

UK energy market to be investigated by the competition regulator

By Trudy Feaster-Gee and David Kilduff (27 March 2014)

Today Ofgem and the OFT/CMA announced the results of their first 'state of the market' assessment of the retail energy market. Trudy Feaster-Gee and David Kilduff look at the findings and what this means for generators and suppliers of energy.

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As we [reported recently](#), the Office of Gas and Electricity Markets (**Ofgem**) and the Office of Fair Trading (**OFT**) and its successor body, the Competition and Markets Authority (**CMA**) have been working together to assess whether the market for supply of gas and electricity to households and small firms in the UK is sufficiently competitive. Today they have [published their findings](#).

Assessment findings

The results confirmed Ofgem's previous analysis that competition in these markets is not working as well as it should. The findings relate to:

- Vertical integration and barriers to entry and expansion - as the six largest suppliers all own energy generation infrastructure, such as power stations, as well as downstream supply businesses, it is difficult for new entrants, who are not vertically integrated, to compete against them. Ofgem believes that despite the wholesale market liquidity reforms which take effect from next month, there are wider issues with vertical integration which merit a closer review.
- Possible tacit co-ordination - although the assessment found no evidence of explicit collusion between suppliers, the timing and size of price announcements suggest that the Big Six suppliers are able to co-ordinate their actions. According to Ofgem this does not breach competition law, but it may result in competition being less effective, leading to higher prices.
- Profitability - the average profits for the Big Six have increased, but there is no clear evidence of corresponding increases in efficiency, which suggests a lack of effective competition.
- Market segmentation and weak customer response - Ofgem is concerned about falling rates of customers switching supplier. In particular, 'sticky' customers (those who have never switched suppliers since the market was opened up to competition 15 years ago and who are often amongst the most vulnerable customer groups) are being charged higher prices than those who have switched suppliers. The level of consumer trust has also fallen. This low level of consumer engagement is insufficient to drive competition in the market.

Market investigation reference

Based on these findings, Ofgem has proposed referring these energy markets to the CMA, which takes over from the OFT on 1 April. The CMA will be able to carry out a full market investigation. Before it makes the reference, Ofgem has to consult on whether it should refer, and the terms of the reference. The consultation document has also been published today and is available [here](#). The consultation is open until 23 May. Ofgem will decide whether to refer to the CMA or not in the Summer. The CMA then normally takes 18 months to carry out its investigation, with a further 6 month period to implement any remedies.

Possible outcomes

If Ofgem does refer the energy market to the CMA for an indepth inquiry (which is very likely), and the CMA decides that there are one or more features of the market with adverse effects on competition, it must take such action as it considers reasonable and practicable to remedy, mitigate or prevent the situation and any detrimental effect on customers resulting from it. This can include structural reform such as ordering the divestment of vertically integrated businesses.

Ofgem believes a reference should be made now, rather than waiting to see if the other reforms it is currently implementing, such as the Retail Market Review and the introduction of smart metering, help to improve competition. The current market and political uncertainty is already creating concern among investors. Ofgem does, however, recognise that a market investigation could make investors even more nervous, given the possibility of structural remedies, and this could result in increased bids in the capacity auctions due to take place at the end of 2014.

Impact on energy suppliers

If the market investigation does lead to structural reform and the break-up of one or more of the Big Six, this will open up the market to smaller generators and suppliers and start to decentralise the energy industry, something that [APSE Energy](#), for example, welcomes. If structural reform was to be undertaken, we may see an increase in municipal and community energy projects in the longer term, but in the short term, investors may well hang fire until the investigation is concluded, which will not be until late 2015 at the earliest.

If your business is likely to be affected by these findings, or may wish to take advantage of potential market opportunities, Walker Morris can help. We have proven expertise in advising on market studies and investigations, including currently acting before the Competition Commission on the indepth inquiry into payday lending. We work together with in-house regulatory specialists and with the leading economics consultancies and have significant experience of external engagement with competition authorities, sector regulators and other stakeholders on sensitive and complex competition issues.

For more information please contact the authors.