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Email to: effectivecompetition@ofgem.gov.uk

Developing a framework for assessing whether conditions are in place for effective competition in domestic supply contracts

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, storage, and energy supply to end users. We have around five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy welcomes the opportunity to provide views on Ofgem's proposed framework for undertaking its assessment of whether conditions are in place for effective competition in the domestic market, as required under the Domestic Gas and Electricity (Tariff Cap) Act 2018. We are supportive of Ofgem engaging early with stakeholders in the design of an assessment framework that is fit for purpose, as per the requirements placed on Ofgem under the Tariff Cap Act. It is also essential that this engagement continues throughout the assessment period to ensure that Ofgem has an accurate view of the operation of the market, including the impacts of the current regulatory framework.

EDF Energy remains convinced that healthy and robust competition is the best way to serve customers' needs over the longer term. It is welcome that in this discussion paper Ofgem acknowledges the need for a well-functioning competitive market to include the ability for efficient suppliers to be able to finance their activities; and that suppliers should be able to make a reasonable level of profit given the range of activities that they undertake. An effective and thriving competitive market, delivering in the best interests of consumers, requires business models to be sustainable in the long term.

EDF Energy observes that, while the energy supply market is experiencing high levels of new entry, there is a question mark regarding the quality of some of these new competitors, and the sustainability of their business models. A market that includes companies with unsustainable business models undermines effective and fair competition, damages consumer trust, and risks real consumer detriment.

Ofgem's assessment of the market conditions, and ultimately its recommendation to the Secretary of State, will inevitably be an exercise of judgement as well as analysis. Given the significance of the matter in hand, Ofgem's conclusions will have important implications for both suppliers and consumers and must be subject to appropriate scrutiny. Therefore, we reiterate that it is essential that Ofgem commits to undertaking

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further engagement and consultation with stakeholders prior to making its recommendation, in line with good regulatory practice. We recommend that Ofgem should promptly set out a clear timetable for this engagement.

Our responses to the questions raised by Ofgem within the discussion paper are set out in the Attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Steven Eyre on 0208 186 1356, or myself on 07875 112625.

Yours sincerely,

A handwritten signature in black ink that reads "R. Beresford".

Rebecca Beresford
Head of Customers Policy and Regulation

Attachment

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EDF Energy's response to your questions

Q1. Are there any features of effective competition that are not covered in our definition?

EDF Energy accepts that there is no consistently applied definition for 'effective competition' that is used by either UK or EU regulatory and competition authorities. On this basis we are supportive of Ofgem using a bespoke definition that is drawn on well-established concepts of 'effective competition'. We also support Ofgem's view that the specifics of the price cap should not necessarily set a precedent for defining and assessing 'effective competition' in other regulatory contexts.

In terms of the proposed definition set out in the discussion paper, we are broadly supportive. However, unambiguous clarity is required as to how Ofgem plans to interpret the concept, and assess the presence of, 'good outcomes for most consumers'. In particular, the inclusion of the term 'good outcomes', is clearly highly subjective and an unestablished concept and therefore the use of this term does not support Ofgem's stated aims. Ofgem should instead adopt the concept of 'fair outcomes' which would be consistent with the standards Ofgem expect suppliers to meet via its licence obligations; and would allow it be applied to all consumers rather than 'most'.

We fully agree that the definition must recognise that there are factors other than price that are important and valuable for consumers, including quality of service. We propose that the definition should be expanded to allow for the inclusion of additional factors such as tariff choice, added services and environmental benefits.

We note that Ofgem has included the term 'rigorous rivalry'. We propose that the inclusion of 'vigorous rivalry' would be more appropriate to the extent that effective competition involves strong and healthy rivalry across suppliers to win and retain customers.

Q2. What are your views on the conditions for effective competition we have proposed? Are they clear and is there anything else you think we should take into account?

We are broadly supportive of the inclusion of conditions for effective competition relating to structural change and the competitive process. We provide further comments on these in our response to subsequent questions. However, as set out above we are concerned with the inclusion of a condition titled 'Good Outcomes' and believe a more proportionate

approach would be to assess whether consumers are in receipt of 'fair outcomes'. Use of the terms 'good' and 'best' outcomes are highly subjective and open to broad interpretation which is counter to Ofgem's transparency principle which should be guiding its framework. While we accept that assessing 'fair outcomes' also involves a degree of subjectivity, it is an established concept that suppliers are already subject to and better understand and may therefore be easier to assess and measure.

We share Ofgem's objective that the market should deliver 'good outcomes' for consumers; yet, recognising that this is dependent on having a regulatory framework in place that facilitates sustainable business models. The use of 'fair outcomes' would be a better way of reflecting this balance. Overall, we would welcome the opportunity to engage further with Ofgem about how it will interpret such broad concepts, including how it will determine whether the conditions have been satisfied or not.

It is welcome that in this discussion paper Ofgem acknowledge the need for a well-functioning competitive market to include the ability for efficient suppliers to be able to finance their activities; and that suppliers should be able to make a reasonable level of profit given the range of activities that they individually undertake. An effective and thriving competitive market, delivering in the best interests of consumers, requires business models to be sustainable in the long term.

EDF Energy observes that, while the energy supply market is experiencing high levels of new entry, there is a question mark regarding the quality of some of these new competitors, and the sustainability of their business models. A market that includes companies with unsustainable business models undermines effective and fair competition, damages consumer trust, and risks real consumer detriment.

There is a balance to be struck between minimising undue barriers of entry and ensuring that new entrants are suitably prepared, resourced and fit to operate in the market. Up until recently, Ofgem's licensing approach was overly focussed on reducing barriers to entry and in some cases resulted in ill-prepared entities entering the market, to the detriment of customers and to effective competition in the market as a whole. We have therefore actively supported Ofgem's reform to market entry, including the need for increased scrutiny of new entrants, and in particular on applicant funding arrangements.

Ofgem's assessment of the operation of the market must robustly explore financeability at a licensee level and not only in the part of the business that is captured by the tariff cap. In making this assessment it is essential that a range of suppliers and existing business models, beyond the traditional large six energy suppliers, are analysed. Extending the requirement to produce segmental accounts to a wider pool of suppliers would assist Ofgem in this respect.

As part of Ofgem's assessment of the conditions for effective competition, Ofgem should review the extent to which the current regulatory framework is distorting or preventing competition. Healthy competition exists where there is an established level playing field. Therefore, distorting policy exemptions must be removed and robust financial standards put in place to ensure that all suppliers bear an appropriate share of the risk that they

impose on the wider energy system e.g. via mutualisation. This should also be supported by ongoing comprehensive monitoring of the financial resilience of all suppliers to give visibility of the sustainability of suppliers' business models and protect the long-term interests of consumers.

In terms of Ofgem competitive process assessment, we agree that Ofgem must establish whether there is any collusion, abuse of market power or other practices that may distort competition. In determining whether this requirement is satisfied, Ofgem must establish whether there is any evidence of such practices rather than attempting to prove a negative i.e. that there are no cases. It is currently unclear how Ofgem could achieve this measure as drafted.

Q3. What are your views on the structural changes that we propose to include in our framework? Are there any specific changes you think we should consider?

We consider that the list of structural changes Ofgem propose to include appear appropriate. However, this will inevitably be a dynamic exercise and so other changes may require consideration particularly in respect of how the Future Energy Retail Market Review evolves.

We recognise that assessment of the smart metering programme is a requirement on Ofgem under the price cap legislation. In terms of Ofgem's assessment of how the programme is progressing, the consumer outcomes being achieved and the extent to which smart meters are facilitating beneficial innovation, it is important that the latest view of the post 2020 regulatory framework is taken into consideration.

It is also important that Ofgem's assessment is of the direction of travel for a number of market reforms (e.g. faster switching, half-hourly settlement and smart programme etc.) rather than determining whether they have been successfully delivered. Many of the reforms are not scheduled to be in place until 2023 and so an over simplified view of the implementation status will not reflect the progress that is already being made towards the objectives and achievement of customer benefits.

We acknowledge the need for Ofgem to consider the CMA's suite of remedies as set out in its Energy Market Investigation decision. However, Ofgem must also consider the extent to which alternative market initiatives have delivered the intended objectives of specific remedies, or are in progress to do so.

Q4. Are there any indicators of the competitive process not listed here that you think we should consider in our analysis?

It is appropriate that Ofgem assesses a wide range of indicators to determine the effectiveness of competition across the three broad categories (market structure, consumer behaviour and supplier performance). However, additional clarity is required

regarding the final list Ofgem proposes to use, including the reasoning for each indicator's inclusion, benchmarks to be considered, and how they will be weighted in the overall assessment.

Ofgem should only use indicators that are relevant to the decision to remove or extend price protection for default customers. For instance, it is unclear why the number of in-home displays installed alongside smart meters is a relevant factor in an assessment of the presence of conditions for effective competition.

We broadly agree that it would be inappropriate to set fixed targets or thresholds for every indicator given the clear interdependency between some of them and the fact that some may well have been impacted by the presence of the price cap.

However, greater clarity on how Ofgem will interpret such evidence is required, especially as this will fundamentally be an exercise of judgement. For instance, it is unclear whether some of the indicators would, as part a competition assessment, be seen as a positive or negative. One such example is the number of SoLR events and whether Ofgem would see this as a positive indication, particularly when it is widely acknowledged that both entry and exit is standard feature of competitive markets.

It is also unclear what Ofgem will determine as 'good' in terms of the consumer behaviour indicators, such as the proportion of customers satisfied with billing and contacting suppliers. One option would be for Ofgem to use relevant comparators in other markets as a means of judging whether energy consumers are benefiting from effective competition.

Ofgem should supplement the consumer behaviour indicator list by including consumer views on the ease of price comparison and switching, rather than limit such consideration to the number of internal or external switched completed.

Q5. What are your views on the consumer outcomes that we propose to assess in determining whether the conditions are in place for effective competition?

Price differentials are a natural feature of competitive markets and their mere existence is not in itself a signal of a poor functioning market. As referenced in Ofgem's discussion paper, the Centre for Competition Policy has argued that the presence of price discrimination does not mean that there is something automatically wrong with the functioning of the competitive process and the CMA has also argued that there are positive benefits to consumers of introductory pricing.

We would therefore encourage Ofgem to provide further visibility of how price differentials will be used to reach conclusions about the level of competition in our market. As part of this process, Ofgem should consider the various reasons for price differentials, including differences in costs to serve diverse customer portfolios, regulatory advantages, entry and growth strategies (including unsustainable pricing), investment strategies and risk management.

We note that Ofgem refers to 'lower price' but provides no clarity as to how this will be assessed, including what it will be compared to. It is important to be clear that low prices do not necessarily coincide with good outcomes, and can reflect poor quality of customer service, limited choice, and unsustainable pricing behaviour by suppliers. Recent supplier exits from the market have in some instances occurred primarily due to the adoption of low pricing strategies that have left parties unable to meet their obligations and resulted in their failure, cost mutualisation and customer detriment.

Price levels are impacted by many factors outside the control of suppliers including those attributable to the recovery of government social and environmental schemes. However, not all consumers pick up the costs of such schemes due to supplier exemptions. Such exemptions should be removed to level the regulatory playing field and ensure all consumers pay their fair share of such costs.

We agree that trust and confidence is a relevant broad factor and should be evaluated as part of this framework. However, it is important Ofgem considers what would constitute a relevant benchmark in this respect. Consistent with our previous comments above, comparisons with other markets may be a valid indicator to consider.

Q6. Is there any other aspect of effective competition that the framework should consider?

As highlighted above, there is a need to consider whether the regulatory framework is restricting or distorting competition. This consideration should include an assessment as to whether the imposition of the price cap itself has had positive or negative effects on the market, including the extent to which it has constrained competition or innovation. This should include due consideration of the sustainability of businesses operating under the price cap. Ofgem is currently considering implementing ongoing monitoring arrangements on suppliers that would allow greater and more effective visibility of the financial resilience of all suppliers over time. If implemented, the results of this monitoring would aid Ofgem's assessment of the impact of the cap on supplier performance.

EDF Energy

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