

# Making markets work for consumers

Dermot Nolan

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ofgem

# Energy is an essential service

- Economic competitiveness, growth and jobs and every one of us as consumers depend on a secure, reliable, sustainable and affordable power supply every second of every day
- So our challenge as the regulator is to ensure that the energy market works in the interest of consumers

# Ofgem's State of the Market Findings

1

## Weak Customer Response

- Evidence that customer activity in the market is low, and trust is low, which is preventing the process of competition from working effectively.

2

## Incumbency Advantages

- Suppliers with large customer base when competition was introduced continue to charge higher prices to less active customers.

3

## Possible Tacit Co-ordination

- We found no evidence of direct co-ordination, but there is evidence of possible tacit co-ordination, which can weaken competitive rivalry.

4

## Vertical Integration

- A full investigation of the balance between the costs and benefits of VI is needed to determine what is best for this market.

5

## Barriers to Entry and Expansion

- Barriers identified in SOM report included credit and collateral requirements, low wholesale market liquidity, extensive industry regulation, and policy uncertainty.

***Ofgem's findings were broadly aligned with the CMA's initial four Theories of Harm***

- Ofgem referred energy market to CMA in June 2014
  - We have a statutory duty to support the investigation and to provide expert advice
- CMA published updated statement of issues and theories of harm on 18 February 2015
- Provisional conclusions due in May/June
- Final report due by Christmas

# The CMA's updated theories of harm

- 1 the market rules and regulatory framework distort competition and lead to inefficiencies in wholesale electricity markets
- 2 market power in electricity generation leads to higher prices
- 3a opaque prices and low liquidity in wholesale electricity markets distort competition in retail and generation
- 3b vertically integrated electricity companies act to harm the competitive position of non-integrated firms to the detriment of the consumer, either by increasing the costs of non-integrated energy suppliers or reducing the sales of non-integrated generating companies
- 4 energy suppliers face weak incentives to compete on price and non-price factors in retail markets, due in particular to inactive customers, supplier behaviour and/or regulatory interventions
- 5 the broader regulatory framework, including the current system of code governance, acts as a barrier to pro-competitive innovation and change.

- Generation and Vertical Integration – first 3 theories of harm initially proposed by CMA
- Initial views would suggest CMA does not see major competition issues in generation markets
- On vertical integration – seems to indicate no major evidence of foreclosure effects
- Ofgem perspective is that it would like clear conclusions on these issues

- Retail – theory of harm 4
- Main focus on unilateral effects particularly for those on standard variable tariffs
- Codes – theory of harm 5
- Question as to whether system and framework of industry code system acts as barrier to entry/expansion

- We'll work with any remedies chosen by the CMA
- We believe that effective competition is the best way to deliver consumer benefit
- We hope for:
  - definitive answers to key questions (eg vertical integration)
  - a dynamic competitive market with active, satisfied customers
  - a regulatory framework that will help us to protect consumers and remove barriers to competition and
  - minimal disruption to investment



- Climate change, smart metering and new entrants to the market mean the energy market is changing dramatically and will continue to do so
- We want to foster innovation, to encourage new ideas and products
- Smart meter roll-out – energy will be supplied and bought in different ways
- We want to create conditions for further competition for the right to build, own and run new assets onshore and use network regulation to promote diversity and competition (eg from connections policy to pricing policy)
- We want to facilitate innovation while ensuring that customers are treated fairly

- We are keen to encourage non traditional business models (businesses that have diverse motivations (technological, social and environmental as well as financial) and different ownership arrangements)
- We have published a discussion paper as the start of a longer term engagement on NTBMs. We want to understand better the drivers , consumer benefits and risks
- We are interested in how they can transform the energy market and how regulation may impact upon them now and in future

- We welcome the industry's acknowledgement that it must do more for its consumers:
  - Indeed, Ian, sitting next to me here, said more recently that *'there's no denying our sector has not always got it right for our customers...In the past, too often there have been poor behaviours right across most of our sector.'*
  - Paul Massara of npower said at the end of 2013 *'we've let many of our domestic customers down.'*
  - ScottishPower's Neil Clitheroe says that *'In the last 12 months, we have struggled to maintain the standards of service that we usually strive for.'*
- We need to see a shift in leadership, both **by** energy businesses to improve service and rebuild trust, and **within** businesses to embed values and practice which will drive more customer focused outcomes from the top of the organisation

- In August 2013 we introduced our Standards of Conduct with the aim of making the market **fairer**
- The SOC use a principles-based approach and require suppliers to embed the overarching objective of “treating consumers fairly”
- They outline outcomes of fair treatment in 3 broad areas: behaviour, information & process
- This certainly isn’t “light touch” - it’s about more effective regulation which is simpler and clearer and it’s about changing cultures
- But we also believe that a simpler regulatory framework will help smaller new entrants for whom the burden of detailed codes is that much greater

From prescription to principles (where possible!)

- We want to build on SOC so that over time we can rely much more on general principles of behaviour than on detailed rules
- We will be engaging with consumers, suppliers and other stakeholders to discuss this new approach
- Above all we are thinking about what kind of regulation the future energy market needs to deliver our 5 key outcomes:



**Ofgem is the Office of Gas and Electricity Markets.**

**Our priority is to protect and to make a positive difference for all energy consumers. We work to promote value for money, security of supply and sustainability for present and future generations. We do this through the supervision and development of markets, regulation and the delivery of government schemes.**

**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.**