

Ofgem consultation on a proposal to make a market investigation reference in respect of the supply and acquisition of energy in Great Britain

Energy UK response – 23 May 2014

1. Introduction

- 1.1. Energy UK is the trade association for the energy industry. We represent over 80 members made up of generators and gas and electricity suppliers of all kinds and sizes as well as other businesses operating in the energy industry. Together our members generate more than 90 per cent of the United Kingdom's (UK) total electricity output, supplying more than 26 million homes and investing in 2012 more than £11 billion in the British economy.
- 1.2. Energy UK is pleased to be able to respond to Ofgem's consultation on its proposal to make a market investigation reference in respect of the supply and acquisition of energy in Great Britain. Energy UK's response is focussed on facts and high-level, reflecting the fact that our member companies are diverse and have different views on many of the issues that Ofgem raises in its consultation and Market Assessment documents.
- 1.3. Energy UK would be happy to discuss any of the points made in this submission with Ofgem, the CMA, or any other interested party if this is considered to be beneficial. If you would like to do so, please contact alun.rees@energy-uk.org.uk in the first instance.

2. Executive summary

- 2.1. Energy UK supports Ofgem's proposal to refer the markets for acquisition and supply of electricity and gas to the Competition and Markets Authority (CMA) on the basis that a Market Investigation (MI) will –
 - a) **Involve an objective, expert, independent and apolitical assessment of the facts;**
 - b) **Facilitate better understanding and evidence-based debate about electricity and gas markets;**
 - c) **Draw a line under current disputes about the health of the market, thereby helping to promote renewed political consensus, consumer confidence, and certainty for investors; and**
 - d) **Ultimately contribute to the delivery of secure, sustainable energy supplies for customers and economic growth for the country.**
- 2.2. To help achieve these objectives, Energy UK considers that –
 - a) The scope of Ofgem's referral should encompass wholesale markets, supply, and the vertical links between the two;
 - b) Ofgem and the CMA should place a high importance on the impact of what they say and do on investor confidence and economic growth in any decision to refer and throughout any MI;
 - c) Ofgem and the CMA should manage the public's expectations about what the possible and likely impacts of an MI and any potential remedies might be (which will be better understood as any MI progresses);

- d) Political parties should give their full backing to any MI, accept what the CMA might conclude, and not prejudge the outcome; and
- e) In any MI, the CMA should take account of the many changes that are occurring in the electricity and gas markets, including in any recommendations or remedies that might result. These changes include: the rollout of smart metering; the introduction of Electricity Market Reform; the move to an integrated European-wide market; Ofgem's Retail Market Review (RMR) reforms; Ofgem's liquidity reforms; and initiatives to reduce the time it takes to switch supplier.

3. Scope of any market investigation reference

- 3.1. Ofgem has stated that **“a comprehensive review...should help restore consumer confidence in the working of the market”**¹. Separately, the CMA has stated that, in its first couple of years, it is likely to focus its attention on regulated sectors “because they are...a cause of public concern”². Energy UK accepts that this is the case in respect of electricity and gas markets in Great Britain. The Government has said that **“where the CMA finds competition in a market is working well it should consider whether and how to explain this to stakeholders, thereby promoting understanding and good practice as well as trust”**³.
- 3.2. To these ends, Energy UK believes that the scope of Ofgem's referral should be wide enough to convey its expectation that the CMA will look at all the main aspects of the electricity and gas markets that are causing concern, **encompassing wholesale markets, supply, and the vertical links between the two**.
- 3.3. Ofgem states that “small business customers...should fall within the scope of the proposed reference”⁴. It has consequently proposed to include non-domestic customers up to a certain consumption threshold, which reflects its revised definition of micro-businesses⁵. Some of our members have queried whether the current drafting of the terms of reference encompasses the smaller sites of large businesses, for example supermarket chains, and indeed whether Ofgem intends for them to be captured. In light of this, Ofgem may wish to revisit the drafting to ensure that it reflects its intended scope without any question of ambiguity⁶.

4. Investment, investor confidence and economic growth

- 4.1. Ofgem rightly sees the impact on investor confidence as a relevant factor in its consideration as to whether to propose an MI, noting that “significant investment is needed in the near term to ensure security of supply”⁷. The Department for Energy and Climate Change has identified the need for the UK to attract up to £110bn investment in new electricity infrastructure between 2013 and 2020⁸.
- 4.2. **Energy UK notes that timely, efficient investment helps promote economic growth. Energy UK believes that Ofgem and the CMA (as relevant) should place a high importance on the impact of what they say and do on investor confidence and economic growth in any decision to refer and throughout any MI.** In this regard, we note that the CMA has said that “in

¹ Ofgem, Consultation on a proposal to make a market investigation reference in respect of the supply and acquisition of energy in Great Britain, 27 March 2014, page 7

² Vision, Values and Strategy of the CMA, 1 January 2014, p. 13

³ Strategic Steer for the Competition and Markets Authority 2014-17

⁴ Ofgem consultation, paragraph 3.49

⁵ Ofgem consultation, paragraph 3.50

⁶ In this regard, it is worth noting that Ofgem addressed the multiple site issue in its final non-domestic RMR proposals⁶. It stated that, where a large organisation may have some individual sites that use very little energy, but where the contract as a whole is for energy use above Ofgem's micro business definition, it considers that the licence condition ‘applies to customers, not sites, and therefore it focuses on the total value of a customer's contract, rather than an individual site's characteristics.’

⁷ Ofgem consultation

⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/305860/DECC_Energy_investment_report_Web_Final.pdf

some cases the desired impact may be to...create legal certainty and send clear long-term messages”⁹.

5. Political consensus

- 5.1. In its justification for proposing an MI, Ofgem notes that “the current...political uncertainty is already creating concern among investors”¹⁰. Energy UK would like the MI to help put an end to such political uncertainty, and to this end be completed as quickly as possible.
- 5.2. Energy UK welcomes the fact that the political parties in Government and Opposition have expressed support for Ofgem’s proposal to make a Market Investigation reference. We believe that this should extend to fully supporting the CMA in its undertaking of any MI, accepting what it might conclude, and not prejudging the outcome.
- 5.3. The risk of political intervention in any MI could undermine investor confidence and complicate the efforts of the CMA. Energy UK notes that the Government has said that the CMA should play a “key role in challenging government where government is creating barriers to competition”¹¹. Energy UK believes that the CMA should consider how this challenger role might apply to political intervention in any MI.

6. Public expectations

- 6.1. In its consultation on the proposal to refer the market to the CMA, Ofgem explains that “at a time when consumers are faced with rising energy prices...there are inevitably questions about how effectively the energy market is working”¹². In this regard, it is a possibility that the public expects lower prices to be an inevitable result of any market investigation, creating the risk of an outcry should prices not fall, in turn exacerbating political risk. It is important that, in any decision to refer, Ofgem clearly communicates to all stakeholders that the purpose of a Market Investigation is to understand whether there is a feature or combination of features causing an adverse effect on competition (AEC), and the decision to refer is not based on the assumption that there is an AEC.
- 6.2. Energy UK welcomes the CMA’s statement that it will “maintain and even enhance existing high standards of transparency and engagement with those affected by our work and the wider community”¹³. **Energy UK considers that these high standards of transparency should extend to Ofgem and the CMA managing the public’s expectations about what the possible and likely impacts of an MI and any potential remedies might be.** Obviously more will be known about the likely impacts as any MI progresses. If, following an MI, the CMA concludes that political and public concerns about the state of competition have been misplaced, and that rising prices have been driven by rising costs, the CMA should undertake a determined public effort to explain those findings.

7. Investigating competition in a changing market

- 7.1. Ofgem is right to highlight that “the energy sector is on the cusp of major change”¹⁴ and to expect the CMA, in considering any reference, to take account of these changes. In its consultation, Ofgem describes a number of those changes including:
 - a) The rollout of smart metering;
 - b) The introduction of Electricity Market Reform;
 - c) The move to an integrated European-wide market;
 - d) Ofgem’s Retail Market Review (RMR) reforms;
 - e) Ofgem’s liquidity reforms;

⁹ CMA Prioritisation Principles, 1 April 2014, paragraph 4.19

¹⁰ Ofgem consultation, paragraph 5.14

¹¹ Strategic Steer for the Competition and Markets Authority 2014-17

¹² Ofgem consultation, paragraph 1.1

¹³ Ibid, p. 10

¹⁴ Ofgem consultation, page 7

- f) Initiatives to reduce the time it takes to switch supplier.
- 7.2. An additional longer-term change that Ofgem does not devote as much time to is the decarbonisation of the UK's electricity supply, and the ambition to electrify heat and transport. This will involve, amongst other things, generating more electricity from sources that produce intermittently (such as wind and solar), generating more electricity closer to where it is used, and more active customer involvement in managing demand.
- 7.3. It is worth noting that the above changes are at different stages: some, such as Ofgem's RMR and liquidity reforms, have only recently been implemented; whereas others are longer-term plans. Like Ofgem, Energy UK would expect the CMA to take account of emerging evidence about the effectiveness of these new reforms, and their impact on consumers as any investigation progresses. It is also essential that the many changes that are currently taking place in the market are fully factored into to any remedies or recommendations that might result from any MI.
- 7.4. More broadly, whilst it is clearly for the CMA to decide what the practical upshot of "taking changes into account" should be for any MI, Energy UK believes that the decision should be reflected on with great care. For instance, the CMA will need to consider whether it judges the market as it is now, as it will be, or both. Whilst recognising that an element of judgment will be required, we nevertheless urge that the CMA takes into account policy and regulatory initiatives being implemented in parallel to the investigation, including any that have not yet started.

8. Historical market rules, and how they have evolved

- 8.1. In addition to taking account of new reforms, Energy UK would expect the CMA to seek to understand what market rules have been in the past, how they have evolved, and take account of their impact on the behaviour and structure of market participants over time. For example, regulation and Government policy can constrain the ability of market participants to act in particular ways, or oblige them to act in similar ways. Regulation can also be informed by objectives other than promoting competition, and can achieve effects contrary to it.
- 8.2. Regulation can also affect companies' ability to enter the market, and grow their customer base once they have. It can do so in positive and negative ways from the perspective of new and prospective new entrants. Whilst Energy UK recognises that markets need to have some rules that are legitimate costs of trade, **Energy UK would nevertheless support the CMA examining the impact of rules such as credit and collateral requirements, social and environmental obligations, and third-party charges on barriers to entry and growth.**

9. Recent developments in household supply

- 9.1. In justifying the MI reference, and the timing thereof, Ofgem states that "there is evidence in some areas that the situation is worsening"¹⁵. To support this statement, Ofgem cites some consumer engagement metrics from the State of the Market Assessment. It is worth examining these, including the extent to which they have changed since the publication of Ofgem's consultation and therefore whether the claim of deterioration holds.
- 9.2. On the number of customers who switch supplier, Ofgem states that "switching rates have fallen year on year since 2008"¹⁶. However, statistics indicate that this decline has reversed and there has been a sustained upward trend in recent months. From November 2013 to March 2014, more customers switched supplier than in the same month the previous year¹⁷. This trend has followed the "spike in switching at the end of last year which saw the highest monthly switching rate for at least five years"¹⁸, which Ofgem itself highlights.

¹⁵ Ibid, para 4.1

¹⁶ Ibid, para 3.12

¹⁷ April 2014 was slightly lower

¹⁸ Ibid

- 9.3. The same period has seen record numbers of customers switching to small and medium sized suppliers, with the proportion increasing month-on-month to 46.88% of total change of supplier events in April 2014.
- 9.4. **As of 31 January 2014, the market shares of the small and medium-sized suppliers were the highest they have been in the 15 years of competitive markets, according to Cornwall Energy¹⁹.** As Ofgem acknowledges, this was “at over 5 per cent”²⁰ at the time of publication of its consultation, amounting to around 1.5 million household electricity customer accounts, nearly 1.2 million household gas accounts and 1.2 million household dual fuel accounts. These market shares have increased since then, in line with the Electralink figures contained in the Energy UK reports.
- 9.5. As confirmed by Cornwall Energy²¹, **the number of suppliers seeking customers in the household market is also at an all-time high.** There are now 18 dual fuel energy suppliers, three electricity-only suppliers and three gas-only suppliers that household customers can choose from.
- 9.6. Ofgem notes that, in 2013, “a large number of domestic consumers don’t switch, or switch very rarely”²², citing research which found that “62 per cent of domestic consumers could not recall switching supplier”²³. The research to which Ofgem refers is the annual consumer engagement tracking survey that it commissions from Ipsos MORI. The equivalent survey carried out in 2011 shows that only 39% of customers could not recall ever having switched gas supplier and 60% could not recall ever having switched electricity supplier. Clearly, the prospect of far fewer customers having ever switched supplier as time has passed is a logical unlikelihood. This shows that survey statistics need to be looked at very carefully in order to ensure a fair interpretation and representation.
- 9.7. Also relevant to the debate about inter-supplier switching is how easy customers find it to switch supplier. **A recent survey carried out by Ipsos MORI and commissioned by Energy UK (which is being submitted today in conjunction with this response) found that 74% found it easy to switch, with only 1 in 10 finding it difficult. The same survey found that 59% of customers find it easy to deal with their energy supplier, with only 7% saying it is difficult.**
- 9.8. Ofgem states that “overall satisfaction and trust in suppliers is low and has continued to fall”²⁴, citing research that found that “43 per cent of domestic customers distrust energy companies to be open and transparent in their dealings with consumers”²⁵. In contrast to this, the survey carried out by Ipsos MORI for Energy UK paints a more positive picture. **Ipsos MORI found that only 15% of customers distrusted suppliers to be open and transparent in their dealings with customers, with 48% trusting them to do so.** There could be a number of explanations for the disparity between the two sets of findings, for example that the latter (Energy UK) survey asked each customer about their supplier, whereas Ofgem’s survey asked about suppliers generally. The fieldwork for Ofgem’s survey was carried out in March 2013, whereas that for the Energy UK survey was carried out around a year later in February and March 2014. Whatever the reason for the difference between research findings, it appears that consumer confidence in suppliers is higher than Ofgem portrays.
- 9.9. With respect to consumer trust in suppliers, other relevant findings from the Ipsos MORI research, which was carried out between 21st February and 10th March 2014, include:
- a) 55% of customers trust suppliers to provide them with a service that meets their needs, with 1 in 10 distrusting them to do so;

¹⁹ <http://www.energy-uk.org.uk/publication/finish/5-research-and-reports/1061-cornwall-energy-competition-in-british-household-energy-supply-markets-report-march-2014.html>

²⁰ Ibid, para 3.16

²¹ Cornwall Energy, *Competition in British household energy supply markets*, March 2014, page 5

²² Ibid, para 3.13

²³ Ibid, para 3.13

²⁴ Ibid, para 3.11

²⁵ Ibid, para 3.11

- b) 40% trust suppliers to deliver value for money, with 19% distrusting them to do so; and
- c) 59% trust suppliers to provide an accurate bill, with 11% distrusting them to do so.

9.10. More generally, we hope that any MI will contribute to restoring consumer confidence in suppliers and the electricity and gas markets as a whole.

10. Wholesale electricity

10.1. To help improve visibility of wholesale electricity prices, from February this year Energy UK has been publishing monthly market reports, which include information on churn ratios. We attach the April edition of the report as an example. As the graphs in the report demonstrate, there is a greater volume of trades for near term delivery (day ahead, month ahead) than in the longer term (season ahead, year/s ahead).

10.2. Liquidity is important for competition in the supply and generation market because it is a determinant of:

- a) The degree to which suppliers are able to access the products they need to meet the shape of their demand;
- b) The degree to which generators are able to find willing buyers in the market for the electricity they generate; and
- c) How easily new entry to the supply and generation markets is facilitated.

10.3. Ofgem should recommend that, as part of any MI, the CMA look at how liquidity is benchmarked. Indicators might include the size of the trades, the volume traded and the availability of certain types of products and trades, in the day-ahead and forward markets, and between different types of parties, though this is not an exhaustive list. Ofgem should also recommend that the CMA examines other issues that may affect the willingness or ability of parties to trade, including credit or collateral barriers, or policy or regulatory uncertainty.

10.4. In any MI, the CMA will need to examine the impact of Ofgem's Secure and Promote measures to improve liquidity in the wholesale market went live on 31 March 2014. Two daily trading windows have been introduced as well as specific Market Making requirements for the obligated parties in terms of bids and offers. As part of any MI, the CMA will need to determine the adequacy of these changes to address any issues with liquidity that it may identify.