Introduction

The Competition and Markets Authority (CMA) is an independent non-ministerial UK government department, and the UK’s primary consumer and competition authority. We work to promote competition for the benefit of consumers, both within and outside the UK. Our aim is to make markets work well for consumers, businesses and the economy by promoting competition. The CMA works closely with sector regulators, including those who have competition powers similar to our own.\(^1\) One of our strategic goals is to extend competition frontiers through using our powers to improve the way competition works.\(^2\) Competitive markets and an effective competition policy can play a major role in delivering productivity and growth in the UK economy.

Although the CMA is not the regulator of the energy markets, we have developed expertise as a result of a number of investigations and studies into aspects of this and other relevant markets. In 2016, we reported on our 2-year comprehensive investigation into the retail energy market, which set out a wide range of proposed reforms to how the market was regulated, and how consumers should be assisted to engage more effectively with it, to achieve better outcomes.\(^3\) Many of our recommendations have or are being implemented and there is evidence that – in terms of consumer engagement – remedies aimed at encouraging switching are having an effect. Switching has been on the rise since 2014 and the number of domestic switches in the 12 months up to the end of June 2018 was 10% higher than in the 12 preceding months for electricity and 23% higher for gas\(^4\).

Our knowledge and understanding in energy markets derives also from our role in investigating mergers – we are currently considering the merger between npower and SSE - and in considering appeals against the decisions of the regulator, Ofgem. Beyond the traditional energy market, we have recently done a market study into heat networks\(^5\).

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1. The CMA and sector regulators report annually on this ‘concurrency’
(alternatively known as district heating) and, previously, on off-grid energy provision, including LPG.

We therefore welcome the opportunity to give views on the Scottish Government (SG) proposal for a new publicly-owned energy company (POEC).

We acknowledge that there is a range of public policy goals that a POEC is intended to deliver and there may be trade-offs between these goals. Our comments are drawn both from what we know about the energy markets but also from principles that are important in considering the effect of government policy on markets more generally. Given the CMA’s role and remit, our submission focuses on the market implications of the proposal. Our comments highlight areas of potential risk which the Committee may wish to consider as part of their overall scrutiny of the proposals.

State of the market

Others have pointed out that a POEC’s effectiveness in reducing energy prices for consumers – which, as indicated below, is one of the most important reasons for a consumer choosing a particular supplier - is likely to be determined by the context of the current GB energy markets. One of the CMA’s recommendations in our 2016 report was that Ofgem publish annually a State of the Market report to provide analysis of (i) the evolution of energy prices and bills over time, (ii) the profitability of key players in the markets (e.g. the Six Large Energy Firms), (iii) the social costs and benefits of policies, (iv) the impact of initiatives relating to decarbonisation and security of supply, (v) the trilemma of trade-offs, and (vi) the trends for the forthcoming year. Ofgem produced the first of these reports in October 2017 and this would appear to be a sensible source of information for the Committee in determining what the context is. The 2017 Ofgem report reflected changes in the market significant to the question of whether to introduce a POEC:

• Substantial new entry which was driving greater competition
• Domestic retail energy markets are still concentrated but levels of concentration have fallen

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7 OFT Government in Markets (see p41)
8 CMA LA report (see para 24 onwards):
9 Scoping Note on a Scottish Publicly Owned Energy Company/Ragne Low, University of Strathclyde
10 The balance between energy security, environmental impact and energy affordability.
Switching is increasing though there are still barriers and delays being experienced by consumers. A large proportion of consumers remain unengaged and do not switch and are paying higher prices.

Since the 2017 Ofgem report was published, other relevant changes are:

- **Consolidation** – the CMA has provisionally cleared the merger between nPower and SSE on the grounds that the two companies are not competing closely on the most expensive tariffs.
- **A few smaller players have exited**
- **The government has introduced a new energy price cap.**

**Market Impact**

Markets benefit from new entry. New entrants with innovative or more customer-focussed business models can attract customers away from incumbents and so incentivise them to improve their business practices and deliver better services, often more efficiently. A new publicly-owned Scottish energy company could be positive for consumers, if it can offer what customers want, which is likely to be competitive pricing and good customer service.

For example, we welcome that there is a prospect of the firm offering a pricing structure that is different and does not depend on disengaged customers maintained on Standard Variable Tariffs. It will require sustained effort to ensure that customers are aware of this when making their choice about which supplier to use.

**Ensuring a level playing field**

The Strategic Outline Case\(^{14}\) recognises that there is a risk of creating a firm that has unfair advantages, in part by virtue of being established with the weight of government behind it and associated endorsement by those in positions of influence and power. This does not necessarily lead to a significant effect on the market that distorts or damages competition, but the risk is there that it could and this requires ongoing attention to ensure that this risk is minimised. The CMA has the following observations on how this could be achieved.

In terms of ownership, there are several options that have been set out in the Strategic Outline Case (SOC) by EY. From those presented, we strongly agree with the

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\(^{12}\) These include Iresa and Future Energy


implementation option which is supported, that of a state-owned not-for-profit energy company. It is critical that the envisaged company is a clearly ring-fenced legal entity, regulated (as any other energy company) by Ofgem, and not a government department or agency. This should limit the risk of unfair advantage. The government as shareholder could have a strategy role but should not provide additional services or support (including publicity) which would benefit the POEC over other energy companies.

As indicated, it is important that consumers are consistently aware that the new company is just one of many suppliers to choose from. Some consumers may assume a publicly-owned company is the cheapest, when it isn’t, or offers the best service, when it doesn’t. At the outset, the Scottish Government may want to promote the concept of a not-for-profit energy company delivering wider public outcomes. However, once the company is set-up, it will be important to ensure that adverts or promotion by the company is not misleading and that announcements by government are neutral, promoting consumer choice in the market. It would be useful to consider the mechanisms and costs to establish these standards and how they will be monitored and maintained.

The POEC will need to win customers to give it the scale to achieve the benefits envisaged, which differentiates it from, for example, Business Stream, which was the incumbent water supplier. There may be questions about whether this will be achieved in part through some form of government intervention (either through favourable access to contracts, mandating public sector organisations to allow it to bid in procurement rounds, politically-endorsed publicity). With each government intervention there are potential implications for competition and risks of distortion in other related markets.

There are also some potential risks should the company, as intended, develop new functions which might allow a conflict of interest to emerge. For example, it is unlikely to be appropriate for a supplier in a competitive market to also provide government sponsored advice to consumers on use of certain forms of energy supply, that may lead customers to favour their retail offer.

In summary, the CMA agrees that a POEC has the potential to benefit customers, where it is able to contribute to a well-functioning market by providing an alternative offer in terms of tariffs and/or quality of service to that which is currently available from the existing suppliers. At the same time, the POEC should be ring-fenced, ongoing interactions with government will need to remain at arms-length, and the procedures should be put in place up front to ensure that this happens.

Conclusion

The CMA hopes that the Committee will find the comments above useful in their continued consideration of the proposal for a POEC. We are happy to provide further information or assistance as required.