the primary responsibility for rebuilding trust rests with energy companies themselves. EDF Energy has demonstrated its commitment to rebuilding that trust. In 2012, we launched our "Customer Commitments", our promise to customers that we will provide them with fair value, better service and simplicity. Internally, we have made significant progress to implement and embed these commitments in the way we work, interact with and serve customers. We have also campaigned externally for improvements to the energy market to improve transparency and trust to deliver benefits for customers. Of course, we recognise that we can do more and we hope that the market investigation will play a facilitative role in this respect.

By taking a thorough, objective look at the issues listed above, the CMA will contribute substantially towards restoring trust. In addition, we recommend that the CMA investigation should:

- **Be a source of reliable, evidence-based information about the industry**

As part of its investigation, we trust and expect the CMA to be a source of reliable, trustworthy information about the energy market, which can help to address any misconceptions.

- **Look for ways of enhancing the provision of reliable and trustworthy information in the future**

We encourage the CMA to consider in particular the role of the regulator in providing reliable, trustworthy information about the industry on an ongoing basis and what the regulator might need to do in order to fulfil that role. Such information might include, for example, an explanation of costs as well as information on service standards and service delivery performance. In doing so, it might be useful for the CMA to review how other regulators maintain trust and the nature of their relationship with the industry they are regulating.

Providing a stable framework for investment

EDF Energy supports the CMA investigation as essential in paving the way for a period of stability in the energy market. This is necessary in the face of the unprecedented level of investment required in new energy infrastructure over the coming years. The Consultation itself recognises this.

The investigation needs to command widespread support, thereby strengthening political consensus around its actions and recommendations.

We note that the Consultation states that the CMA should take account of the Government's EMR programme. EDF Energy strongly advocates that the CMA investigation should take account of the EMR framework as laid down by Government and not seek to challenge it. EMR has been subject to prolonged and detailed consultation, and has a strong democratic mandate, having been voted through Parliament. It is necessary to underpin the significant investment needed in new energy infrastructure, and particularly low carbon generation.

Scope of the investigation

In light of our comments above, we have the following points to make about the scope of the investigation and the terms of reference:

- We agree that the primary focus should be on the supply of gas and electricity to domestic customers and small businesses. We agree with Ofgem and the CMA's intention not to include the industrial and commercial (I&C) market. We believe a minor amendment is needed to the proposed terms of reference in order to achieve this – see Annex.
- We believe that the terms of reference needs to be sufficiently wide so as to allow the CMA to look into the role and conduct of intermediaries, including switching sites. We suggest that a minor amendment is needed to the proposed terms of reference to ensure this is in scope – see Annex.
- We see it as necessary that the CMA considers the provision of related products and services that may impact customer engagement, e.g. energy services, and we believe the current wording of the terms of reference is sufficiently wide to achieve this.
- We also believe the current wording of the terms of reference is sufficiently wide to enable the CMA to look into other aspects that might impact the operation of the domestic / small business retail market. For example, the CMA will necessarily need to look into the operation of the wholesale market.
- We are convinced that the investigation must take EMR as a given.

We hope these suggestions and observations prove useful in establishing the scope and focus of the proposed CMA investigation. We are looking forward to engaging constructively with the CMA, and sharing our ideas about the operation of the market in more detail with the CMA as the investigation progresses.

EDF Energy
May 2014

Annex – Suggestion on the legal draft relating

EDF Energy agrees with Ofgem and the CMA's intention not to include the I&C market in scope for the market investigation. However, it should be noted that the current terms of reference has been drafted in a manner which refers to 'premises'² rather than 'consumers' and would therefore capture the smaller sites of large I&C customers. The terms of reference should instead refer to 'relevant consumers' and retain the existing consumption thresholds (but associating these with customers rather than premises). We would welcome the opportunity to discuss a relevant definition with Ofgem which would address our concerns.

EDF Energy believes that the terms of reference needs to be sufficiently wide so as to allow the CMA to look into the role and conduct of intermediaries (non-licensed entities), including switching sites. To achieve this, we suggest that the drafting of the definition of 'supply'³ in the current terms of reference should be expanded as follows: "supply' means the activities of, and activities connected with, wholesale supply and retail supply of energy whether or not carried on by a person supplying gas and/or electricity'. This wording is based on that used in the Energy Act 2013 which attempted to clarify the activities to be included as connected with the licensed activity of supply.

² Ofgem, 'Consultation on a proposal to make a market investigation reference in respect of the supply and acquisition of energy in Great Britain', 27 March 2014, p.42.

³ Ofgem, 'Consultation on a proposal to make a market investigation reference in respect of the supply and acquisition of energy in Great Britain', 27 March 2014, p.42.