

---

## Issues Facing Independent Suppliers

# Haven Power

18<sup>th</sup> June – Central Hall



## Haven Power

---

- Specialist Supplier of electricity to small businesses
- Established in 2006
- First sales in 2007
- Part of Welsh Power Group



## Main Issues

---

- Dominance and behaviour of the “Big Six”
- Vertical Integration and its effect on markets
- Credit
- Cash out
- Predatory re-contracting



## Dominance & Behaviour of the Big Six

---

- British Gas Business has over 20% market share in the GB SME market and is we believe dominant.
- Ex PES suppliers have large market shares in their ex PES areas and are almost certainly dominant in those areas.
- Competition law restricts the range of legitimate activities for dominant players notably around predatory pricing and other abuses of dominance
- Examples of abuse
  - Non contract supplies should be at deemed rates. Many customers who are not on contract are billed at different rates. Suppliers should either lower their deemed rate to match their lowest out of contract rate or apply their deemed prices properly.
  - The current practice means that many customers are left in limbo on rates for which there is no clear legal basis whilst continuing to apply higher deemed rates (which are supposed to cover the same situations) to other customers. This makes it more difficult to win business than it would otherwise be.
  - Some of the Big Six suppliers offer very low prices to either win new business or to prevent the loss of a customer. These prices are up to 30% below the level that would be required to properly reflect wholesale market costs.
  - This selective deep discounting makes it much more difficult to win new business.
- These activities should be formally investigated.



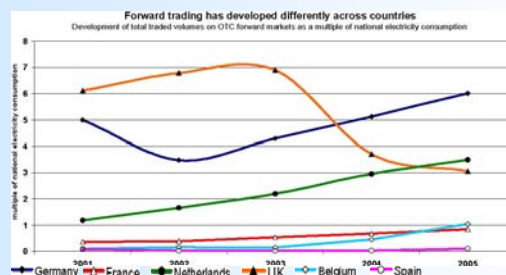
## Vertical Integration and its Effect on Markets

- All of the Big Six are vertically integrated
- This means that they can meet most if not all of their energy needs from their own generation.
- This in turn means that a large proportion of GB electricity is not traded through the wholesale market.
- The wholesale market is marginal as far as the integrated players are concerned.
- This leads to very low liquidity.
- The issue is exacerbated by the lack of independent Generators and Traders.
- Generator & Trader numbers have approximately halved since the advent of NETA and the early promising liquidity has evaporated with the emergence of vertical integration and the concentration of generation ownership amongst the Big Six
- The early encouraging liquidity following NETA led to a relaxation in the self supply limit opening the door to vertical integration
- A remedy is required



## Low Liquidity in the Wholesale Market

- Liquidity has declined sharply since 2003!



## Low Liquidity in the Wholesale Market

---

- At times there is virtually no trading in the wholesale market.
- Analysis of wholesale trades reported by Bloomberg shows that the key seasonal products: winter and summer base load for 08/09 and 09 respectively, **traded on only 54% of weekdays** between 25/6/07 and 4/4/08
- Fundamental products such as these would trade many times on a daily basis throughout this period in any form of liquid market.
- We suspect that traded volumes were low on many of the days when these products did actually trade.
- The vertically integrated suppliers continued to write 1, 2 and 3 year business throughout this period without the need to access the wholesale market. This is not an option that is available to smaller non integrated players.
- There have also been issues with shorter term products that are critical for balancing requirements. Sometimes there has simply been nothing on offer!



## Low Liquidity – So What?

---

- The lack of liquidity and the effective marginalisation of the wholesale market means that:
  - Non integrated players cannot rely on being able to either have an up to date market reference or on being able to source their requirements. This increases their exposure to the balancing market and restricts the range of products that they can offer.
  - Prices tend to be higher than they would be if a greater proportion of generation output were traded. There are many occasions when Big Six companies have sold into the retail market well below (20% to 30%) the level of the wholesale market. They may do this to avoid having to sell more power on a wholesale basis which would depress prices in the wholesale market.
- Furthermore, smaller suppliers do not have access to the same range of counterparties as the larger players and this further restricts access to what is already a limited market. Some wholesale products are quite simply not available to smaller suppliers.



## Credit

---

- Credit and collateral requirements are the largest source of cash / credit required by a small supplier.
- Collateral requirements easily exceed normal working capital requirements.
- Some players will simply not trade with small suppliers.
- Others insist on draconian terms including potentially large margin calls at short notice.
- Cross default provisions of standard GTMA bite hard on default effectively closing business.
- At NETA launch there were traders who would supply smaller suppliers on sensible terms (e.g. Vattenfall, TXU, Enron, El Paso) but these have now vanished
- The extent of credit and collateral acts as a brake on what smaller suppliers can offer as longer contract terms require proportionately more credit and carry a higher risk of large margin calls.
- The credit crunch has made it exponentially more difficult to provide collateral.



## Cash Out

---

- Ofgem's analysis shows that high and volatile cash out prices that we have seen are not cost reflective, they are heavily polluted by system costs, create unnecessary risk and artificially inflate prices.
- Impact is around £1M pa for a typical small supplier, a huge amount for a low margin business.
- Reform is essential but the nettle is not being grasped.
- Small suppliers do not have the resources to properly propose and promote change in this area.



## Predatory Re-Contracting

---

- The Big Six supply over 95% of the SME market.
- Their renewal prices are typically a lot higher than the prices they quote to new customers.
- This gives smaller suppliers an opportunity to undercut them at renewal.
- Smaller suppliers are able to make a sale by offering a competitive price and service package.
- Having won a new customer the supplier has to register them and the old supplier is informed of their loss at this stage.
- Under arrangements which have been endorsed and reinforced by Ofgem the incumbent supplier is allowed to use the loss notification to offer the customer a much lower 'save' price and then to block the transfer of the customer (provided their contract contains the provision).
- This practice confuses customers (who then believe it is OK to break their contract with their new supplier) and means that incumbents can offer higher renewal prices safe in the knowledge that they can have last knockings at the end of the process.
- From a suppliers perspective this increases costs and damages reputation as well as destroying customers faith and understanding of the market.
- Despite this Ofgem have not only supported the practice but actively endorsed it through licence change.
- This practice should be banned.



## Possible Remedies

---

- The dominance of the Big Six should be investigated and their pricing practices should be examined to identify abuse.
- Liquidity in the wholesale market must be improved. The following measures would help:
  - Mandatory trading of generation output by vertically integrated companies may provide a partial solution;
  - Self supply limits were required before and would seem to offer scope to improve liquidity;
  - A requirement on vertically integrated companies to offer terms to third parties that are no worse than their intra group terms (coupled with a realistic approach to credit);
  - Forced divestment of plant (as happened twice in the 1990s); and,
  - Other measures are set out in the paper "Maintaining a Healthy Competitive Fringe".
- Level the credit playing field. Introduce changes that require identical treatment from a credit perspective of all supply businesses including those that are part of vertically integrated groups.
- Consider licensing of electricity trading to regulate approach and to provide assurance on a level playing field.
- Reform of cash out arrangements to eliminate system pollution of prices. Consider tolerance bands that reflect the practical reality if reform is too difficult.
- Ban predatory re-contracting and make it clear that use of industry data flows as part of a retention or renewal strategy is unacceptable.



## Summary

---

- The Big Six have the vast majority of the market.
- The growth of Vertical integration has destroyed liquidity in the wholesale market.
- Prices are higher as a consequence and smaller supplier often find they cannot buy what they need to service their customers.
- Smaller suppliers are frozen out of a large part of the market by the need for large amounts of collateral. Vertically integrated suppliers are insulated from the need to provide collateral.
- The cash out arrangements favour integrated players.
- The regulator is not proactive in tackling these issues and has been supportive of predatory re-contracting which is damaging smaller supplier sales efforts and runs the risk of bringing the market into disrepute.
- Smaller supplier are not looking for a free ride but we would like the balance restoring. Arguably the playing field should be tilted the other way in the interests of competition.