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Response to the CMA's Provisional Findings and Notice of Possible Remedies

We referred the energy market to the CMA because we have long been concerned that competition is not working as well as it could for consumers. We welcome the CMA's Provisional Findings and Notice of Possible Remedies, and the thorough analysis the CMA has conducted on the market. The adverse effects on competition (AECs) you have identified largely reflect our own concerns about the problems in the market. We will provide you with our full support in developing an effective, coherent, achievable and forward-looking package of remedies for the benefit of consumers.

The CMA's findings are provisional and you will obviously need to consider the views of stakeholders. Nevertheless, on the basis of the information published by the CMA, we consider that the evidence would support confirmation of these findings in due course. This letter sets out our initial thoughts on some of the possible remedies being considered by the CMA.

Addressing the problems in the retail market

We strongly agree with the CMA's analysis on weak customer response and the presence of unilateral market power over inactive customers in the domestic retail market. The domestic retail market features a large number of inactive customers, an uneven distribution of such customers across suppliers, with the majority remaining with legacy suppliers, and the ability of suppliers to easily segment the market between sticky and active customers. The combination of these factors weakens competitive pressure between incumbent suppliers and creates barriers to entry and expansion for independent suppliers.¹ The CMA's analysis confirms that this effect is a significant impediment to competition. We agree that addressing the issues you have identified in the retail market should be the central focus of the final remedies package.

To protect the interests of disengaged consumers, the CMA proposes the introduction of a transitional safeguard tariff. We understand the rationale behind this proposal. If the CMA decides to proceed with this remedy, we will provide all the support we can in the development of its detailed design. In general, our view is that consumers' interests are best protected by effective competition. For this reason, we would like to explore with the CMA how to ensure that any safeguard tariff is tightly targeted, and is accompanied by effective measures to encourage consumers to engage in the competitive market. It is also

¹ Ofgem (2015): Incumbency in the retail energy market, Submission to the CMA

important that any safeguard tariff is transitional: a key element of its design will be a plan for exiting from the tariff at the appropriate time.

Your notice of possible remedies considers whether a safeguard tariff should apply to the microbusiness market, as well as the domestic market. There are important differences between the domestic and microbusiness markets which add complexity to the safeguard tariff design. For example, setting an appropriate level for the safeguard tariff in the microbusiness market is likely to be particularly challenging, bearing in mind the wide range of costs associated with serving different types of microbusiness consumers. We are keen to work with the CMA to consider these challenges further.

Promoting engagement in the retail market

As part of the package of retail market remedies, the CMA proposes to remove the 'simpler choices' rules introduced by Ofgem as part of the Retail Market Review (RMR). We respect the CMA's view that these rules have limited the products available to consumers and competition, including competition between price comparison websites. We will work with the CMA to support the detailed consideration of how supply licences should be amended.

We agree with the CMA that price comparison websites (PCWs) can play a key role in helping consumers to engage in the market. The CMA envisages a market in which part or all of the 'simpler choices' component of the RMR has been removed, where there is no whole-of-market requirement on PCWs, and in which PCWs compete with each other by securing exclusive tariffs from suppliers. In this context, trusted sources of information will become even more important. There are a number of possible ways to achieve this, including an Ofgem-run price comparison service, and we are keen to work with you to explore these options. The PCW market is dynamic and is likely to evolve over time, especially with the roll-out of smart meters. It is important that the regulatory regime does not constrain innovation and competition in this market.

We have been concerned that complexity can be a barrier to accessing and assessing information in the market. We would therefore like to support the CMA's consideration of how such barriers can be overcome. As well as exploring how PCWs and other intermediaries can help consumers navigate the market, it may be worth considering whether there is a role for rules based on principles in addressing complexity. Furthermore, it is important to consider how to promote engagement among harder to reach consumer groups, such as those without internet access or who do not have the confidence they will get the right deal from using a PCW.

We agree with the CMA that once they are rolled out, smart meters could be central to promoting engagement in the market. We share the objectives of maximising the benefits of smart meters as quickly as possible, and aim to ensure all consumers are settled on a half-hourly basis soon after the roll-out of smart meters. To meet this timetable, we will work with DECC in the coming months to develop a plan for the implementation of half-hourly settlement. This plan will need to take into account the other significant changes in train in the industry, including the smart meter roll-out and the move to next day switching.

Microbusinesses

The CMA's analysis of the microbusiness market provides evidence of significant detriment to these consumers. The profitability analysis is particularly informative and reinforces some of the concerns we have had. We are very supportive of the CMA's proposed remedies in this area. In particular, we welcome the CMA's proposal to introduce further price transparency for microbusiness consumers. We believe an initiative of this type has the potential to have a transformative impact on engagement and could support the development of services such as price comparison websites for microbusinesses.

In developing the final remedies package in relation to microbusinesses, it would be helpful for the CMA to consider how some of the proposed remedies will interact with the current objections processes and rules in this market, which can form a barrier to switching. More generally, the microbusinesses market has some unique characteristics that must be borne in mind in the design of potential remedies: for example, unlike domestic consumers, there is no duty to supply microbusinesses and there is significant scope for contract negotiations between customers and suppliers. We will be happy to discuss these issues with you in more detail.

Industry governance and the regulatory framework

We strongly agree with the CMA's conclusion that the current code governance regime, including the limited incentives that incumbent players have to promote and deliver change that could benefit consumers, gives rise to an AEC. We believe there are changes to the industry governance regime that can address these issues, building on the options you set out in your notice of possible remedies. A reformed set of institutions would be central to ensuring that the regulatory regime is able to respond to the innovation and change the industry is going to see in the coming years. We look forward to discussing these changes with you in more detail.

In a similar vein, we welcome the CMA's analysis on the place of competition in our statutory duties and on the respective roles of Ofgem and DECC in energy policy making. We see the Strategic Policy Statement (SPS) as one important route for providing more clarity over our respective roles. We look forward to exploring this area further with the CMA and DECC.

Wholesale markets

We agree with the CMA's assessment that there are no features in the wholesale gas market that give rise to an AEC, and there are no significant issues associated with market power in the wholesale electricity market. These conclusions echo our own analysis on these issues. We will continue to monitor the wholesale markets closely for signs of competition problems and will take action where necessary.

We also agree that the current system of self-dispatch in the wholesale electricity market is fit for purpose and that other models of market design do not provide clear advantages in terms of fostering a more effective competitive environment.

The CMA's analysis finds that the absence of locational pricing for transmission losses gives rise to an AEC. We agree in principle that locational losses could improve price signals and the efficiency of investment in generation. Further analysis would be needed to fully understand the costs and benefits of such a change. We would like to support the CMA's consideration of these issues.

Vertical integration and transparency

Vertical integration has been the focus of much attention in the energy market, and gaining a greater understanding of its impacts on competition was a key rationale for our referral of the market. We welcome the CMA's analysis of wholesale market liquidity and foreclosure and note your overall conclusion that vertical integration is unlikely to be detrimental to competition in the energy market, and may give rise to efficiencies that could be passed on to consumers.

We agree with the CMA that transparency in this aspect of the market is important, and note the CMA's suggestion that a new 'market-orientated' regulatory accounting framework could be introduced for the large vertically-integrated energy suppliers. Ofgem has taken steps in this direction through requiring the large vertically integrated firms to produce

Consolidated Segmental Statements (CSS). We are keen to work with the CMA on the best ways to provide more information about the large vertically-integrated suppliers, including providing greater visibility of trading activities, as well as how we could overcome some of the practical challenges and potential burdens we have encountered when we have considered extending the CSS rules. It may be that the CMA's additional legal powers provide a route to overcoming these barriers. In any event, the potential benefits of developing a new set of transparency rules need to be balanced against the potential costs and burdens on industry.

Concluding remarks

The CMA's Provisional Findings conclude that there is a range of features in the energy market which give rise to adverse effects on competition and that change is needed to deliver effective competition for consumers. As you finalise the design of the remedies in the coming months, it will be important to consider the most effective implementation routes in each case – for example, whether the remedies should be delivered directly by the CMA or through a recommendation to Ofgem or other parties. Furthermore, it will be important to develop an effective plan for monitoring and evaluating the impact of remedies once they are in place. Ofgem's ongoing role in monitoring the market – for example the annual survey we conduct as part of our RMR evaluation and our regular collection of market data – means we are well-placed to help you devise this plan.

I would like to end by reiterating that we welcome the CMA's Provisional Findings and we are fully committed to supporting you in developing remedies that can improve market outcomes for energy consumers.

Yours sincerely,

Rachel Fletcher
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