

Conditions for Effective Competition

9 July 2019

Introduction

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership covers over 90% of both UK power generation and the energy supply market for UK homes. We represent the diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 27 million homes and every business in Britain. Over 680,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry invests over £12.5bn annually, delivers around £84bn in economic activity through its supply chain and interaction with other sectors, and pays £6bn in tax to HMT.

This is a high-level industry view; Energy UK's members may hold different views on particular aspects of the consultation. We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

Executive Summary

Energy UK welcomes many aspects of Ofgem's proposed framework for assessing whether conditions are in place for effective competition in domestic supply contracts. It is positive for Ofgem to recognise that the definition for effective competition that is decided upon for this workstream would not be suitable for its other workstreams, noting the dynamic nature of competition and the distortive impacts of the cap on any indicators.

However, there are a number of key concerns that Energy UK has with the proposed framework. Most importantly, we are concerned that Condition 3 does not recognise that effective competition delivers different outcomes for different consumers, which is an inherent feature of competitive markets. Customers require incentives to switch and tariff differentials reflect cost differences between customer groups and suppliers. Instead, Ofgem must address the underlying causes of the perceived inefficiencies of competition within the market e.g. the mutualisation of supplier defaults. Energy UK, therefore, supports Ofgem's Supplier Licensing Review and progressing this in parallel with Ofgem's assessment under this framework, will help to pave the way for the removal of price caps.

In addition, there are aspects where Energy UK believes Ofgem should provide more clarity into its thinking at this stage before finalising the assessment framework. Energy UK strongly agrees that there should not be set thresholds for the various indicators laid out in the consultation, but a better understanding of Ofgem's views towards how those indicators would factor into its overall judgement is needed. For example, the exit of firms and number of Supplier of Last Resort (SoLR) events are included within market structure indicators, but it is not at all clear what Ofgem would consider to be a 'good' result from these indicators that shows effective competition to be in place in the market.

Process

Noting the key implementation milestones outlined on page 25 of the consultation, Energy UK would urge Ofgem to include and pursue future engagement opportunities as part of the framework development and assessment process. We are concerned that Ofgem currently plan to publish the final framework in October and begin to collect its chosen data without giving stakeholders the ability to comment on any decisions made as a result of responses Ofgem receives from this discussion paper. Such a consultation should also seek to address points raised further in this response regarding the manner in which Ofgem intends or expects to weigh up and balance indicators against each other. We welcome the assessment framework's guiding principle of transparency, and would urge Ofgem to ensure that the development of the framework itself is also transparent to stakeholders.

In addition, Ofgem should set out its plans for how it will seek to consult stakeholders ahead of making its final recommendation to the Secretary of State. At a minimum, we would urge Ofgem consult on a draft of its report produced under Section 7 of the Act before it is finalised and sent to the Secretary of State. We believe that such exercises would deliver upon the framework's proposed guiding principle of *Transparency* and *Evidence-based* that is outlined in paragraph 2.2 of the consultation.

Consultation Response

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

Energy UK believes that Ofgem could give more consideration to competition as a continuous process of discovery within its definition, and subsequent assessment. While paragraph 3.8 of the consultation document does highlight Professor Stephen Littlechild's argument on this definition of competition,¹ we do not believe it has been accounted for within the proposed definition. In particular, the definition should reflect the greater importance of the properties of effective competition that Littlechild describes as "discovering more efficient methods of production", and "discovering what customers want". As summarised by F.A. Hayek in his work on competition as a discovery procedure, "*it would be patently absurd to sponsor a contest if we knew in advance who the winner would be.*"² Ofgem should be cautious when assessing what 'good' outcomes are, and ensure that it is not inexplicably prescribing the actions and behaviours of competitors and consumers by limiting the scope of its definition, and as a result limiting the outcomes from which consumers could benefit.

In addition, we do not believe that Ofgem has given sufficient explanation of what it considers 'good' outcomes would entail for 'most consumers' within the definition. As currently constructed, the definition and Condition 3 together fail to recognise that different outcomes for different consumers is both an inherent result of, and necessary driver for effective competition. Ofgem's assessment, therefore, risks being in tension with effective competition, which ensures efficient outcomes rather than equal outcomes or politically desirable outcomes.

Question 2: Views on the conditions for effective competition? Are they clear? Anything else to take into account?

Energy UK is concerned that the current wording of the *Competitive Process* condition could be too absolute, and necessitate the difficult position of Ofgem proving the absence of something that is not there. Specifically, in paragraph 3.19, Ofgem notes that "*there should be no collusion between firms; abuse of market power or other practices that distort competition*". We fully agree with the principle behind the condition but are concerned that as currently worded Ofgem would be seeking to overcome the high hurdle of proving a negative. We would, therefore, suggest that there being "no evidence" of anti-competitive behavior might be better phrasing that still captures the original intent. In addition, we would welcome further details from Ofgem on how it would seek to demonstrate that this aspect of the condition could be met.

¹ Littlechild, S (2011), "[The Nature of Competition and the Regulatory Process](#)", in "[Effective Competition](#)' in [Telecommunications, Rail and Energy Markets](#)", *Intereconomics* 2011, 1.

² Hayek, F.A (1968), translated by M S. Snow (2002), [COMPETITION AS A DISCOVERY PROCEDURE](#), *THE QUARTERLY JOURNAL OF AUSTRIAN ECONOMICS* VOL. 5, NO. 3, 9-3

Question 3: Views on the structural changes included in the framework?

We would welcome further clarity on the structural changes that Ofgem would assess (including smart metering, faster switching and half hourly settlement), and how it would seek to assess their success and impacts upon effective competition. Energy UK would urge Ofgem to avoid requiring the various programmes to hit specific milestones and treating it as a box-ticking exercise. Instead, the direction of travel should be the main focus, as opposed to ensuring hard milestones are achieved, particularly as this could take us beyond 2023.

Question 4: Any indicators of the competitive process not listed?

Energy UK does not have any additional indicators to propose. However, we are concerned that the current list does not provide any details of how Ofgem intends to use the indicators, and so it is not possible to effectively scrutinise their inclusion within the assessment framework. For example, we are not clear how the number of in-home displays would be indicative of effective competition. Additionally, it is not clear how Ofgem intends to interpret the number of SoLR events in the context of assessing competition. As a result, we would urge Ofgem to share a full list of indicators once finalised, along with the reasoning for each indicator and Ofgem's understanding of how they will be used in its overall assessment of whether the conditions for effective competition are in place for the cap to be lifted. We believe the greater clarity that this would provide would be in line with the framework's guiding principle of transparency.

However, we strongly agree with Ofgem's position that it should not seek to prescribe definitive thresholds for the indicators under assessment, and this should not change when providing greater clarity and understanding.

Question 5: Views on the consumer outcomes to be assessed?

The consultation document refers to a "lower price", without giving clarity to what Ofgem will compare prices. A "lower" price does not necessarily mean better outcomes for the customer, and has knock-on impacts to other customer outcomes such as quality of service, choice and innovation. Energy UK would, therefore, urge greater clarity on how Ofgem will use price as part of its evaluation of the conditions for effective competition.

Furthermore, we are concerned that Ofgem has not given due regard to the drivers of price differentials, including differences in customer bases' costs to serve, wholesale prices and hedging strategies, levels of investment and cost of capital. Price differentials are a symptom of competitive markets and are drivers in customer behaviours, such as switching, and in driving the discovery process. More clarity is needed on Ofgem's intentions in assessing price differentials, and its understanding of what a 'good' outcome for consumers would be for this indicator.

Question 6: Any other aspect of effective competition that the framework should consider?

Energy UK believes that Ofgem should actively consider the impact of the cap upon the market and consumers as part of this workstream, in addition to assessing whether the conditions for effective competition are in place for the cap to be lifted.

Although assessing the impact of the cap is not a requirement of Section 7 of the Tariff Cap Act, Ofgem does have a primary duty to protect the interests of current and future consumers, wherever appropriate by promoting competition. We believe that it would be prudent for Ofgem to also consider whether the imposition of the cap is actively harming competition or consumer outcomes, which could include in areas such as the cost and availability of investment, consumer access to innovation, quality of service, supplier financial viability and market attractiveness to new entrants.

If you would like to discuss the above or any other related matters, please contact me directly on 020 7747 2931 or at steve.kirkwood@energy-uk.org.uk.