

## ENERGY MARKET INVESTIGATION

### Notice regarding assessment methodology for losses remedy – appointment of economic consultancy

1. On 7 July 2015, the Competition and Markets Authority (CMA) published its provisional findings and notice of possible remedies (the Remedies Notice) for the energy market investigation (the Investigation). Remedy 1 of the Remedies Notice set out the introduction of a new standard condition to electricity generation, supply, interconnection, transmission, and distribution licences to require that variable transmission losses are priced on the basis of location in order to achieve technical efficiency.
2. On 16 September 2015, the CMA published a notice informing parties of its intention to carry out additional analysis in relation to transmission losses and remedy 1, specifically a new cost-benefit analysis for the introduction of pricing for losses (the [Losses Notice](#)). The Losses Notice described the process that the CMA was minded to follow, including the appointment of experts to assist it in running four to five scenarios of likely impacts and developing an appropriate quantification methodology.
3. On 20 October 2015, the CMA published a notice informing parties of its intention to appoint NERA Economic Consulting ([www.nera.com](http://www.nera.com)), 66 Seymour Street, London, W1H 5BT (NERA) for the purpose of this assessment (the [Intention to Appoint Notice](#)).
4. Four parties have commented on the proposed approach. Two of them were satisfied with the CMA's proposals to avoid potential conflicts of interest and ensure that the proposed analysis was genuinely independent. The other two parties have raised concerns around potential apparent bias, confirmation bias, or both, arising from the appointment of NERA and the timetable for completing the work. The broad concerns raised were that:
  - there is a risk of apparent bias from asking NERA to comment on the strengths and weaknesses of work it has previously conducted for RWE Npower, in particular, in the context of locational pricing for transmission losses in Great Britain;
  - there is a risk of confirmation bias in the work NERA does for the CMA, given the analysis it has previously conducted in this area for

RWE Npower that has been submitted to the CMA in the context of the Investigation;

- there is insufficient time to conduct the analysis set out in the notice and appropriately consult with third parties (one party had inferred from the Annex to the Intention to Appoint Notice that the process would end in November).
5. In light of the above, one party has submitted that the proposed work, if conducted by NERA, would not be a robust and credible source of evidence, and therefore the CMA should instead remedy this provisional finding of an adverse effect on competition by making a recommendation to Ofgem to carry out a cost-benefit analysis in the provisional decision on remedies and final report.
  6. In relation to the concerns about possible apparent bias and confirmation bias, the CMA noted in the Intention to Appoint Notice the highly technical nature of the work required, and accordingly all bids received in response to the call for tender were from consultancies that had done previous work in this field and hence raised potential concerns of apparent bias or confirmation bias, or both. During the remainder of the Investigation (and any potential subsequent appeal relating to transmission losses), NERA will not perform work for any third party in relation to transmission losses.
  7. As regards the concern that NERA would be commenting on its own previous research carried out for RWE Npower, we understand that this concern arises from paragraph 4 of the Losses Notice, which states that the process for conducting the new cost-benefit analysis will involve a component to ‘Assess the CMA results together with any results that may have been developed and submitted in parallel by interested parties’, and the Annex to the Intention to Appoint Notice, which states ‘similar exercises have been performed in the past, for example in relation to Ofgem’s and Elexon’s decisions over P229. We would expect the expert to show familiarity with the strengths and weaknesses of that work.’
  8. The CMA would like to clarify that NERA will not be asked to comment on, or assess, its previous analysis on transmission losses, including the [analysis](#) that was submitted by RWE Npower in the context of the Investigation. Instead, NERA will be asked to perform a new analysis. In doing so, it will rely on models developed by NERA, in collaboration with Imperial College London (Imperial), that were used in previous analysis. However, within the context of this project, the CMA will have a strong influence on the models, methodology and scenarios used (adopting a transparent process, as noted further below). In particular, the CMA will require NERA to amend certain assumptions and

consider a number of factors that had not been contemplated previously in NERA's and Imperial's models. Moreover, the task of comparing and/or assessing the strength and robustness of any analytical work submitted to, or carried out by, the CMA within the context of the Investigation will fall exclusively to the CMA.

9. In light of the above, the CMA believes that any concerns of possible bias or confirmation bias can be adequately addressed through the central role that the CMA will play in steering and interpreting the analysis conducted by NERA.
10. In addition, the CMA intends this work to be a transparent and iterative process, which will continue throughout the development of the CMA's analysis. For instance, the CMA intends to have ongoing interaction with NERA, and third parties, in relation to the model, the design of the methodology and scenarios, the performance of the analysis and the assessment of its results. The CMA encourages parties to engage with this process, and in particular to suggest any relevant amendments to the methodology or scope of the analysis and to carry out further analysis and assessment of the evidence.
11. In relation to the third concern regarding timing, as stated above the CMA will engage with parties throughout the development of its analysis. It will consider any submission made to it on this matter and amend the timetable of this work if appropriate (subject to the constraints of the statutory time frame for the Investigation). The timescale set out in the Annex to the Intention to Appoint Notice was used as an indication for the purpose of the pricing of tender bids. It does not prevent the CMA from carrying out (in collaboration with NERA) further analysis on this issue throughout the Investigation (including running additional scenarios or amending the methodology).
12. In summary, the CMA proposes to use NERA and Imperial's models and modelling expertise, as it would not have been practical to develop a new model within the time available. The CMA will have a central role in the design of the methodology and process and will carefully consider parties' representations throughout this process. In forming a judgement on the relevance of this work to its findings, the CMA will be mindful of the issues highlighted in this Notice.
13. The CMA is of the view that the above clarifications should provide parties with comfort that sufficient safeguards will be in place to mitigate any potential risks of apparent bias or confirmation bias, or both.

14. More generally, the CMA notes the existing evidence base set out in the provisional findings in support of the provisional finding of an adverse effect on competition concerning transmission losses. The CMA nonetheless considers that, in the round, the additional work to be commissioned from NERA will be an informative supplement to its understanding. No conclusion has yet been reached on the weight the CMA proposes to give to such work in the context of the final report.
15. The next step in this process will be the publication of the methodology and scenarios for NERA's analysis.

30 October 2015