



## RESPONSE TO OFGEM RETAIL MARKET REVIEW

**OVO ENERGY**  
**1 JUNE 2011**

### **Introduction**

1. Ovo Energy welcomes Ofgem's acknowledgement that the current retail energy market is failing consumers and is not delivering a functioning competitive market.
2. While supporting the proposals set out in the RMR, we urge Ofgem to go further and to be more assertive in creating an environment where competition works for the consumer by ensuring there is a level playing field for all retail suppliers.
3. We propose two specific immediate actions for Ofgem to take as a first step to developing effective retail competition:
  - limiting the price differential between of the median and lowest tariffs offered by any supplier
  - a tariff comparison measure based on the 'APR' and 'AER' systems used in the retail financial services market
4. If Ofgem is more assertive in creating a truly competitive retail market it will help foster a more vibrant and confident investment environment in infrastructure and the wider energy market.
5. The current dominant energy companies -- the 'Big 6' -- have an important role in the future development of the energy market, but the retail market and consumers will benefit from new business models and visions of how to cost-effectively deliver safe, secure and sustainable energy.
6. The time has come for Ofgem to look beyond the 'Big 6' to find 'consumer-friendly' solutions.
7. True competition should mean that if the 'Big 6' want to maintain their profit margins they will need to find efficiencies from within their own businesses rather than simply passing the costs onto consumers.

## **Market overview**

8. Despite the best intentions of the architects of the 1980's energy privatisations, 99% of Britain's consumers remain customers of the direct descendants of the old state monopolies – and two-thirds of consumers are with the same regional supplier they had before privatisation.
9. The 'Big 6' have not achieved growth, as normal companies do in other consumer markets, by acquiring customers through offering attractive new services or enhanced customer service. They have simply inherited their large customer base, with no incentive to innovate or serve customers well.
10. The best way to change any consumer market is to actively encourage the creation of a competitive level playing field driven by new entrants -- this requires incumbent operators to adapt and respond to commercial competition rather than regulation.
11. While we generally welcome Ofgem's proposals, as a way of addressing issues in the short-term, we believe Ofgem must now take a more strategic interventionist approach in order to nurture competition. This will also enhance prospective new investor's confidence in the wider energy market, potentially providing more new money than can be provided by the 'Big 6' alone.

## **Strategic market management**

12. Telecommunications provides a blueprint and precedent of how a regulator can work with new entrants to create a competitive level playing field, initially by stopping incumbent dominant operators from stifling fledgling companies, and allowing those dominant incumbents time to make the changes they need to make to operate successfully in a fully competitive marketplace.
13. One obvious example of how Ofgem can operate strategically to nurture new entrants in the retail energy market and support the development of a truly competitive market responsive to consumer needs, is to stop the 'Big 6' energy companies from simply under-pricing new entrants.
14. Figures in Ofgem's Review make clear that the 'Big 6' energy companies currently overcharge the majority of Britain's energy users (ie they make greater margin from those customers) in order to subsidise acquiring new customers with the cheapest (ie lowest margin) tariffs. It cannot be right that the most 'passive' consumers should pay for this 'illusion of competition'. These subsidised tariffs also make it more difficult for new, innovative companies to offer consumers real choice and better value on a sustainable basis.
15. We propose that Ofgem introduce controls which limit the price difference between all suppliers' median and lowest tariffs.

16. This should provide immediate benefit for the millions of consumers on higher margin tariffs, offering them better value for money, and being inherently fairer. It would also provide the level playing field new entrants require to enter and grow in the market, by stopping this effectively 'anti-competitive' pricing by dominant incumbents.
17. A similar strategic market management approach by the telecoms regulator Oftel was critical to ensuring the growth, the investment, the innovative new services and the improved customer experience we all now take for granted. Oftel ensured, until the new competitive market was sufficiently viable, that BT could not simply price new entrants out of the market.

### ***Consumer choice and comparative measures***

18. While we broadly welcome and support the initiatives proposed by Ofgem, we have several observations to preserve consumer choice and service innovation.
19. In proposing to standardise evergreen contracts across suppliers, care should be taken to ensure that this does not lead to homogenisation and the reduction of consumer choice.
20. We would propose that Ofgem establish an "APR-equivalent" as the basis for comparison between energy suppliers.
21. In the financial services market, 'APR' is a standard comparative measure which helps consumers understand, in a simple and clear way, the cost/impact of an otherwise complex financial product. It takes account of variable rates, and other incentive/penalty charges in order to provide the consumer with a headline point of comparison.
22. Such an "Energy APR" would be based on each suppliers' guaranteed or underlying price per kWh over one year, taking account of all discounts or other tariff-specific features. Energy tariffs will necessarily remain complex products, just as with financial products. However, adopting this 'APR' approach would provide consumers with an easy to use and understand comparative measure, without constraining suppliers' ability to innovate.

### ***Wholesale market***

23. Liquidity in the wholesale market is critical. It is self-evident that greater transparency and openness will help create a more level playing field for new retail entrants and hence create better choice and value for consumers.

24. We look forward to seeing the details of how Ofgem proposes to improve access to and understanding of the wholesale market. We expect safeguards to ensure that the market cannot be manipulated or distorted by third parties either within or from outside the energy market, eg it would not be in consumers' interests if an MMA allowed financial speculators to acquire capacity for immediate re-sell to an energy retailer, with the speculator's additional profit margin added to the wholesale price.

#### ***Policing and enforcement of licence conditions***

25. Enhanced policing and enforcement will be necessary in the short-term. However, if Ofgem were to take a more strategic market management approach which nurtured true competition, by supporting new entrants, it is much more likely that normal market mechanisms and operations will evolve in a relatively short timescale, therefore significantly reducing the need (and costs) of prolonged detailed regulatory oversight.

#### ***Switching sites***

26. It is vital that switching sites, or any other comparison mechanism, have the trust of consumers. This will require the early adoption of a transparent and easily understood mechanism for fairly, and consistently, comparing tariffs.

27. We have indicated our preference for something similar to the 'APR' system used in the consumer financial services market, which takes account of discounts/etc to provide a standard comparative base across different products, services and tariffs.

28. We welcome the work being done on this issue by Consumer Focus, but remain concerned about who will take this work forward after the planned demise of Consumer Focus.

29. The ways in which comparison sites are governed, and standard comparative indices are utilised in other consumer markets (insurance, travel, etc) may provide insight on the best way forward within the energy market.

#### ***Appointment of independent accountants***

30. If Ofgem brings forward proposals to improve liquidity in the wholesale market, bringing greater transparency to pricing and the market, this should help in providing a better understanding of the transfer pricing and hedge accounting practices of the 'Big 6' energy companies. We see no immediate reason to appoint independent accountants.

## Conclusion

31. Ovo Energy prides itself on being a good example of how a new energy company can deliver value, innovation and customer benefit, and help change the face of the energy market. We have led the industry in simplifying bills, standardising tariffs and providing the best customer service, culminating in *Which? Switch* recently giving Ovo Energy a 5-stars rating.
32. So while we welcome Ofgem's proposals to require the industry to move in line with Ovo's consumer-centric approach, our more important message is that Ofgem can achieve its consumer objectives by assertively creating a competitive level playing field for all energy suppliers.
33. It will be necessary in the short-term for Ofgem to impose and police licence conditions on the 'Big 6'. But in the longer-term, if Ofgem creates the right environment where market forces drive innovation, regulatory intervention will decline as the 'Big 6' respond commercially to market developments and consumer demands without the need for 'coercive' licence conditions.
34. We believe the first steps in the process should be:
  - the adoption of a financial services-style 'APR' comparative measure for energy tariffs, to give consumers clarity and confidence in evaluating choice;
  - a limit on the price difference between suppliers' median and lowest tariffs, so that passive consumers are not 'victimised' and all suppliers can compete on an equal basis.

These two simple steps alone would have a dramatic positive impact on the market.

35. Consumers have the right to expect choice, innovation and value for money. The best way to deliver this will be for Ofgem to strategically manage the market to create the conditions which encourages new players, and allows a truly viable competitive market to develop.