

## State of the Market Assessment

27 March 2014

ofgem

## Key Messages

- We are consulting on a proposal to make a market investigation reference (MIR) to the Competition and Markets Authority (CMA)
- Joint assessment with OFT/CMA reinforces previous Ofgem analysis that competition not working as well as it could
- We are proposing an MIR because
  - Evidence that confidence in the market has fallen further recently
  - Need to explore every way to improve competition, including those options only available to the CMA
  - Market investigation provides an opportunity to clear the air and reduce uncertainty
- Complimentary to Ofgem's RMR reforms and liquidity measures, which will bring real benefits to consumers quickly

**Ofgem believes a Market Investigation Reference (MIR) to the CMA now is in consumers' best interests – we are seeking views on that proposal**

## Background

### Supply Market Probe 2008

- Found range of features that weakened competition, no evidence of cartel
- Developed package of measures to improve functioning of the market

### Retail Market Review (RMR) 2011 – Present

- Need to regain consumer trust
- Failure of suppliers to respond sufficiently to 2008 Probe remedies
- Package of further reforms (coming into effect end 2013 / beginning 2014)
- Ofgem to monitor impact of reforms and report regularly on state of market

### Competition Assessment 2013 – Present

- Autumn/13: Commitment to produce annual assessment (in response to ECCC), work with OFT/CMA and deliver first report in March 2014
- Dec/13: Assessment framework published – potential sources of harm
- Mar/14: Joint assessment finds competition in retail energy market may not be sufficiently effective

**Competition issues have been persistent; consumer trust and confidence have declined further over the last year**

## State of the Market Report – Findings & Conclusions

- Joint assessment shows problems that indicate a lack of effective competition in energy market:
  - **Weak customer response** – switching falling (bar recent spike) despite increasing prices and available savings; low engagement due to intrinsic nature of product, tariff complexity and long switching times; low level of consumer trust
  - **Unilateral market power** – incumbents still able to charge ‘sticky’ (and potentially more vulnerable) customers higher prices
  - **Weak competition** – aligned pricing strategies (timing & extent); no evidence of explicit collusion, but possible tacit coordination; prices raised more rapidly and to greater extent when costs increase than reduced when costs fall
  - **Vertical integration** – benefits (reduced risks/costs), but can be barrier to entry for non-integrated suppliers who may be unable to obtain wholesale products needed to compete
  - **Other barriers to entry and expansion** – low wholesale liquidity, credit & collateral arrangements, suppliers’ pricing strategies, regulatory barriers, reputational risks, ECO exemption may create disincentive to expand

**Conclusions reinforce those found previously in Probe and RMR**

## Market Investigation Reference (MIR)

### Why?

- “Reference test” threshold met: reasonable grounds to suspect features of market restrict/distort competition
- Still expect RMR reforms to directly address market failings, but investigation will clear the air and allow CMA to ensure right industry structure is in place

### Scope

- Supply of gas & electricity to GB households and small businesses
- Features of the market that could harm competition (see slide 4)
- Recognising Ofgem’s RMR remedies and future developments

### Process

- Mar/14: Ofgem MIR – 8 week consultation, decision Jul/14. If yes –
  - Jul/14-Jan/16: CMA market investigation – 18 months, can add 6 months
  - Jan/16-Jul/16: CMA remedies (if required) – 6 months, can add 4 months

**MIR now would lead to faster conclusion to market uncertainty**

## Timetable and potential next steps

	2013			2014	
Retail Market Reforms (RMR)	Mar/13 Final proposals	Aug/13 Fairer treatment in place	Dec/13 Simpler tariffs in place	Apr/14 Clearer information and Liquidity reforms in place	
Competition Assessment	Sep-Nov/13 Ofgem commits to report annually (in response to ECCC), work with OFT/CMA & report by Spring			Dec/13 Assessment framework published	Mar/14 State of the Market report published
Market Investigation Reference (MIR)				Mar/14 Ofgem proposes MIR	8 week consultation → Jul/14 Ofgem decision on MIR ↓ If yes CMA Market Investigation (18 months + 6 months if remedies required)

# Q & A

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CMA:

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## Contact

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**We work effectively with, but independently of, government, the energy industry and other stakeholders. We do so within a legal framework determined by the UK government and the European Union.**