

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

RWE welcomes the opportunity to respond to this consultation. We are responding on behalf of the following RWE companies operating in the UK:

- RWE npower supplies gas, electricity and energy services for nearly 6 million customer accounts.
- RWE Generation produces over 10% of the UK's electricity from our nine gas, coal and oil-fired power stations. We also manage a portfolio of gas and biomass-fired combined heat and power plants across the country.
- RWE Innogy is one of the UK's leading renewable energy developers with an operational portfolio in the UK of 935MW and a potential UK development portfolio of over 4GW, including wind farms, hydro plant and biomass generation to produce sustainable electricity.
- RWE Supply & Trading is one of the leading companies in European energy trading and is responsible for all of RWE's activities on the international procurement and wholesale markets for energy.

RWE Dea UK is part of RWE Dea AG, an international exploration and production company for oil and gas. RWE Dea UK operates a number of gas fields in the North Sea. RWE AG has entered into a contract to sell RWE Dea AG, the transaction is expected to complete during 2014. Consequently, RWE Dea is not included within this response.

Proposed market reference

RWE welcomes the proposed referral of the market to the Competition and Markets Authority for a full market investigation.

We welcome the CMA investigation because we believe that an independent evidence-led investigation by the CMA will show that the energy market is competitive and ensure that the facts about the operation of the market and the way suppliers compete are made clear for our customers, government, regulators and other stakeholders. This is essential if we are to restore confidence and trust for consumers, and ensure the investment Britain needs to meet its energy trilemma of secure, low carbon and affordable energy.

RWE believes that the energy market is competitive. Our own daily experience is that we must compete for the business of all of our customers. We want to see a thriving, competitive and fair energy market. In our view, the outcome of a market investigation should be a market that:

- is competitively based, as competition is the best way to deliver the best outcome at the lowest cost for customers;
- is honest and transparent with customers about cost drivers for bills;
- provides a level playing field for the customers of all market participants, regardless of their size. Currently small suppliers are not subject to some of the obligations and costs imposed on larger suppliers.

Should a CMA investigation take place, it will do so at a time when we are seeing radical changes in GB energy markets at many levels.

- On a national level, the government needs to ensure that energy policy delivers continuity of supply and reduce carbon emissions, which require significant long-term investment in the GB energy sector. RWE is firmly of the view that to ensure the required levels of investment are reached, the energy markets need to be underpinned by a regulatory framework that supports competition and enables energy suppliers to focus fully on their customers. To achieve this, such a framework needs to be characterised by stability over the long term and where regulatory intervention must bring a guarantee that decision making is fully and properly informed, independent, appropriate and proportionate.
- At a customer level, there has been substantial recent change. For example the recent growth in switching to smaller supplies (which on latest Ipsos Mori figures is reported to be around half of all switching), and our own sale to Telecom Plus which enabled a new supplier in the market place with over 750,000 accounts. We have also seen numerous regulatory changes, such as the end of doorstep selling and the introduction of the limit of four tariffs that have had an inevitable impact on switching, choice and the nature of competition in the retail market.

Whilst RWE has a good reputation for service in relation to its industrial and commercial and small business customers, our domestic customer service has not been as good as it should have been over recent years. RWE's customer service to households is undergoing significant improvement which includes the following:

- We have completely redesigned our business around each customer journey.
- We have been at the forefront of simplifying customer bills in response to customer feedback.
- We have introduced new ways of working across our business to improve customer service.
- We have taken significant steps to lower the cost base of our businesses in order to remain competitive.
- We have taken a lead in communicating with customers about the reasons for the rising costs of their energy bills through our Energy Explained events and reports to help ensure clarity and a better understanding about the energy industry.

RWE has also played an important part in helping make transparent the interactions between different levels of the energy supply chain.

- It is already structured as separate electricity generation, renewables, trading and supply businesses in the UK. These four businesses are independently managed, coming together only at the RWE AG Board level in Germany.
- Our generation and retail volumes are traded openly and transparently on the wholesale power markets. Transactions between the different companies in the group are done at wholesale market prices. The trading business provides a route to market for the retail business and for the generation business.
- Only a small minority of trades are done directly between retail and generation and these trades are also done at wholesale market-based prices.

RWE is fully committed to supporting government in resolving the energy trilemma, i.e. delivering a low carbon energy supply that is also secure, in the most affordable way. Over the past few years, RWE has invested heavily in energy infrastructure for the UK, investing more than £6bn since 2008.

Observations on aspects of the current energy markets

RWE would like to take the opportunity to make the following observations on aspects of Britain's energy market.

Retail market

The foundations of the GB energy market are solid so there is much to preserve and build upon. Great Britain has led the world in consumer empowerment in energy supply, with significant liberalisation of the domestic gas and electricity supply sectors. However, there has been a move away from these principles to a more interventionist and less market-orientated approach over recent years.

This evolution of the regulatory model within which all energy companies must operate has been a challenge. In particular, the significant increase in the volume and impact of new regulation has meant that suppliers have had to focus on complying with regulatory measures which at times may have been to the detriment of other changes to improve customer service. These regulatory changes have impacted on the overall business models of suppliers as well as diverting resources away from other improvement projects.

There is also concern about possible regulatory intervention that may run concurrently with any investigation. In the event of any market investigation therefore, it would be helpful if policy makers are encouraged to allow the market investigation to run its course before implementing significant change to market design beyond those already in progress, exacerbating the resource issue highlighted above.

Should a reference be made, we would hope that ultimately the outcome of an investigation by the CMA will resolve such issues and inconsistencies thereby delivering the best outcome for consumers and the GB energy market in terms of ensuring an affordable clean, secure and reliable supply of energy.

Wholesale electricity and gas market

The GB wholesale power and gas markets are characterised by a number of diverse and competing counterparties. In addition to physical players seeking to hedge the volume and price risk associated with their generation and retail businesses, a range of traders, including utility affiliates, act as specialist risk-bearing wholesale intermediaries. The GB wholesale gas and power markets are among the most liquid wholesale energy markets in Europe with active trading of standardised contracts both on exchange and "over the counter" via brokers. Recent years have also seen increasing competition and linkage with other power and gas markets and exchanges in North West Europe which has further broadened the scope of competition and participation in the GB wholesale market. The liquidity and competitiveness of the GB wholesale markets now underwrites one of Europe's most competitive power generation markets, one of Europe's most competitive markets for gas supply and acquisition and one of Europe's most competitive retail energy markets.

Terms of reference (scope of investigation)

RWE agrees, subject to the following comments, with the proposed terms of reference for the market investigation, namely the market for “the supply and acquisition of energy in Great Britain” as described in the consultation.

The supply market is complicated, and the dynamics of competition in supply are affected by many different factors. A thorough and comprehensive investigation will need to look at all of those factors. It will be important for the CMA to be able to consider and address not only those features of the market on which Ofgem has concentrated in its market assessment, but also any other market features which could potentially give rise to an adverse effect on competition in energy supply in Great Britain.

In this context, we consider that the following will merit review:

- The role of Third Party Intermediaries in relation to customer switching within the market;
- Whether customer conduct in the purchase of gas or electricity may be influenced by the provision by suppliers (or companies associated with suppliers) of energy services products, insurance and/or energy efficiency measures, and the impact that any such conduct may have on supplier incentives;
- Metering, including smart metering.

RWE considers that when the CMA seeks to understand price levels and their movement over time, as well as the profitability of the companies involved across the energy value chain, it will be very important for the CMA to consider the evolution of costs and profitability, including those associated with energy efficiency initiatives, with smart meter roll-out, and with the investment in and operation of the transmission and distribution networks

We assume Ofgem will take the view that the terms of reference as drawn under Appendix B to the consultation are sufficiently wide to allow the CMA to consider all the above points. Should that not be the case, Ofgem may wish to clarify further the terms of reference.

In particular, we note that the public perception of any market investigation is likely to be that the energy industry in its entirety is under scrutiny. It will be important therefore for the CMA and/or Ofgem to be explicit in its communications as to which areas of the energy value chain are out of scope as well as confirming those that are within scope.

Conclusion

We believe that the outcome of any market investigation should ensure that the GB energy market is governed by independent, appropriate and proportionate regulation, which protects customers, enhances competition and provides an affordable and sustainable supply of energy to its customers.