

Opening statement to CMA, 3rd December 2014

Prof Catherine Mitchell, Dr Bridget Woodman, Dr Matthew Lockwood

I am Professor Catherine Mitchell, the head of the Energy Policy Group – or EPG - at the University of Exeter. My colleagues are Dr Bridget Woodman from the EPG, and Dr Matthew Lockwood, a Research Fellow on an EPSRC funded project called IGov which is based in the EPG. The EPG's research focuses on energy policy and regulation, and the role that these play in the shift to more sustainable energy systems. The IGov project which I lead is researching the complex relationships between innovation and governance with the aim of developing a framework for governance that better enables a faster transition to sustainable, secure and affordable energy in the UK. As part of the project we are researching energy markets internationally – in Denmark, Germany, Texas and California.

Thank you for inviting us to this hearing.

We are not economists. Our research focuses on innovation and a more 'whole system' approach to how energy systems might change from their current configurations to something which is more sustainable while also ensuring affordability and security. It is very important that climate change is addressed. The required reductions in emissions of carbon dioxide will not be achieved overnight, and it is generally accepted that the change in energy systems will be cheaper and more secure if it is carried out strategically and in a managed manner over a period of time rather than doing very little in the short and medium and then rushing to meet our commitments in 2050 towards the end of the period.

While economics - and price issues – clearly play a role in this, systemic change in the context of the Government's energy policy goals also involves other factors. It seems to us, that efficiently managing the transformation of an energy system is a multi-dimensional problem which is far more complex than price – and needs to take account of system momentum and inertia, politics, social / cultural aspects and so on.

The most important of these factors, we would argue, is innovation – not just in terms of technological development, but also in terms of practices – new ways of doing things and of behaving – this is technologies, but also institutions, business models, new relationships between customers (domestic, LA etc) and their energy use; social attitudes to energy etc . An example of this may be the management and impact of intermittent renewables and how that may be integrated alongside demand side management.

As argued in our submission, current governance arrangements raise barriers to new technologies and entrants: if there is to be a shift to a more sustainable system, there particularly needs to be innovation in how the system is governed to allow new technologies to be adopted and deployed, and new entrants to come into the market but also at an increased rate in order to meet the desired reductions. So although there are six large suppliers in the market we are sceptical that they will deliver sufficient / radical innovation. We think they have too many assets and core capabilities bound up in the current way of doing things.

As it happens, ensuring competition in retail [via increased transparency of prices; liquidity of markets and customers; accessible and trustworthy comparison sites; accessible Codes and Licenses etc] are all complementary to the conditions needed to support new entrants and new practices. The 2 go together and we would argue that there is not sufficient competition to enable these practices.

We argue that there are many elements which individually keep the current system momentum going but which are sometimes hard to prove – for example, herd-like or coordinated behaviour – or which add a certain level of difficulty to a new entrant – for example, the lack of liquidity in forward markets. However, when these elements are summed they become a decision-making environment in GB which is not conducive to innovation.

From this starting point, we welcome the CMA's investigation, but believe that the scope of its Theories of Harm is too limited. This is particularly relevant for the electricity system, where the market design and its regulation maintain a self-reinforcing decision making environment and an entrenched mode of problem solving. For example, we now have a market wide capacity mechanism to deal with issues arising from increased variable power. This GB capacity mechanism is a

retrenchment of an old system rather than a mechanism (such as a targeted mechanism) which may have been a way forward to greater competition.

This in turn maintains the current means of operating and regulating the system to the benefit of incumbents and to the detriment of competition, innovation and consumers. Addressing the CMA's theories of Harm without a broader consideration of the overarching governance of the energy sector would be treating the symptoms rather than the cause - in other words, examining the current system and attempting to make it more competitive rather than asking what would the basis of a competitive system be, and then establishing it.

The entrenchment embodied in market design and governance conflicts with the need to shift towards lower carbon energy systems. The growth in technologies and practices which could enable this shift are both constrained by current institutional arrangements and even the modest growth we have had threatens the current way that the system is operated. This is the beginnings of disruption in GB, although it is happening elsewhere.

Alternative ways of operating the electricity market do exist, and are currently encouraging more renewable generation, flexible system operation, demand side participation and innovation while also ensuring security and affordability. These alternative models are the focus of the IGov project and we are beginning to see the impact of the operation of low carbon technologies in other systems where renewable generation is both shifting the supply curve to the right, displacing fossil fuels, and reducing peak prices. This in turn threatens the profits and business models of the incumbent fossil based companies. We urge the CMA to consider these alternative examples as part of its ongoing investigation.

Finally, from the perspective of price only – one way to show that competition is NOT occurring is if retail profits were 'high'. As far as we know they are about 6% real – but (1) do we really know what they are because of trading / transfer pricing; and (2) is there an agreement about what is the 'right' profit? We do not know this we do argue that the CMA should get to the bottom of what actually the profit is, including through trading etc. It seems to us an essential part of a regulatory system that analysis is able to be undertaken. Our preference is that this occurs transparently, but at the very least such information should be available to a market monitor (as occurs in some US States).