

**Call for Input** – The development of a competition framework for the domestic retail market



Making a positive difference  
for energy consumers

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## The development of a competition framework for the domestic retail market

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Contact:	Gavin Knott
Email:	competitionframework@ofgem.gov.uk

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Any enquiries related to the text of this publication should be sent to Ofgem at:

10 South Colonnade, Canary Wharf, London, E14 4PU.

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## 1. Introduction

- 1.1 Ofgem is the economic regulator of the energy sector with a primary duty to making markets work in the best interests of current and future customers including having regard to consumers with protected characteristics (eg those in vulnerable circumstances). These interests are defined as their interests as a whole, including in the reduction of greenhouse gases and the achievement of the net zero targets. Ofgem also has a secondary duty to promote effective competition wherever this represents the best means of achieving the primary duty.
- 1.2 In its May 2022 report into Ofgem’s regulation of the energy market, Oxera recommended, among other things, that Ofgem (i) put in place a consumer interest framework; (ii) develop a framework for how effective competition is defined and measured; and (iii) when making decisions, that Ofgem use both the consumer interest and effective competition frameworks to make decisions on future market design options.
- 1.3 Through its past interventions, Ofgem has promoted an open and competitive retail market with the objective of delivering the best outcomes for consumers. However, we have concerns that such an approach has not delivered value for all consumers, particularly those inactive consumers who do not seek to engage with their energy supplier or shop around the market to switch suppliers. Furthermore, the onset of the wholesale energy price crisis has exposed the risks of a very open market with low barriers to entry, in terms of the risks of supplier failure which is costly to all consumers.
- 1.4 At the same time Ofgem must balance these risks against building a heavily protected and regulated retail market which limits the development of effective competition and the ability of suppliers to innovate and develop new services that consumers value. A Competition Framework for the domestic retail market will help Ofgem evaluate its regulatory options to ensure it promotes the right balance between competition and regulation in the interests of consumers.
- 1.5 When making a policy decision, Ofgem undertakes an impact assessment to understand and highlight the competition (as well as consumer and other) impacts of the policy. A competition framework will support Ofgem in taking an holistic view of the wider impacts of policies on competition in the market.
- 1.6 A competition framework will also allow Ofgem to both assess the state of competition in the market and to consistently and systematically assess the

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competition impacts of possible policy interventions including, where relevant, any trade-offs with other policy objectives.

- 1.7 In addition to Ofgem’s role as sector regulator, the CMA has competition law powers that apply across the Economy. In this Call for Input we are particularly concerned about applying the competition framework to the use of our regulatory powers. As discussed below we also work with the CMA on the application and enforcement of competition laws.
- 1.8 We are now seeking views on the development and implementation of a competition framework for the domestic retail market. We set out specific questions at the end of this document. We are seeking written comments to these questions by **20 September 2023**. Please send comments to [competitionframework@ofgem.gov.uk](mailto:competitionframework@ofgem.gov.uk).

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## 2. Ofgem’s role in competition in the retail energy market

2.1 The domestic market in retail energy has been liberalised for many years, since changes to market structure in the late 1990s. While the market is liberalised, market outcomes remain heavily influenced by regulation designed to address risks that the market might not deliver effective outcomes in the interest of consumers. For example:

Suppliers operate through procuring wholesale energy and network services on regulated terms.	We created the market in the first place by enforcing the separation of the monopoly companies’ retail businesses, and imposing an obligation on the network companies to provide their services to all suppliers in the market. The wholesale market is liberalised, but the products offered are regulated, and subject to review by government. <sup>1</sup>
Suppliers have to meet a range of minimum licence requirements, including on what services they are expected to offer to energy users.	Suppliers can only operate in the market if they hold and comply with the licence that we have put in place (and which we have continued to modify on a regular basis). This includes a duty to supply any customer that accepts the offer of terms, and rules on how suppliers interact with the rest of the supply chain, including networks and wholesale markets.
There are some limits on prices charged, including a cap on the default tariffs charged to customers.	Since 2019, we set a cap for the Default Tariff for customers on standard variable tariffs. The Default Tariff cap sets a maximum price that energy suppliers can charge consumers for each kilowatt hour (kWh) of energy they use and is designed to ensure that prices for customers on default energy tariffs are fair and cost-

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<sup>1</sup> The Government is currently undertaking a major review into GB electricity market design to enhance energy security and cut costs of electricity for consumers in the long term (see [‘UK launches biggest electricity market reform in a generation’](#)).

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	reflective. Since August 2022, the Default Tariff Cap has been updated on a quarterly basis.
Suppliers are required to meet certain quality of service standards.	We set rules around the Quality of Service and recently consulted on reforms with the intention to drive up standards for consumers. <sup>2</sup> These include the introduction of an overarching consumer standards framework that sets out how we regulate to raise consumers standards; proposals for specific improvements we could make to existing rules; and how we can continue to most effectively monitor and track consumer standards going forwards.
We set rules on the tariffs retailers can offer.	During the crisis, we introduced the following temporary rules designed to support the stability of suppliers which place limits on tariffs and switching <sup>3</sup> :  The Ban on Acquisition Tariffs (BAT): a requirement for suppliers to make new customer tariffs also available to existing customers.  The Market Stabilisation Charge (MSC): a requirement for a supplier that wins a customer from rivals to pay a charge to the previous supplier. <sup>4</sup>
We expect suppliers to have sufficient capital to cover the risks that they carry.	Following the costs incurred by consumers as a result of the collapse of Bulb and other retailers, we are introducing additional requirements on suppliers to increase their financial resilience and to limit the impact

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<sup>2</sup> See link to policy consultation here: [Consultation on a framework for consumer standards and policy options to address priority customer service issues](#)

<sup>3</sup> Although both these measures could have a role in any market structure, they were brought in to reflect a risk inherent in the price cap, which effectively obliges suppliers to buy forward, leaving them exposed to losses if prices drop and customers switch away. The BAT and MSC were originally due to expire in 2022, but have been extended twice.

<sup>4</sup> The original decision on the BAT and MSC are [here](#). Our latest decision to extend them is published [here](#)

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	on consumers in the event of future failures by ringfencing payments made under the Renewable Obligations scheme. <sup>5</sup>
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- 2.2 We have monitored the outcomes from the competitive process in the past through our State of the Market and Conditions for Effective Competition reports <sup>6</sup>. Whilst these provide indicators of the current effectiveness of competition and trends over time, we recognise that it may not be sufficient to understand the overall effects of our interventions on consumers. A change in competitive dynamics may benefit or harm consumers (or sub-groups thereof) in other ways, for example if it affects the resilience of suppliers, or the ability of suppliers to innovate and develop new services that consumers value.
- 2.3 The purpose of the competition framework is to provide a mechanism by which future interventions in the retail market can be assessed on a consistent basis to test how they will contribute to effective competition, and the implications for those interventions on the consumer interest.

### **Characteristics of energy market competition**

- 2.4 Alongside the role of regulation, the retail energy market has certain other characteristics that heavily shape the role that competition plays within it:
- Energy is a necessity good, meaning that consumers have no choice about whether they are part of the market or not.
  - Energy is an almost entirely homogenous product; the partial exception to this relates to how it is generated, which enables some suppliers to differentiate themselves by offering energy from renewable sources.
  - The market includes a significant proportion of customers that rarely or never switch - in a 2019 survey, 49% of customers reported that they had never switched, or only ever switched once.
  - For much of its existence the market was dominated by the 'Big 6' suppliers that emerged from the original pre-privatisation monopoly

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<sup>5</sup> Our decision is published [here](#), and the Impact Assessment is [here](#)

<sup>6</sup> We published our final State of the Market report in 2019, which is available [here](#). The Conditions for Effective Competition report was produced from 2020 to 2022; the Framework for this is available [here](#), and the 2022 report is [here](#).

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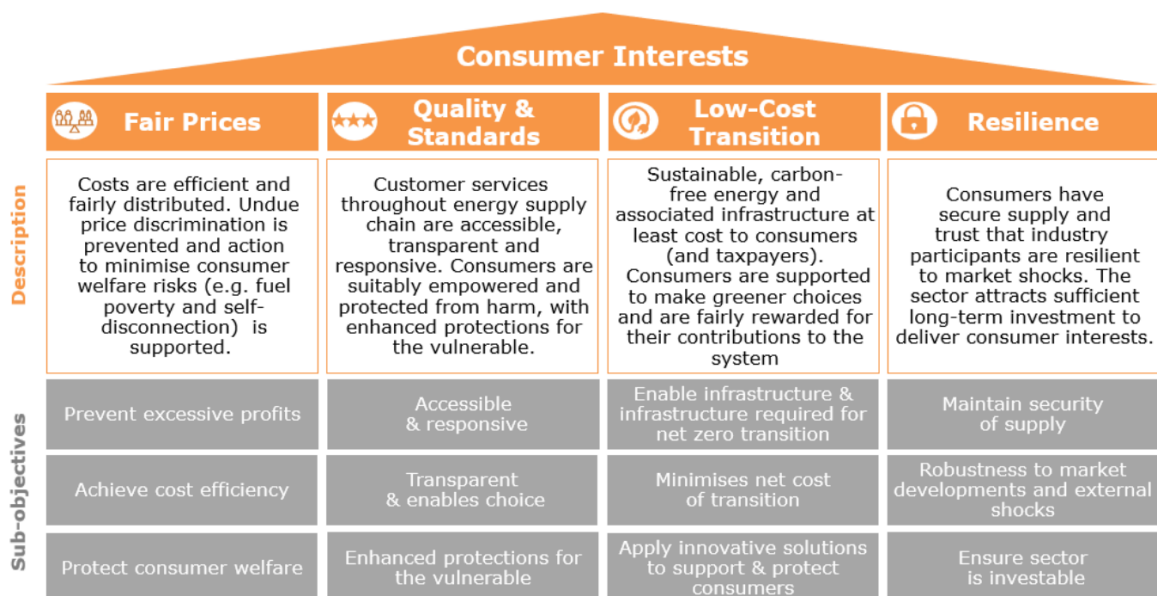
businesses. In recent years, however, this has started to evolve: two of these suppliers merged, and a third was taken over by a new entrant, while another new entrant (Octopus) has succeeded in growing to a similar scale as the former incumbents. As a result, the combined market share of the 6 largest suppliers had dropped to below 70% at the end of 2019, as the new entrants won market share, but has now returned to almost 90% (due to the mergers and acquisitions mentioned above).

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### 3. Outline of the Competition framework

3.1 We propose to monitor and measure market outcomes against those set out in Ofgem’s Consumer Interests framework (see Figure 1 below).

**Figure 1: Ofgem’s Consumer Interests Framework**



3.2 Our proposed competition framework is split into three themes which correspond to those underlying features of the market which affect these market outcomes. These themes are:

- **Consumer engagement & empowerment** – this corresponds to the demand side of the market. Our objective is for customers to effectively react to market signals to an extent that it disciplines the behaviour of suppliers. We will look at both positive responses to price signals and negative responses (such as self-disconnection). The theme explores questions such as to what extent do customers react to prices and service level offerings by shopping around to find the best deal? To what extent are switching rates sufficient to discipline the behaviour of suppliers? This will determine the extent to which competition alone will ensure good outcomes for the majority of consumers.
- **Market rivalry** – this corresponds to the supply side of the market. Our objective is for a well-functioning market where suppliers compete



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vigorously to acquire and retain customers. The theme considers issues such as, to what extent do companies have market power in the supply of energy, or within market segments such as pre-payment meter customers or green tariffs? To what extent does rivalry between firms, entry or expansion (or the threat of it) sufficiently discipline the behaviour of incumbent suppliers? Are market participants identifying and developing opportunities for innovation? If barriers to entry are high and switching is low, the sector risks becoming a 'cosy oligopoly', with limited competition between suppliers.

- **Structural parameters of the market** – this theme corresponds to the 'rules of the game' such as Government legislation and regulation, as well as external factors affecting and interacting with retail market outcomes such as wholesale prices, technology and social factors. Our objective is for the market to react dynamically and efficiently to external changes. We therefore need to ensure that our retail market regulation is flexible and can support that objective.

## Populating the competition framework

3.3 Under each of the three themes of the competition framework sit a number of indicators/evidence sources that we propose to use to populate it. In considering these indicators it may be necessary to assess groups of indicators together, in the round. We also acknowledge that indicators could move in different directions, revealing differing market outcomes, and will take account of this in interpreting these indicators.

<b>Theme</b>	<b>Indicator/evidence</b>	<b>Rationale</b>
Consumer engagement & empowerment	Price dispersion	A large gap between prices offered by different suppliers may be indicative of search or switching frictions resulting in weak customer response or the existence of price discrimination.

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<b>Theme</b>	<b>Indicator/evidence</b>	<b>Rationale</b>
	Customer satisfaction scores	Important indicator of non-price market outcomes
	Switching rates	Indicator of the extent to which consumer behaviour is disciplining suppliers in the market.
	Internal customer engagement measures	Indicator of the extent to which customers who don't switch are engaged with their supplier.
	Market/behavioural research	Provides insights into consumers' shopping around and switching attitudes/behaviour.
Market Rivalry	Market Shares	Where persistently high market shares are held by one or more firms this may be indicative of high barriers to entry or unilateral market power
	Concentration ratios/HHI	
	Profitability analysis/ price-cost margins	Pricing in excess of cost or profitability exceeding cost of capital over a sustained period may be indicative of firms earning excessive rents (subject to suppliers' level of efficiency).
	Recent entries and expansions	May be indicative of high barriers to entry and expansion to the extent that entry, expansion or the threat of it do not constrain the behaviour of incumbent suppliers.

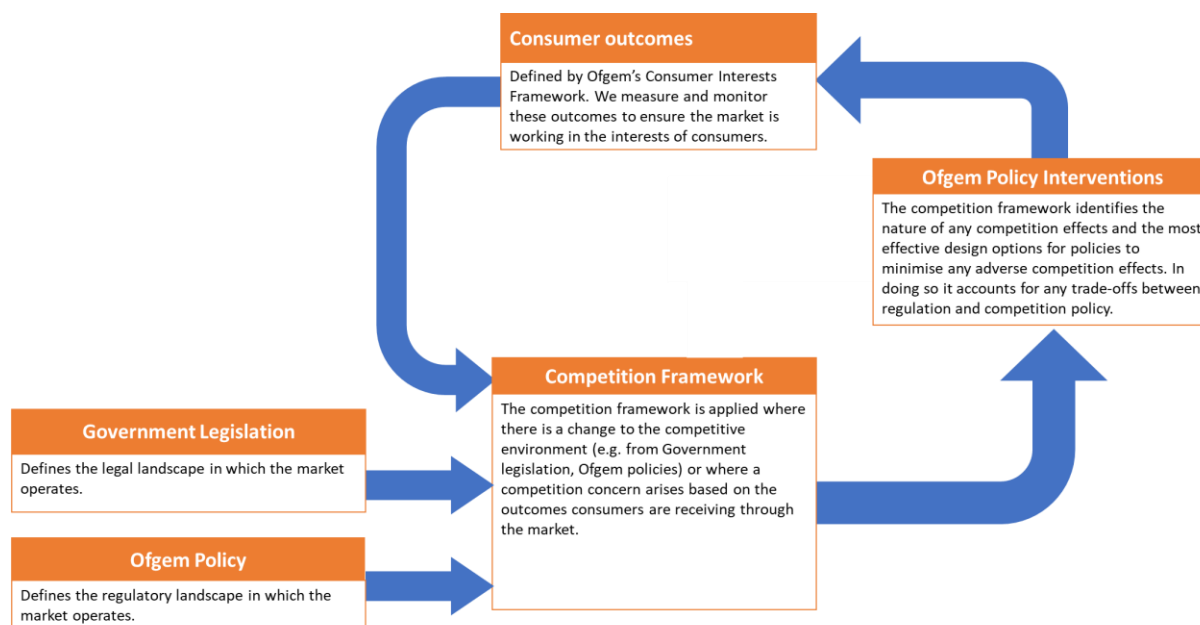
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Theme	Indicator/evidence	Rationale
Structural parameters of the market	Interest rates/ availability of capital	Cheaper finance will enable potential new entrants to get funding more easily, and will affect the level of expected returns from the market.
	Opportunity costs to exit the market	High exit costs i.e. unrecoverable sunk costs may act as a disincentive to market entry and its ability to attract new investment
	Capital requirements/other regulatory barriers to entry/expansion	Regulatory barriers may act as a disincentive to entry, expansion or innovation.
	Provision of bundled energy services such as energy efficiency, solar panels, heat pumps	We expect that development of green technologies will drive demand for smart, flexible, and EV specific tariffs, and that retailers would have a role in supporting customers in the transition.
	Take-up of EVs, heat pumps and other technologies affecting structure and level of energy demand	
	Take-up of smart meters	Will drive demand for smart and flexible tariffs.

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- 3.4 Taking these together, we will look to understand the mechanisms by which the consumer interest will be affected by our interventions.
- 3.5 We note that these themes and indicators assume the current model of retail competition. If we were considering the current framework against alternative models not based on open competition then we would need to compare some but not all measures and indicators. For example, while switching rates would not necessarily be a relevant measure we would continue to assess both price and non-price outcomes such as internal engagement with suppliers and customer satisfaction indicators.
- 3.6 Figure 2 below demonstrates how we envisage the Consumer Interest and Competition frameworks fitting together with the Ofgem policy making process.

**Figure 2: Overview of when the competition framework is applied**



- 3.7 The overall objective is to provide a framework against which to assess the current state of competition in the market, and to test how proposed interventions might influence this.

### Applying the competition framework

- 3.8 We will apply the competition framework where a competition concern or requirement for a policy change is first identified, for example:

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- (i) where our retail market monitoring activities identify a competition concern e.g. pace of emergence of cheaper fixed term tariffs as wholesale prices begin to fall, or pace of uptake of tariffs linked to new low-carbon technologies;
- (ii) when Government announces a change in policy/legislation or where factors necessitate a change in Ofgem’s regulation of the market
- (iii) when we are reviewing new or existing interventions. As part of this, the framework will also be applied in our competition impact assessments going forward.

## **How we work with the CMA**

3.9 The Competition and Markets Authority (CMA) has competition law powers which apply across the whole economy. Ofgem has concurrent competition powers with the CMA in the sectors which Ofgem regulates. In 2016 Ofgem and the CMA signed a Memorandum of Understanding setting out the practical detail of how the CMA and Ofgem will work together within the framework of competition law.

3.10 Under this Memorandum, Ofgem is recognised as the sectoral regulator of gas and electricity markets and both Ofgem and the CMA have concurrent responsibility for competition enforcement cases and market investigations. We have discussed a draft of this competition framework with the CMA and welcome further engagement with it as our thinking progresses.

## **Call for views on the competition framework**

- 1) Do you agree with the aims and objectives of developing and implementing a competition framework?
- 2) Do you agree with the sources of evidence and measures we are proposing to use in the competition framework. Are there any important evidence sources missing? How should these measures all fit together?
- 3) Ofgem has a primary statutory duty to protect the interests of current and future customers, as part of which it must consider their interest in the achievement of the net zero targets. Ofgem also has a secondary duty around the promotion of competition. We welcome views on how we should trade-off competition effects against other impacts of regulation, given our wider statutory duties.