



## Competition Concerns Identified in UK Energy Market Investigation

The UK Competition and Markets Authority (“CMA”) published a report on 7 July 2015 setting out its provisional findings in a market investigation of the energy sector, in particular for gas and electricity at both wholesale and retail levels in the UK. Market investigations involve in-depth reviews of markets to identify whether there are any features of the market that have an adverse effect on competition.

The report found that competition in the wholesale gas and electricity markets works well and that the presence of vertically integrated firms does not have a detrimental effect on competition.

However, the CMA has provisionally identified a number of adverse effects on competition in the retail energy market that act to the detriment of UK consumers. The report found that the six main energy suppliers in the UK (British Gas, Eon, EDF Energy, nPower, Scottish Power and SSE) have enjoyed unilateral market power over each of their inactive customer bases, which they have been able to exploit through their pricing policies. This has resulted in higher prices for retail and small business customers over recent years than would have been the case in a fully competitive market. The CMA also found that certain forms of regulatory intervention by the energy sector regulator,

Ofgem, had failed to succeed and may have contributed to a poorer competitive outcome.

The CMA has proposed several remedies to correct market deficiencies, one of which involves a transitional price cap. However, the CMA’s emphasis remains on promoting market competition and the need to strike an effective balance between furthering competition between suppliers and protecting the consumer.

### Remedying Weak Consumer Engagement

A main theme of the provisional findings was that adverse effects on competition in the retail energy market were caused by persistent consumer inactivity—which they referred to as “weak customer engagement”—when it comes to shopping around for better prices and switching suppliers. The CMA made clear that customer engagement is required in order to drive competition. In particular, the prices of the major suppliers will be pushed down if consumers regularly switch in order to secure the most competitive price. The report found evidence that consumers who had switched providers had saved on their energy bills. Active consumers also encourage innovation and product development. However, the CMA found that over a third of respondents to a survey had never even

considered switching provider. Similar low levels of switching by consumers have been identified in the UK retail banking sector, especially for personal current accounts, which is also the subject of an ongoing market investigation by the CMA. It is this consumer inertia that the CMA hopes to remedy.

The report identified certain characteristics of energy consumption that impede customers acting to counter higher prices, including a lack of quality differentiation and the use of legacy energy meters that are difficult to read. A number of the CMA's proposed remedies seek to address this, and the CMA also indicated strong support for the ongoing program to roll out smart meters in the UK, to facilitate improved consumer awareness of energy consumption and cost. This will in turn increase consumers' understanding of and ability to identify available lower prices and switch suppliers.

## Encouraging Competition Over Regulation

The CMA's preferred solution to consumer inertia therefore involves "nudging" customers into making more rational choices, rather than imposing regulatory price caps to protect them. The report places significant emphasis on encouraging market competition, with the hope of delivering better market outcomes for consumers, rather than direct regulatory intervention. This is representative of a general trend in UK sector regulation and is consistent with the obligation that the Enterprise and Regulatory Reform Act 2013 imposes on all UK sector regulators to consider the use of their general competition powers over regulatory powers. The report also noted concern that elements of the Retail Market Review rules introduced by Ofgem, which attempted to simplify retail tariffs into a maximum of four categories, in fact reduced the suppliers' ability to innovate in the design of tariff structures.

## Transitional Price Cap

Despite the preference for market-based solutions, in considering the range of possible remedies that could be deployed to counter consumer inertia, the CMA recognized that many would take time to have any effect in the market. As an interim measure, the CMA therefore has proposed a transitional energy price cap, a measure that the CMA has the power to impose at its own initiative without the need for legislation or any other political approval. Such an interventionist approach

is politically controversial in the UK, and the CMA recognizes that such a measure should be implemented cautiously, with due regard for the need to balance competition alongside effective protection of the consumer in the short term.

The current proposal involves a limited form of price cap, which would apply on a transitional basis pending the other remedies and developments taking effect in the market. Either the CMA or Ofgem would set a default tariff for customers who do not choose a new tariff at the end of their existing contract, despite being provided with reminders about how they could switch tariff or supplier to secure a lower rate. The tariff would be based on a competitive cost to protect the inactive consumer, but with some "headroom" to encourage competition. It is expected that any proposal to impose price caps will be met with strong resistance from the energy suppliers, not least because of the precedent that it sets for future intervention, and would therefore also be regarded with concern by other sectors.

## Levels of Overcharge

The CMA provisionally estimated that the suppliers' unilateral market power had enabled them to overcharge retail consumers by up to 5 percent, while small and medium-sized enterprises could have been overcharged by up to 14 percent, relative to prices that would have prevailed in a competitive market. The report claimed that had competition functioned more effectively over the period 2009 to 2013, domestic customers would have collectively paid around £1.2 billion less on their energy bills.

The report's findings are provisional, and the CMA expects to undertake more detailed analysis of these estimated levels of overcharge. Nevertheless, the possibility of claims for compensation being brought against the suppliers by consumers and small businesses cannot be ruled out in due course. However, such claims would face legal difficulties. On the one hand, the Consumer Rights Act 2015 will enter into force in October 2015 and will facilitate class actions in the UK for the first time. On the other hand, there may not be a strong legal basis for their claims. The CMA report dismissed allegations of tacit price coordination amongst the six primary energy suppliers but did assert that each of the suppliers enjoyed unilateral market power over its inactive customer base. As

the report does not make a legal finding of dominance for the purposes of the Competition Act 1998, claimants in any damages claim would have to prove that the energy companies were dominant and that they abused that dominance by engaging in excessive pricing.

## Wide Scope of Market Investigations

The CMA's report provides a good indication of how the UK competition authority can use market investigations to examine and redress markets it believes may be malfunctioning. These investigations involve a detailed review across a whole market to identify whether there are any features of the market that may have an adverse effect on competition. The CMA has a wide range of actions that it can take to remedy those adverse effects, ranging from price caps to even breaking up companies, as it has done in a number of cases, notably in the airport and cement sectors. These powers go beyond similar market-wide or sector inquiry regimes in other jurisdictions, including at the EU level. For example, the European Commission is currently undertaking an extensive and detailed sector inquiry of the e-commerce sector. While the information that the EC will gather from the investigation will enable it to take further actions to address any concerns, the EC does not have the same extensive powers enjoyed by the CMA directly to impose behavioral or structural remedies.

## Next Steps

The CMA is consulting on its provisional findings and proposed remedies. The market investigation will continue for some time with a final report expected to be issued in November or December 2015. The CMA's press release concerning the report can be found [here](#). A summary of the report is [here](#), the full notice of provisional findings is [here](#), and the notice of possible remedies is [here](#).

## Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at [www.jonesday.com/contactus/](http://www.jonesday.com/contactus/).

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