

Maureen Paul
Office for Research and Economics
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

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Dear Maureen,

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

Thank you for the opportunity to provide views on this framework. We welcome Ofgem giving early consideration to the criteria for removing the cap. The fact that many suppliers, large and small, are expected to make losses this year, with several seeking to exit the market, illustrates the difficulty faced by Ofgem in setting the cap at a sustainable level – and the desirability of removing the cap as soon as the conditions are right.

Our answers to the consultation questions are in Annex 1 to this letter and our main points are as follows:

- We consider the definition of effective competition to be a reasonable starting point but it requires further refinement. In particular, we disagree that competition should necessarily result in good outcomes for *most* consumers. Competition is generally very effective at delivering good outcomes for consumers in aggregate (through greater efficiency, choice, innovation etc) but may not deliver desired distributional outcomes (such as ‘fairness’). In assessing whether it is appropriate to lift the price cap, the question should be whether competition, complemented by other targeted consumer protection regulations, will be sufficient.
- We agree that progress with industry ‘structural changes’ (faster more reliable switching, smart meter rollout, etc) will be a key consideration; indeed it will be difficult to argue that conditions have moved on sufficiently without reference to these programmes. However, we would caution that some of the programmes listed by Ofgem will take many years to complete and may not be *necessary* for effective competition. Ofgem’s assessment framework should therefore avoid creating artificial preconditions (such as achievement of particular milestones), but instead be forward looking, considering momentum and overall direction of travel.
- As part of the overall assessment, Ofgem should be balancing the risks of removing the cap against the risks of retaining it. The latter include the risks of distorting market participants’ incentives, gaming, lower efficiency and weakened customer engagement. We would encourage Ofgem to consider the evidence for adverse impacts of the cap alongside the assessment of conditions for effective competition.

If and when Ofgem is able to make a case to the Secretary of State (SoS) for removing the cap, it will be more persuasive if it can also point to the risks to consumers of not removing it.

- We are concerned about the apparent lack of opportunity for further consultation on the detailed metrics to be monitored in the 'framework' or indeed the methodological approach for weighting and balancing all the various indicators and arriving at an overall assessment. In the interests of transparency and good regulatory practice we think Ofgem should consult:
 - on the proposed 'final framework' in October 2019, including an explanation of how feedback on this consultation has been incorporated;
 - on the 'first assessment' due May/June 2020, so that consultation responses can be reflected in the required recommendation to the SoS.
- We believe Ofgem has proposed sufficient indicators of the competitive process in this framework. However some of the indicators, as we explain in Annex 2, require more context in terms of how they relate to the competitive process.

Please do not hesitate to contact me or James Soundraraju (tel 0141 614 2421, jsoundraraju@scottishpower.com) if you have any questions arising from this response.

Yours sincerely,



Richard Sweet
Head of Regulatory Policy

DEVELOPING A FRAMEWORK FOR ASSESSING WHETHER CONDITIONS ARE IN PLACE FOR EFFECTIVE COMPETITION IN DOMESTIC SUPPLY CONTRACTS – SCOTTISHPOWER RESPONSE

Question 1: Are there any features of effective competition that are not covered in our definition?

Ofgem defines competition to be effective if “it involves rigorous rivalry between firms to win and to retain customers, and it results in good outcomes for most consumers in terms of what matters to them (eg price and quality of service)”.

We consider the definition to be a reasonable starting point but it requires further refinement. In particular, we disagree that competition should necessarily result in good outcomes for *most* consumers. Competition is generally very effective at delivering good outcomes for consumers in aggregate (through greater efficiency, choice, innovation etc) but may not deliver desired distributional outcomes (such as ‘fairness’). In assessing whether it is appropriate to lift the price cap, the question should be whether competition, complemented by other targeted consumer protection regulations, will be sufficient to deliver good outcomes for most consumers in terms of what matters to them (eg price and quality of service).

As per the CMA observation quoted by Ofgem (Appendix 2, Table 1), effective competition creates the right environment for new services and innovation and will *usually* lead to the best outcomes for consumers. Ofgem’s definition also ignores the lag in achieving results implicit in the process of discovery (of efficient methods of production and what customers want) that Stephen Littlechild articulates in his description of the properties of effective competition¹. Therefore, we think it would be helpful if Ofgem could include some explanatory text around its definition to bring out some of these points.

Question 2: 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?

Ofgem lists three broad conditions for effective competition that it proposes to assess.

- Condition 1: structural changes are facilitating or can be expected to facilitate the competitive process;
- Condition 2: the competitive process is expected to work well in the absence of the cap; and
- Condition 3: competition is expected to deliver good outcomes for most consumers, including those who are less-active in the market.

In general, we agree with the perspective of the Centre for Competition Policy (CCP) who state that, “what constitutes “effective competition” and what “conditions” are required for this

¹ Littlechild, S (2011), “The Nature of Competition and the Regulatory Process”, in “Effective Competition’ in Telecommunications, Rail and Energy Markets”, *Intereconomics* 2011, 1.

to occur are inherently uncertain and may change through time”². Although we understand the need for Ofgem to propose conditions for the purpose of its assessment, it needs to be borne in mind that these conditions may not always capture the whole picture.

We welcome the recognition in Condition 1 that structural changes do not need to be in place, but rather that they *can be expected to be* in place. The structural changes Ofgem is considering (smart metering, CMA remedies, Ofgem-led programmes and Future Energy Retail Market Review) are long-term and complex programmes of work which are likely to experience delays and evolve for technical reasons – as has been the case with the smart metering programme. Indeed, paragraph 3.14 indicates that Ofgem recognises this possibility as it states that, “Structural changes, including the smart meter programme and related innovations, *should* be progressing well”.

Ofgem expands on Condition 2 in paragraph 3.19 where it states that, “there should be no collusion between firms; abuse of market power or other practices that distort competition”. We would suggest that this reference could be amended to state that, “there should no *evidence* of collusion...”, to avoid implying that Ofgem needs to prove the absence of such practices. (The CMA’s EMI concluded that there was no evidence of tacit collusion, but only after a fairly exhaustive investigation.)

Condition 3 implies that competition alone can be expected to deliver good outcomes for *most* consumers, including less active customers. As noted above, we think the reference to ‘most’ could set the bar too high and does not reflect the fact that competition will not in general deliver distributional outcomes such as ‘fairness’ (though it is extremely effective at delivering good outcomes for consumers in general). It is important that Ofgem does not in its final assessment conclude that the ‘conditions for effective competition test’ is not met, if the test could otherwise be met in the presence of alternative and less intrusive interventions (eg protections targeted at vulnerable consumers).

Question 3: 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?

Ofgem proposes to consider smart metering, CMA remedies, Ofgem-led programmes, Future Energy Retail Market Review and, as stated in paragraph 4.5, “other market developments that could affect the demand- and supply-side of the market”.

We agree that progress with industry ‘structural changes’ (faster more reliable switching, smart meter rollout, etc) will be a key consideration; indeed it will be difficult to argue that conditions have moved on sufficiently without reference to these programmes. However, we would caution that some of the programmes listed by Ofgem will take many years to complete and may not be *necessary* for effective competition. Ofgem’s assessment framework should therefore avoid creating artificial preconditions (such as achievement of particular milestones), but instead be forward looking, considering momentum and overall direction of travel.

It is unclear which of the CMA’s remedies Ofgem is proposing to consider in its review. There are certain remedies in Ofgem’s CMA Remedies Implementation Plan³ that are

² David Deller, Elizabeth Errington, Amelia Fletcher, Morten Hviid, David Reader & Catherine Waddams [response](#) to BEIS Committee: Pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill inquiry, December 2017

³ <https://www.ofgem.gov.uk/publications-and-updates/cma-remedies-implementation-plan>

behind schedule or appear to be evolving and may no longer be relevant (eg remedies in the 'robust and independent regulator' section of the plan).

The inclusion of a 'catch-all' statement that Ofgem will also review "other market developments" introduces uncertainty. We do not think such a statement is necessary as Ofgem is already considering the key structural reforms over the medium-term and there are options available to Ofgem, such as an open letter consultation, if it wishes to add more market developments to the framework at a later point.

Question 4: Are there any indicators of the competitive process not listed here that you think we should consider in our analysis?

Ofgem has three broad categories of indicators it proposes to monitor and assess: market structure indicators; measures of how consumers are responding to market developments; and indicators of supplier performance.

We think the list of indicators provided in Appendix 3 of the consultation document is reasonably comprehensive and there are no obvious gaps, but some clarification would be helpful; we provide views on each indicator in Annex 2.

In general, we agree with Ofgem's approach of not setting specific thresholds on the indicators that it will monitor and to consider these indicators in the round, rather than one-by-one in a tick-box fashion. However, the discussion paper does not provide any clarity on how Ofgem proposes to weigh up the indicators or the methodology it will adopt for arriving at a balanced judgement in its assessment. This is another reason why we feel it is appropriate for Ofgem to consult on the framework before finalising it in the Autumn.

Question 5: What are your views on the consumer outcomes that we propose to assess in determining whether the conditions are in place for effective competition?

The consumer outcomes Ofgem proposes to assess are categorised under the themes of 'Price and price differentials', 'Quality of service', 'Tariff choice', 'Switching process' and 'Trust and confidence'.

In respect of 'price and price differentials' Ofgem says "we will also consider the extent of price differentials between the tariffs that engaged and less active consumers face". We agree that it is important to consider this metric, given the level of public concern over the size of the differential, but we would note two points:

- Ofgem must recognise that for competition to be effective there needs to be some reward to customers for taking the time to survey the market and shop around. The presence of a reasonable differential should not therefore be seen as evidence of ineffective competition. The presence of a very wide gap may be indicative of a weakness of competition, but it may also be indicative of other issues, such as small suppliers pricing at unsustainable levels (as is likely to have been the case for many of the recent supplier insolvencies).
- Ofgem should also recognise that price differentials between SVT and fixed price products may be distorted by the presence of the cap. For example, at the start of 2019 when wholesale prices were increasing, product prices converged with SVT. More recently, with wholesale prices falling, a wide gap has opened up. Whilst the gap between fixed price products and SVT did go up and down before the price cap, it is reasonable to suppose that the price cap has exacerbated this. In the absence of the

cap we might have expected to see higher SVT prices at the start of 2019 and lower SVT prices more recently.

It is unclear how Ofgem proposes to ensure that the sample of customers used to assess 'Trust and confidence' is fair and statistically significant and how it proposes to mitigate the risk of survey biases in its assessment of this outcome. For example, Ofgem only has access to survey data from customers who consent to the use of their data and this would potentially limit the sample size and introduce participation bias. We encourage Ofgem to provide more information on how it intends to address these risks.

Question 6: Is there any other aspect of effective competition that the framework should consider?

As part of the overall assessment, Ofgem should be balancing the risks of removing the cap against the risks of retaining it. The latter includes the risks of distorting market participants' incentives, gaming, lower efficiency and weakened customer engagement. We would encourage Ofgem to consider the evidence for adverse impacts of the cap alongside the assessment of conditions for effective competition. If and when Ofgem is able to make a case to the Secretary of State for removing the cap, it will be more persuasive if it can also point to the risks to consumers of not removing it.

**PROCESS AND OUTCOME INDICATORS IN THE FRAMEWORK
SCOTTISHPOWER RESPONSE**

Theme	Indicator	ScottishPower Views
Market structure indicators		
<i>Innovation</i>	Number of initiatives going through Ofgem's regulatory sandbox	Initiatives in the regulatory sandbox are by definition not currently in the market. We accept that they could be leading indicators of innovation. An indicator of initiatives <i>in the market</i> would complement this indicator – see below.
<i>Innovation</i>	Number of smart meters (SMETS1 + SMETS2) operating in domestic premises	The volume of operational smart meters is not an effective measure of innovation. The number of initiatives <i>currently in the market</i> and linked to smart meters would complement the number of initiatives going through the Sandbox. (Also see 'Tariff Choice')
<i>Innovation</i>	Number of in-home displays installed alongside smart meters	The relevance to innovation of 'Number of in-home displays installed alongside smart meters' is unclear. Eg, if a smaller proportion of smart meters are having IHDs installed, is that a positive sign of innovation (because it implies some more innovative service must have taken the place of the IHD) or a negative sign?
<i>Innovation</i>	[New indicator]	We note that the above indicators are all indirect measures of innovation. We think there would be merit in considering a more direct measure, such as a list of innovative products and services launched by suppliers in each year. Ofgem could create such a list by defining relevant criteria and inviting suppliers to submit examples for consideration.
<i>Rivalry</i>	Market shares: - Large energy suppliers (> 5%); - Small and medium suppliers (1-5%);	Small and medium suppliers are described as "<5%" in other indicators.
<i>Rivalry</i>	Market concentration	No comments at this stage.
<i>Supplier entry / exit</i>	Entry and exit of firms	We agree that (efficient) entry and exit are generally positive indicators of effective competition - and the absence of significant barriers to entry/exit. However, any assessment of trends in exit and entry should take account of other changes in the market such

		as Ofgem's Supplier Licensing Review (which can be expected to discourage inefficient entry).
<i>Supplier entry / exit</i>	Number of Supplier of Last Resort (SoLR) events	It is unclear what additional information SoLR events provide over and above information on market exits.
Consumer behaviour indicators		
<i>Engagement and switching</i>	Number of domestic customers switching by fuel type: - internal switching (with the same supplier) - external switching (between suppliers)	No comments at this stage.
<i>Price and price differentials</i>	% of accounts by tariff type: - Large energy suppliers (> 5%); - Small and medium suppliers (< 5%);	(See comment in Question 5)
<i>Trust and confidence</i>	Proportion of customers satisfied or very satisfied with overall customer service	<p>More clarity is needed on how Ofgem will :</p> <ul style="list-style-type: none"> • frame survey questions as these could influence responses • ensure sampling is fair and that samples are statistically significant (as Ofgem can only survey customer who give consent for their data to be used). • deal with the risk of bias (eg where survey results become non-representative because the participants disproportionately possess certain traits which affect the outcome.)
<i>Trust and confidence</i>	Proportion of customers who find it very or fairly easy to contact supplier	
<i>Trust and confidence</i>	Proportion of customers satisfied or very satisfied with billing	
<i>Vulnerability</i>	Customers in debt / blocked switches	Ofgem will need to exercise care in using and interpreting these indicators. The number of customers in debt is strongly influenced by the economic cycle which has nothing to do with effective competition. If customer switches are being blocked for legitimate and rational reasons, that is not a failure of competition - though it may be the case that competition would be enhanced by regulating to reduce blocking of switches (which might have the effect of socialising costs).
<i>Vulnerability</i>	Priority Service Register (PSR)	This indicator lacks context in terms of how Ofgem will relate it to the competitive process. Ofgem could be more explicit if, for example, it envisages measuring the number of customers on the PSR.
Supplier performance		

indicators		
<i>Efficiency</i>	Earnings before income & tax (EBIT) margins	No comments at this stage.
<i>Efficiency</i>	Operating costs - per customer - relative to price cap allowance	Ofgem will need to be careful to measure this on a consistent basis and to interpret the results appropriately. Even in a market with effective competition some companies will be less efficient than others at any given time.
<i>Trust and confidence</i>	Complaints resolved by the end of the next working day: - Large energy suppliers (> 5%); - Small and medium suppliers (< 5%);	No comments at this stage.
<i>Trust and confidence</i>	Complaints resolved within 8 weeks: - Large energy suppliers (> 5%); - Small and medium suppliers (< 5%);	No comments at this stage.
<i>Price and price differentials</i>	Average tariff prices (SVT vs fixed tariff): - Large energy suppliers (> 5%); - Small and medium suppliers (< 5%);	We would encourage Ofgem to provide more detail on how these metrics will be calculated. Eg, will averages be flat or weighted? How will Ofgem deal with acquisition tariffs that are offered (for example) for weekends or other short periods of time? (See also comment in Question 5)
<i>Quality of service</i>	Domestic energy supplier's customer service performance	No comments at this stage.
<i>Quality of service</i>	Energy survey results	(See comments on 'Trust and confidence' in 'Consumer behaviour indicators')
<i>Quality of service</i>	Best energy service companies	Ofgem should look at trends instead of absolute levels as the majority of customers who are satisfied with their supplier do not have an incentive to comment on Trustpilot.
<i>Quality of service</i>	Satisfaction and trust (from survey data): - to charge a fair price - to provide clear and helpful information - to treat you fairly	(See comments on 'Trust and confidence' in 'Consumer behaviour indicators').
<i>Tariff choice</i>	Number of tariffs offered in the market	Although not all tariffs will be 'innovative', this could potentially be used as an additional indicator of 'Innovation', to complement measures suggested above, such as the number of smart meters operating in domestic premises.
<i>Switching process</i>	Average switching time for domestic customers	We would note that reliability of switching (which may be captured by separate metrics) is likely to be more important than speed in

		reducing perceived barriers to switching.
<i>Switching process</i>	Number of erroneous transfers	No comments at this stage.
<i>Switching process</i>	Switching perceptions (from survey data): - length of time to complete process - complexity of process - risks to changing supplier - lack of time to engage	(See comments on 'Trust and confidence' in 'Consumer behaviour indicators')
<i>Switching process</i>	Proportion of customers satisfied or very satisfied with switching process (among those who have ever switched supplier)	
<i>Trust and confidence</i>	Consumer survey results of trust in suppliers and the market to provide high quality services at a fair price	

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