

State of the Market Assessment

27 March 2014





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 nonintegrated 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



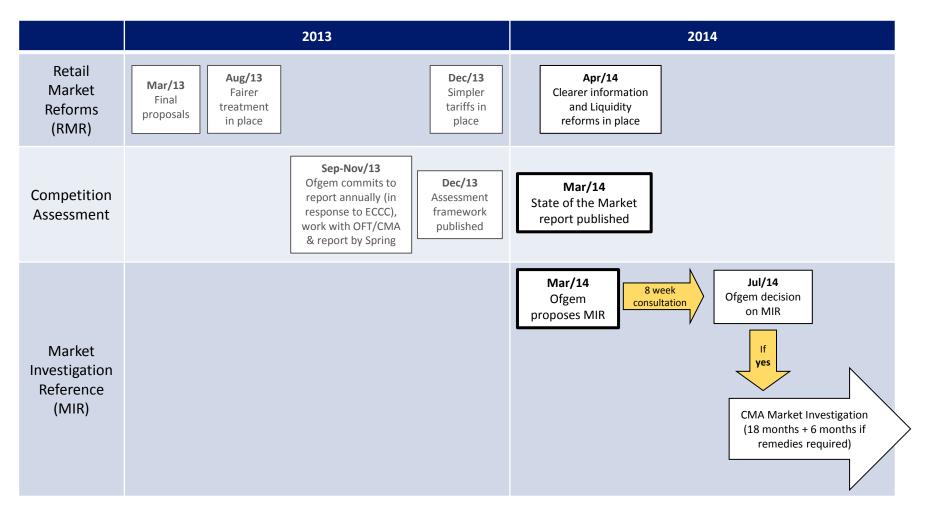
Market Investigation Reference (MIR)

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





Q & A

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Ofgem is the Office of Gas and Electricity Markets.

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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.