

Antitrust Registry
(Energy Sector Inquiry)
DG Competition
European Commission
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Dear Sir or Madam

RWE npower response to DG Competition Energy Sector Inquiry's Preliminary Report

Introduction

RWE npower supports the aims of DG Competition's Energy Sector Inquiry to analyse and identify the obstacles to the development of the single energy market in co-operation with DG Energy and Transport. Liberalised and competitive energy markets that provide appropriate price signals will also enhance security of energy supply for the UK.

We welcome the Preliminary Report's positive findings with regard to the UK's state of competition in energy markets and would like to highlight UK's position in terms of the competition areas identified by the Preliminary Report. For additional RWE input, in particular on the German energy markets, we would refer you to the response by RWE AG.

Market Concentration

In both gas and electricity, DG Energy and Transport's Report ("the Report") on progress in creating the internal gas and electricity market (15 November 2005) shows that the UK has the lowest concentration levels in terms of the biggest three electricity producers and gas wholesale suppliers.

In terms of the HHI, the Report puts the UK alone for gas import and production in the moderately concentrated [750-1800] category whilst electricity generation is in the same category. For electricity this has recently been supported in the Office of Fair Trading's decision to clear RWE npower's acquisition of Great Yarmouth Power Station, where it determined the GB generation market to be under HHI 1000 (OFT, 6 February 2006).

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In gas, RWE npower concurs with the Preliminary Report finding that the “UK NBP is by far the most heavily traded hub, and the UK also sees significant “beach trading” activity” [paragraph (63)] and furthermore that “the incumbent share of domestic production and imports is relatively low.” [paragraph (83)].

On the supply side, the Report places Great Britain second and third for gas and electricity levels of switching. Ofgem’s Domestic Retail Market Report – September 2005 (6 February 2006) states: “In general, the indicators in this report [changes in market shares, switching and prices] show that there is continued evidence of effective competition between domestic energy suppliers.” As the Report states the former incumbent suppliers’ market shares continue to fall and there are now three regions where the former electricity incumbent share is less than 50% and monthly switching rates are 300,000 in gas and 350,000 in electricity.

Vertical Foreclosure

In gas, the Preliminary Report concludes that vertical integration at various levels of the supply chain can foreclose the availability of crucial inputs for active or new entrants and that long-term contracts can have the same effect. However it states that the UK NBP is the exception to concerns that the wholesale gas markets in Europe are not liquid enough to provide confidence in the availability of gas [paragraph (1120)]. As measured by RWE Trading and Europe Spot Gas Markets (ESGM), RWE npower’s view is that liquidity in the UK remains healthy.

In electricity, to the extent that the Preliminary Report’s concerns relate to generation and retail links, we concur with the Preliminary Report comments that: “In the UK, apart from larger integrated companies, a number of independent generators with their own business strategies exist.” [paragraph (301)] For example, the Drax Group and International Power are significant non-integrated generating companies.

The evidence supports the Commission’s conclusion that the drop in wholesale market liquidity in the United Kingdom is not due to increased vertical integration. [paragraph (431)] RWE Trading as part of its work with the Futures & Options Association’s Power Trading Forum to address the fall in liquidity attributes it to a number of reasons such as the loss of US trading companies such as Enron, recent bankruptcies due to low prices, lack of a single recognised index price discouraging financial institutions and credit issues.

Market Integration

In gas, the issues identified by the Preliminary Report relate primarily to a lack of incumbents entering other markets as well as a lack of availability of transit capacity because of legacy contracts. However, in UK electricity, there has been marked entry of incumbents into each other’s regional electricity markets as well as from the gas incumbent. Equally regional electricity incumbents have entered the gas market nationally. In addition, UK networks operate under common and transparent network access arrangements with very few legacy contracts.

As regards GB electricity interconnection, the introduction of the British Electricity Trading and Transmission Arrangements (BETTA) has effectively integrated the Scottish and English & Welsh markets into a single market.

Transparency

In gas, the key shortcoming which has been identified particularly in relation to cross-border pipelines and entry points does not apply to the UK as such information and much else is provided in the UK.

In electricity, the Preliminary Report stated that more than 80% of respondents called for more information. However, RWE npower concurs with the Preliminary Report's findings that the UK is first in terms of transparency information published. RWE npower supports the Eurelectric approach and agrees with the principles in ERGEG's Guidelines for Good Practice on Information Management and Transparency in Electricity Markets as the UK clearly complies with these Guidelines.

Price Formation

In gas, Global Insight states that the UK gas forward market is a functionally liquid hedging and trading market, with efficient price-formation outside of short spike periods. This aligns with the Commission's observation that UK NBP is the most heavily traded hub, the UK also sees significant "beach trading" and gas forwards trading activity. [paragraph (63)]

In electricity, recent DTI analysis has confirmed that prices follow the track of input costs such as the marginal fuel, consistent with the operation of a competitive market.

Conclusion

To sum up, against the five issues identified by the Preliminary Report, the evidence supports the conclusion that the UK exhibits competitive market characteristics.

Yours faithfully

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Corporate Economic Regulation Director