Exploring key Questions around Entry to the UK Energy Supply Market for Small Firms

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Executive Summary

The GB Energy market is facing period of unprecedented change. The government’s Electricity Market Reform programme has placed in statute (through the Energy Bill, 2013) the mechanisms needed to underpin more than £110 billion of investment in the UK electricity sector before 2020, in order to set the UK on the pathway of a decarbonised economy which is energy secure and affordable. More recently, on March 27th 2014, Ofgem published its long awaited ‘State of the Market Assessment’, the latest in a number of regulator led market assessments. This is the biggest investigation of the British energy markets since privatisation and deregulation began in the 1980s. The report concludes that competition in the energy market is not working as well as it could be. In addition to low customer switching and increasing generation profits amongst the ‘Big 6’ (£3bn in 2009 to £3.7bn in 2012), Ofgem highlight that the significant level of vertical integration in the UK electricity market amongst the ‘Big 6’ makes it difficult for new entrants (who don’t own generation assets) to compete against them.

In the context of these significant changes, this report explores the current GB electricity retail market structure and how it is dominated by six large, vertically integrated energy companies (the ‘Big 6’). A number of key market failings and perceived barriers to entry for small scale electricity suppliers are highlighted, including: inability to achieve scale economies, branding, cost of finance, regulatory complexities, ‘Big 6’ market influence and a number of wholesale market issues. However, over the past three years, the share of domestic small suppliers has started to grow from a very small base of around 1% to 5.2% in 2013 (Ofgem, 2014). A number of factors have contributed to this, including: exceptions from environmental and social policy obligations for small suppliers, improving liquidity and stability in the wholesale markets, and increased consumer switching spurred on by price hikes amongst the ‘Big 6’. The announcement of a full market review in this area, considered alongside wider EMR and Ofgem initiatives to reduce market entry barriers, will likely mean a period of significant change in the UK electricity retail sector. This will likely include the potential for more new market entrants and existing small suppliers to increase their foothold in the market.
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The UK Electricity Market

The UK electricity sector can be divided into four elements; generation, transmission, distribution and supply. It can also be split into three geographical areas; England and Wales, Scotland and Northern Island. The current report will focus primarily upon the challenges and future opportunities presented by the supply market within England and Wales.

Background

It is now nearly 15 years since the Electricity Act (1989) set in motion liberalisation of the UK electricity market. Prior to privatisation and liberalisation, the electricity market in England and Wales was characterised by a nationalised Central Electricity Generating Board who were responsible for generation and transmission and a number of regional Area Boards that controlled distribution and supply across the country. Ofgem set price controls in line with what it believed to be ‘the consumers best interests’ and fully regulated this vertically integrated market with no separation of supply, generation, distribution or transmission.

Deregulation of the UK electricity sector had the effect of opening the market up to private ownership and competition, transforming this once vertically integrated process into four separate market segments; generation, transmission, distribution and supply.

In the UK electricity market, the number of suppliers was at its highest in the period immediately following market opening (Ofgem, 2008); At this time, the market consisted of 14 former public electricity suppliers (PES’s), British Gas and a number of new suppliers (Frontier Economics, 2011). Following a period of consolidation through M&A activity and attrition of smaller suppliers, the market today is dominated by six large suppliers, which account for 95% of the total domestic market (Ofgem, 2014).
In addition to the six largest suppliers (the ‘Big 6’), there are currently 13 small suppliers involved in domestic electricity, forming a fringe group that supply the remaining 5% market share (Ofgem, 2014). Many of these companies have identified niches such as environmentally conscious customers or have focused on certain payment mechanisms. There also exists a number of ‘affinity companies’ such as several supermarkets and banking energy suppliers, whereby companies with an established brand name market the electricity of an established provider (usually one of the ‘Big 6’). Whilst some companies have succeeded in building some scale, such as Atlantic Electricity and Gas or TXU Energy, they were acquired by larger competitors before becoming fully competitive with market leaders. Appendix 1 includes two charts; the first demonstrating the evolution of all 6 market leaders today and illustrates that all have ties back to the original PES’s. The second shows small supplier entry and exit of the GB domestic energy market since 1996.
Figure 1: Current Market Share of the ‘Big Six’ (Ofgem, 2014)

Figure 2: ‘The Other Group’ - Current Small Suppliers in the Market
Current Market Failures and Barriers to Entry for Smaller Suppliers

As with any market of this nature, there are a number of barriers to entry and expansion, particularly for small to medium sized suppliers. This is evidenced when considering 25 years since market liberalisation, there does not exist a significant competitive fringe and those small suppliers which have gained a foothold in the market, have been unable effectively scale their businesses to compete with market leaders.

Scale Economies, Branding and the Cost of Finance

Potential supply market entrants face a number of significant start up costs that could act as major barriers to entry; especially when considering the financial resources available to many of these smaller organisations and inability to achieve scale economies when compared to the ‘Big 6’.

IT System Costs – IT system costs represent perhaps the most significant cost for any potential supplier. New market entrants must develop, purchase and maintain IT systems to securely administer customer data such as billing information, personal data and payment collection. Whilst estimates for these costs range significantly, accountancy firm PKF, were commissioned by Ofgem to assess supplier costs in this area and ascertained that costs can range between £1.5m for a small market entrant anticipating around 50,000 customers to over £30m for firms who have large scale ambitions of competing with the ‘Big 6’ attracting 5m+ customers. Whilst these figures obviously vary depending upon a number of factors, they do provide an idea of how significant IT system costs are within the sector. Ofgem’s (2013a) retail market assessment does suggest that some suppliers have entered the market with significantly cheaper IT systems initially and scaled up with customer size.
Attracting Customers (Branding and Advertising) – Attracting an initial customer base is a key challenge for any potential market entrance regardless of size. As most small scale suppliers do not have the same financial resources to brand and advertise as their larger counterparts they have adopted a number of innovative ways to minimise upfront expenditure in this area. These include adopting an online only sales and advertising model, as well as targeting niche markets. For example, Ecotricity (a small scale supplier with 100,000 customers as of 2014) has specifically advertised based upon its ‘green’ credentials, generating 40% of the electricity it uses from renewable sources. Other suppliers have targeted specific groups such as the rental market. Some suppliers have also minimised branding and advertising costs by capitalising on an established brand already known amongst its target customer base.

Raising credit – In order to enter the energy supply market, in any capacity, there will be a requirement to secure initial set-up and funds for ongoing operation. Initial set-up fees may include those investments discussed above, whereas longer term ‘working capital’ will be required for a range of areas, including; sufficient finance to cover customer credit periods/debt, credit requirements and collateral for trading on exchanges or directly with generators on the wholesale markets, as well as credit for network operator charges and industry code/agreement compliance. In 2014, Ofgem published a report asserting that all small suppliers report credit and collateral requirements to be a significant burden and several acknowledged that the current arrangements favour larger, established suppliers. A report by Frontier Economics notes that the requirements for significant credit or collateral by small scale suppliers represents a barrier to entry for two reasons. Firstly, due to a lack of competition within the market, the amount of collateral required is higher than it should be, thus reducing margins for that supplier. Secondly, even if this price premium were not there, the presence of credit risk agreements for smaller suppliers, acts as a significant barrier for poorly capitalised players to enter the market. Some suppliers have tried to navigate a way around this barrier. For example, Telecom Plus, trading as utility warehouse, has recently signed a long term, 20 year contract with Npower for services including energy, lowering up front credit requirements (Ofgem, 2014).

**Vertical Integration and Pricing Policies amongst the ‘Big 6’**
The dominance of the GB electricity market by 6 vertically integrated energy companies presents a significant barrier to market operation,
efficient completion and new supplier entry. The level of vertical integration, or the extent that one organisation operates in both supply and generation markets, is depicted in Figure 3 below. As can be seen, all but Centrica generate the majority of their required capacity independently; with EDF, E.ON and Scottish Power generating above 80%. As an industry, Ofgem (2014), report that since 2000, generation capacity ownership between the ‘Big 6’ suppliers has increased from 36% to 70%. This is a concern both for Ofgem (2014) and for significantly smaller suppliers, as the ability for the vertically integrated Big six to sell energy to self-supply their required electricity capacity (mostly in non-transparent over the counter, OTC, trades) distorts the market and can mean that offers being made to ‘Big 6’ customers bear little resemblance to the trading price of energy. In essence this vertically integrated market arrangement means that the ‘Big 6’ can operate a lower margin on the supply size of their business, offsetting this through generation profits. As will be discussed below, the fact that the ‘Big 6’ do not need to purchase all of their energy on the wholesale markets is reflected in the relatively low liquidity of the GB wholesale electricity market.

The pricing policies enacted by the ‘Big 6’ energy companies, is also seen as being a significant barrier for established small scale suppliers, as well as potential new market entrants. These policies are best summarised by Ofgem (2013a), who observe; the ‘Big 6’ pursue a strategy of differential pricing, targeting the keenest, lowest margin prices at the most active part of the domestic market, while sustaining significantly higher prices for less
active customers’. This presents a significant challenge for smaller suppliers and potential new market entrants who do not have an established, low-activity customer base who can be used to cross-subsidise lower margins amongst active-switching market segments.

**Government Policy, Regulation and Industry Codes**

As an essential public service, the energy supply industry in the UK is heavily regulated. Not only must suppliers obtain a licence from Ofgem to supply energy in the domestic or SME markets, they must also adhere to and monitor a number of industry codes and government regulations. In their ‘State of the Market Assessment’, Ofgem (2014) found that a number of the smaller suppliers surveyed, raised the complexity of regulation and cost of compliance as a major barrier to entry.

Licencing and Industry Codes - Participants in the GB energy sector are subject to an array of industry arrangements and regulations which are extremely complex. Moreover, frequent change and costs associated with these arrangements can be seen as a significant burden for any potential market entrant. As will be discussed in more detail later in this report, initially firms must obtain a licence from Ofgem in order to supply electricity to the market. They must then accede to a number of industry agreements, including; the Balancing and Settlement Code (BSC) and the electricity Connection Use of System Code (CUSC), as well as operating in accordance with the Master Registration Agreement (MRA) and providing assurance of sufficient credit cover. Whilst it is clearly essential that all market participants have robust systems in place, the complexity, cost and time taken to adhere to these arrangements are all seen as concerns for potential new market entrants.

Regulatory requirements and delivering government policy – Regulatory requirements which affect suppliers in the electricity market are dynamic to say the least and the frequency with which changes and requirements change will bear a cost for any new supplier to the market. This will likely impact smaller suppliers who have less resource to spend on regulatory impact analysis etc. Some key areas of regulation which specifically affect suppliers include: the delivery of government environmental obligations such as ECO and the Green Deal, government pressure to pursue social objectives such as fuel poverty alleviation and more recently the focus on more accurate smart metering. Frontier Economics (2011), report that regulation in these areas present a significant barrier to new market
entrants as they; increase the financial and administrative burden on suppliers, their complexity and dynamic nature are difficult to manage, targeting of regulation at specific low income segments can impact overall market competition and energy bill rises associated with regulations such as this can bring indiscriminate, negative media attention on the whole supply industry.

**Access to Energy Supplies – Wholesale Market Issues**

Small scale electricity suppliers have, to date, primarily entered the retail market as stand-alone suppliers, rather than vertically integrated entities like the ‘Big 6’. Therefore, the sourcing of sufficient wholesale electricity to meet customer load demand is a fundamental aspect of any supplier’s operation, regardless of size. Sufficient liquidity in wholesale markets is essential for new entrants and can be measured in a number of ways; for example, total number of trades, traded volume or market churn.

In both Ofgem’s 2008 and 2014 market consultation, respondents cited inadequate wholesale liquidity in the electricity market, as the most significant issue facing potential new entrants and small scale companies. After-all, smaller suppliers tend to have different requirements from the wholesale market than their larger counterparts, such as requiring smaller contract sizes.

The most recent studies on this area (Ofgem, 2013a, 2014 and Frontier Economics 2011), conclude that the UK market has much less liquidity than in many commodity and electricity markets in other countries. In fact, Ofgem (2008) specifically note this as ‘a matter of concern’. One of the most significant measures of liquidity is the market churn ratio. This is a measure which shows the number of times a unit of generation is traded before being delivered to the final customer and allows for comparison of different market sizes and geographical areas. Wholesale markets which are more liquid are usually characterised by a high churn rate, with each unit of output being traded many times. Figure 4 below, illustrates the rate of market churn within 5 key European markets and illustrates that that liquidity in the GB market has fell from a high of 7 in 2003, to 3 in 2013 (Ofgem, 2014). In their latest report in to wholesale market liquidity, Ofgem (2012) note that in 2012 the market churn rate continued along a downward trend which started in 2009. It has been argued that this was in part due to the significant vertical integration and consolidation in the industry – especially amongst the big six.
Electricity Trading and Transparency

The trading of electricity in the GB market can take place either through transparent online exchanges (such as APX and the newly established N2EX), or bilaterally through trading agreements and over the counter (OTC) trades. Trading in the GB market is dominated by OTC trading, notable for a lack of transparency, which is markedly different to the rest of Europe where there is more emphasis on exchange based trading. This can be demonstrated by considering Figure 5 below.

Trading through online exchanges has been cited as a key influencing factor in making other European electricity markets more liquid. For example, it has been argued that exchanges offer transparency and this generates more robust references prices that are more readily trusted by market participants; especially smaller suppliers. In this sense, a lack of trading transparency amongst the ‘Big 6’ can be seen as a key barrier to market entry.
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The need for Longer term Trading of Electricity
Another consistently cited market failure and therefore potential barrier to new entrants is a lack of electricity trading beyond the short-term ‘prompt’ stage (on the spot, prompt and day ahead markets); i.e. trading beyond a 1 month time-frame (Ofgem, 2014). As can be seen from figure 6 below, the GB market is characterised by trading largely in the near-term using the methods discussed above. This is problematic for independent market participants as longer term trading allows those suppliers to hedge financial risk by fixing their wholesale electricity prices months and years in advance, generally meaning minimal price fluctuation can be provided for customers. In Ofgem’s (2014) market assessment, the majority of respondents to a questionnaire in this area stated that they had not seen any improvements in liquidity for longer term products; a message that remains a concern.

Figure 5: Proportion of Electricity trading on exchanges vs OTC, 2007-2011 (Ofgem, 2011a)
Availability of Appropriate Wholesale Products for Smaller Suppliers

Finally, the number and type of electricity products available in the wholesale market could be an issue of concern for independent market entrants. Ofgem (2010) suggests that smaller market participants are concerned about the limited availability of products with a smaller minimum trade size (clip size). When revisiting this research recently, Ofgem (2012) found there to have been a small increase in the number of counterparties active in the market. They also note that since 2010 there have been efforts by some large vertically integrated players to improve their service offering to smaller market participants (ScottishPower and EDF have both published their commitments in this area).
Key Policy Reforms and Impacts for New Market Entrants

Electricity Market Reform under the Energy Bill (2013)

In Dec 2013, the Energy Bill received Royal Assent. This Bill contains the framework for Electricity Market Reform (EMR), which is intended to underpin more than £110 billion of investment in the UK electricity sector before 2020 in order to set the UK on the pathway of a decarbonised economy which is energy secure and affordable – The EMR Goals (Allen & Overy, 2012).

EMR is underpinned and rests on three pillars:

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<td>1</td>
<td>A Contract for Difference (CfD)</td>
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<td>2</td>
<td>A Capacity Market (CM)</td>
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<td>3</td>
<td>Institutional Arrangements</td>
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These three pillars are supported by a number of other policy mechanisms, these including:

- A carbon price floor - Based on underpinning the EU-Emissions Trading Scheme carbon price to a level that is consistent with the EMR Goals.
- An Emissions Performance Standard (EPS) – A regulatory backstop that will effectively prevent the development of new build coal
fired power stations which are not equipped with Carbon Capture and Storage technology.

- Electricity Demand Reduction (EDR) measures – Whilst this will partially be achieved through the CM, smoothing peak electricity demand, through for example financial incentives and levy’s, is seen as playing an increasingly important role in EMR Goals.
- Increasing liquidity in the market – Improving market access for independent generators; through for example longer term power purchase agreements and liquidity measure to enable the government to take action to improve the liquidity in the electricity market
- Transitional Arrangements – To enable early investment in advance of the CfD regime and minimise any investment hiatus

Considering the principle objectives of EMR (The EMR Goals), it is perhaps unsurprising that many of the Energy Bill’s provisions are largely focused upon underpinning investment in sustainable and secure upstream electricity generation in the coming years. The lack of supply side focus has been a point of contention throughout the Energy Bill’s passage through parliament. In fact, the Parliamentary Committee, building upon a large number of submissions and witnesses, raised this issue as a primary concern (HC, 2012 p4).

Whilst EMR under the Energy Bill (2013), does little to address many of the more procedural barriers to entry discussed in the previous section, supporting provisions are made to increase general market liquidity; an area which has been discussed in detail above.

The Energy Bill makes progress in relation to liquidity of wholesale electricity by acknowledging that poor liquidity in the GB wholesale electricity market is an important barrier to entry for both independent electricity generators and suppliers. In terms of delivering EMR mechanisms, a deep and liquid market is essential, as liquidity and transparency are essential pre-cursors to ensuring appropriate CfD and long term PPAs, which reflect robust reference prices. As will be discussed below, it is the role of Ofgem to address these liquidity challenges – which has been done through a full market review and a number of licence alterations. In addition to this, the Energy Bill (2013) creates a powerful government backstop, by including an important power for the Secretary of State to further intervene in the operation of the energy markets to seek to create liquidity.
In addition to issues around market liquidity, there are important impacts on small suppliers from the Bill’s introduction of CfD and CM mechanisms. Under CfDs, low-carbon generators will be eligible to receive payments when the energy reference price falls below an agreed level (from a yet to be announced counterparty body). Similarly, generators with a capacity agreement will receive payments from the Capacity Market Settlement Body (CMSB) for making capacity available (and be penalised when it is not). Neither the CfD counter-body or CMSB will be generating their own income. Instead, they will need to source funds from licenced electricity suppliers. This will likely take the form of a supplier obligation — a mandatory obligation levied on suppliers and passed on to consumers in a similar way to existing environmental obligations. Moreover, current proposals envisage that suppliers will have to have sufficient forward credit to meet CMSB obligations. Whilst DECC (2012) has stated that it is minded to place these obligations on suppliers in proportion to their market share, these impacts could form a significant burden for smaller suppliers.

**Ofgem Retail Market Review (2011a)**

Building on the findings of their 2008 Energy Supply Probe, Ofgem’s Retail Market Review (2011a) demonstrated that more action is needed to make energy retail markets in GB work more effectively in the interest of customers. The review aimed to make energy retail markets simpler, clearer and fairer, making it radically easier for consumers to choose their energy supplier; wherever appropriate by promoting effective competition (such as the introduction of new suppliers). It is proposed that low engagement in retail markets and poor liquidity in wholesale markets can have mutually reinforcing effects. Ofgem assert, therefore, that the RMR and the liquidity project discussed below are complementary aspects of Ofgem’s overall work to break this cycle and ensure that the markets work effectively in the interests of consumers.

Under the banner ‘Simpler, Clearer, Fairer’, Ofgem categorised its RMR findings and reforms in to three distinct categories. Simpler choices for consumers will ensure that complex tiered tariffs will be banned and choosing new deals/switching suppliers will become much easier. Clearer Information will need to be provided by suppliers, such as more informative bills and annual statements, regular information about
whether a cheaper tariff is available (including a Tariff Comparison Rate that can be compared between suppliers) and clear details of any price increases. Finally, Fairer Treatment of consumers will need to be embedded within supplier’s organisations, increasing transparency and upholding tough new standards of conduct put forth by Ofgem. In terms of potential small scale suppliers this is definitely a step in the right direction. It was noted above, that a key barrier to entrance revolves around existing ‘Big 6’ pricing policies which puts emphasis on increasing prices for long-term customers and using this to cross-subsidise lower margins in more competitive market segments. Simpler and clearer information for consumers will enable them to become more aware of competition in the market and larger suppliers will have to compete more effectively on price and service. A clear Tariff Comparison Rate will also allow smaller suppliers to more effectively demonstrate how competitive their rates are.

Market liquidity was again a significant aspect of the RMR. Specifically, Ofgem note the importance of consideration of liquidity in the wider context of retail market completion. For example, without a credible threat of entry from new suppliers, competitive pressure in the retail market will be weakened. In essence, consumers benefit (through more competitive pricing and service) from the removal of barriers to entry, which have thus far limited completion in the market. Considerations around the area of liquidity from the Retail Market Review have fed through into Ofgem’s more specific investigation in to whole sale power market liquidity.

**Ofgem’s Liquidity Project (2013) - Investigation in to Wholesale Power Market**

Whilst the Energy Bill (2013) contains a statutory backstop in the form of increased powers for the Secretary of State to intervene in the market, improvement in wholesale electricity market liquidity has been first and foremost been the remit of Ofgem.

Ofgem has set out its own proposal for market intervention in a consultation entitled ‘Wholesale power market liquidity; final proposals for a Secure and Promote licence condition’. Three key characteristics have been identified, which Ofgem believe need support for the functioning of a liquid, competitive market (See figure 7 below). By incorporating a new licence condition within certain electricity generator’s licences (largely the
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‘Big 6’), Ofgem believe the market will be opened up to increased completion from smaller suppliers. Perhaps most significantly for small suppliers, the rules seek to ensure that negotiating trades with small suppliers is not treated as a low priority by large generators and that credit agreements and collateral are subject to both fair and transparent terms – Specific detailed requirements are considered for example; smaller contract (clip) sizes, fair negation of trading agreements and credit, a wider range of range of products and fair/ transparent pricing. There are also specific provisions to ensure that the necessary long-term market products are available to trade regularly from large generators. As has been discussed previously, this is important for small suppliers as it allows them to hedge risk and provide smoother pricing curves to their customers.

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<th>Characteristic</th>
<th>Proposed intervention under S&amp;P</th>
<th>Licensees subject to obligation</th>
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<tr>
<td>1 Availability of products that support hedging</td>
<td>Supplier Market Access Rules – Rules to ensure small suppliers can access the wholesale market products they need</td>
<td>Centrica, Dansk Power, E.ON UK, EDF Energy, GDF Suez, RWE Npower, ScottishPower, SSE</td>
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<td>2 Robust reference prices along the curve</td>
<td>Market Making Obligation – Licensees must post bid and offer prices in the market, supporting price discovery and ensuring regular opportunities to trade</td>
<td>Centrica, E.ON UK, EDF Energy, RWE Npower, ScottishPower, SSE</td>
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<tr>
<td>3 Effective near-term market</td>
<td>Reporting requirements – Monitoring of near-term to ensure it remains liquid. Market intervention only if necessary</td>
<td>Centrica, Dansk Power, E.ON UK, EDF Energy, GDF Suez, RWE Npower, ScottishPower, SSE</td>
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Figure 7: 3 Characteristics of a liquid, competitive market to be addressed by the Secure and Promote licence condition (Ofgem, 2013a)

**European Financial Legislation, Integration and Target Model – Impact on Liquidity**

The vision of a single European Electricity market by 2014 through ‘market coupling’ is set out in the European Target Model and may impact upon liquidity. Ofgem (2013a) note that to facilitate market coupling at the day-ahead stage, a virtual hub is being developed to create a single day-ahead price for the GB price zone. This will pool liquidity across the two existing day-ahead auction platforms, potentially providing a spur to liquidity in this part of the market. European financial regulation reforms (such as revisions to the Markets in Financial Instruments Directive (MiFID II) and the European Market Infrastructure Regulation (EMIR) could also have implications for trading in energy wholesale markets.
Recent Developments and Conclusions

On March 27th 2014, Ofgem published its long awaited ‘State of the Market Assessment’. The report reinforces previous studies in the area (such as Ofgem’s own 2008 Supply Probe and Frontier Economics 2011 report) and concludes that competition is still not working as well as it could be. In addition to low customer switching and increasing generation profits amongst the ‘Big 6’ (£3bn in 2009, to £3.7bn in 2012), the report specifically found that the significant level of vertical integration in the UK electricity market amongst the ‘Big 6’ makes it difficult for new entrants (who don’t own generation assets) to compete against them. Ofgem’s reforms to open up the wholesale power market discussed above and EMR generally aim to tackle this and increase liquidity. However the report states that ‘there are wider issues with vertical integration which need a close review’ – Many of these have been discussed above. Although new suppliers now account for 5 per cent of the electricity market, there are significant barriers to entry and expansion which may prevent them from posing a disruptive competitive threat. As a result, on March 27th Ofgem released the following statement:

“Ofgem has today acted to remove uncertainty from the energy market by proposing a market investigation by the Competition and Markets Authority (CMA). A market investigation will once and for all clear the air and allow the CMA to ensure that there are no further barriers to effective competition. An investigation would reassure consumers and complement Ofgem’s reforms for a simpler, clearer and fairer energy market.” (Ofgem Statement on the State of the Market, 2014)

Although the ‘Big 6’ have warned of energy investment freezes and a heightened risk of blackouts, Ofgem and industry observers have publically stated that the review represents one of the most significant inquiry’s in many year and will clear the air once and for all, amidst evidence of soaring profits and plunging consumer confidence. Dermot Nolan, the newly installed chief executive of Ofgem, has insisted the probe would ‘enhance confidence in the investment climate’. He added: ‘Ofgem believes a referral to the CMA offers the opportunity to once and for all clear the air and decide if there are any further barriers which are preventing competition from bearing down as hard as possible on prices’. The inquiry could take up to two years to complete and will have genuine powers as it will be undertaken by the newly created Competition and Markets
Authority (CMA); these could include separation of ‘Big 6’ supply and generation businesses or significant fines ‘amounting to tens of millions’ if rules are broken.

From 2011-12 the share of domestic small suppliers started to grow from a very small base of around 1% to 5.2% in 2013 (Ofgem, 2014). A number of factors have contributed to this, including: exceptions from environmental and social policy obligations for small suppliers, improving liquidity and stability in the wholesale markets, and increased consumer switching spurred on by price hikes amongst the ‘Big 6’. The announcement of a full market review in this area, considered alongside wider EMR and Ofgem initiatives to reduce market entry barriers, will mean a period of significant change in the UK electricity retail sector. This will likely include more new market entrants and existing small suppliers increasing their foothold in the market. Whilst significant barriers to entry (such as capital and credit costs) still exist and have been discussed at length above, it is though that there will be significant opportunity for new suppliers to enter the domestic and SME electricity market over the coming years.
Appendices and References

Appendix 1: Consolidation of 14 PES’s and British Gas to the ‘Big Six’ (Ofgem, 2008) and non-incumbent entry and exit to the GB domestic energy markets (Ofgem, 2014)
Appendix 2: Example Wholesale Energy Cost (APX as example Power Trader)

APX Power UK Spot - 2013

APX Power UK Auction - Feb
**Key Reports and References**

Allen & Overy – UK Electricity Market Reform (2013)

Consumer Focus – Liquidity in European Wholesale Electricity Markets (2010)


Frontier economics – Competition and entry in the GB electricity retail market: A report prepared for Energy UK (2011)

Newbery, David – Progress on the UK Electricity Market Reform (2012)


OFGEM – Liquidity in the GB wholesale energy markets: A discussion paper (2009)

OFGEM - The retail market review: Findings and initial proposals (2011a)

OFGEM – What can behavioural economics say about GB energy consumers? (2011b)

OFGEM – GB wholesale electricity market liquidity – Summer 2011 assessment (2011c)

OFGEM – Wholesale power market liquidity: consultation on a ‘Secure and Promote’ licence condition (2012)

OFGEM – The retail market review: Implementation of simpler tariff choices and clearer information (2013a)

OFGEM – Capacity market strawman v11 (2013b)

OFGEM – Making it easier for independent suppliers and generators to compete (2013c)

OFGEM – Capacity market: detailed design proposals (2013d)

OFGEM – State of the market assessment (2014)

OFGEM – Press release on proposal for CMA to investigate the energy market (March 27, 2014)
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Ofgem – Press release on breaking down barriers so that competition can work better for energy consumers (March 27, 2014)