



Market Investigation Team

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State of the Market
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Re: Consultation on a proposal to make a market investigation reference to the CMA in respect of the supply and acquisition of energy in Great Britain

Dear Sir or Madam,

E.ON supports an electricity and gas markets investigation reference to the Competition and Markets Authority (CMA). We view this as a key way for all customers and stakeholders to gain full confidence in the operations of the electricity and gas markets. Events and rhetoric of the last few years have had a negative impact on the standing of the energy industry in Great Britain. Our hope is that an independent inquiry will draw a line under this and create a new paradigm against which the industry can be viewed, through resetting perceptions of the industry and its operation. This does not presuppose any particular outcome of the Investigation, but relies on the fact that it will be both in-depth and objective. We would like to make some comments on the exact scope proposed for the reference, which we have detailed below.

In this response, we focus on your proposed reference and not on the State of the Market Assessment produced by you, the Office of Fair Trading and the CMA. Considering that report in brief, we welcome the new analysis of data presented. However, this does not mean that we would accept the as yet untested hypotheses as an accurate and final evaluation of the markets at this stage. We believe that this is best reviewed by the CMA and so will not address these issues further in this response.

The Scope of the Investigation

We note that Ofgem has proposed that the reference to the CMA is of “the supply and acquisition of energy in Great Britain”, where

- supply is defined as supply to domestic and those businesses premises with lower consumption (microbusinesses, in your terminology);
- acquisition is defined as “wholesale purchase or trading of energy for purposes which may ultimately include retail supply”; and
- energy is defined as electricity or gas.

We support this focus; however, we are concerned that the proposed reference should not be interpreted too narrowly.

We believe there are a number of adjacent activities, which have characteristics the CMA may need to examine in order to fully understand the nature and effectiveness of competition in energy supply. Examples of the adjacent activities we believe could be relevant are:

- Domestic energy services (e.g. boiler maintenance which is often bundled with energy supply)
- Electricity and gas supply to businesses with higher consumption
- Electricity and gas metering
- Brokers and Third Party Intermediaries (including price comparison websites)

This is not intended to be an exhaustive list and we do not believe the activities listed above will necessarily be the most important to any CMA Investigation. The adjacent activities that are the most significant may only become clear during the investigation, which is why we suggest (see below) broadening the scope of the proposed reference.

To be clear, we do not suggest that a reference to the CMA focuses on any of these adjacent activities in their own right, but rather that these adjacent activities are included in any reference in order to fully understand competition in the supply and acquisition of energy. The supply and wholesale markets at the core of the current proposed reference are complex and, given the statutory duration of an Investigation, any unnecessary dilution of the CMA's focus might reduce the effectiveness of the Investigation into these markets.

We therefore suggest expanding the reference to “the supply and acquisition of energy in Great Britain and matters ancillary to these activities”. We believe this would capture the aspects of all relevant markets that have the greatest impact on end customers.

The Functioning of the Market

We believe that most aspects of the electricity and gas markets work well and in the interests of customers. Highlights include:

- Strong competitive behaviour in supply – As a major player in electricity and gas supply, we are in a market where our competitors' behaviour continually pushes us to innovate, deliver higher quality services and minimise our costs and prices so as to seek to maintain our competitiveness and longer-term profitability. In domestic supply, we have seen a gradual increase in the number of new-entrant suppliers, some of whom have achieved particularly high growth in customer numbers, reaching a collective market share of over 5%. In supply to businesses with the largest consumption, we see a mix of suppliers in the market, which is now very different to that at privatisation.
- Vibrant wholesale competition – We believe the wholesale markets are highly competitive, something reflected in the changes in ownership of electricity generation and gas import and production capability over the decades since

liberalisation (albeit that ownership diversity was significantly reduced with the purchase of British Energy by EDF and Centrica).

- Links to European and global markets – Both the electricity and gas wholesale markets are increasingly linked to their European and, in the case of gas, global counterparts. These links, through interconnection and European market frameworks, create an effective increase in the number of participants active in the GB markets.

Despite these successes, we do accept there are a number of areas where further scrutiny would be welcome and could result in positive changes for customers:

- Regulatory complexity and burden – As a licensed supplier we face a regulatory system that has become increasingly complex and which sees an increasing rate of regulatory change. Whilst we would not contend that no change was needed, the approach taken has consumed a significant proportion of our business's capability to cope with change. We suspect the challenge for smaller suppliers and potential new entrants is even greater. Against this background we would welcome the Investigation to consider the most effective regulatory approach. We would also note that Ofgem has recently introduced a number of regulatory changes the full effects of which may not yet have become evident in the market, but which should nevertheless be taken into account by the CMA during the Investigation.
- Political and regulatory uncertainty – The industry sees frequent and significant changes in key aspects of the regulated design of the market, making investment unnecessarily risky. Current examples include the Government's decision to revise the Energy Company Obligation one year into a two and a half year programme and Ofgem's many changes to the arrangements for balancing contracted and actual production and consumption in the wholesale markets ("cash-out") since 2001. Given the scale and pace of investment that is required in the GB energy sector, we do not consider that such political and regulatory uncertainty benefits consumers.
- Transparency for small business – The provision of electricity and gas supply to small businesses is less regulated than that for domestic customers. Whilst a different regulatory approach is partially justified by the greater needs for flexibility of small businesses, we are concerned that the way the market has evolved, for example with respect to auto-rollover, is not always in customers' best interest.
- Competitor market share – We believe that electricity and gas supply is now a largely national market, with increasingly little differentiation between regions. However, we note that at a national level, over a decade after liberalisation, the former national gas monopoly provider has a market share of around 40% for both domestic and smaller business customers.
- Product bundling – We recognise that the sale of energy related products (e.g. boiler maintenance services) alongside the supply of commodity gas and electricity to end users may have both costs and benefits to customers. However, this form of horizontal integration may also operate as a barrier to switching, particularly for domestic and smaller business customers.

- Vertical Integration – As noted by Ofgem, this can have both costs and benefits to customers. We believe that there may be real benefits to customers of co-ownership of electricity supply and generation assets, some of which (e.g. collateral reduction) are dependent on some level of integration. However, we believe that full integration of certain operations may bring little benefit to customers and may be harmful to customers' interests; issues here include:
 - Internal trading between generation and supply may limit volumes traded and thus liquidity in the wider market, reducing efficiency and creating a potential barrier to others.
 - Cross-subsidy between generation and supply can undermine the ability of competitors, whether new entrants or existing competitors with a smaller presence in one market, to compete effectively.

We believe that these issues may be more pronounced due to the concentration of ownership of nuclear generation, given nuclear generation's unusual position in the market. We have previously called for a form of management separation and greater trading of power on the day-ahead market to address these issues, though it would need to be carefully designed in order to preserve customer benefits and limit customer harms.

We look forward to seeing the development of your reference to the CMA.

E.ON