Competition and Consumer Protection in retail energy markets

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Competition and Consumer Protection in retail energy markets

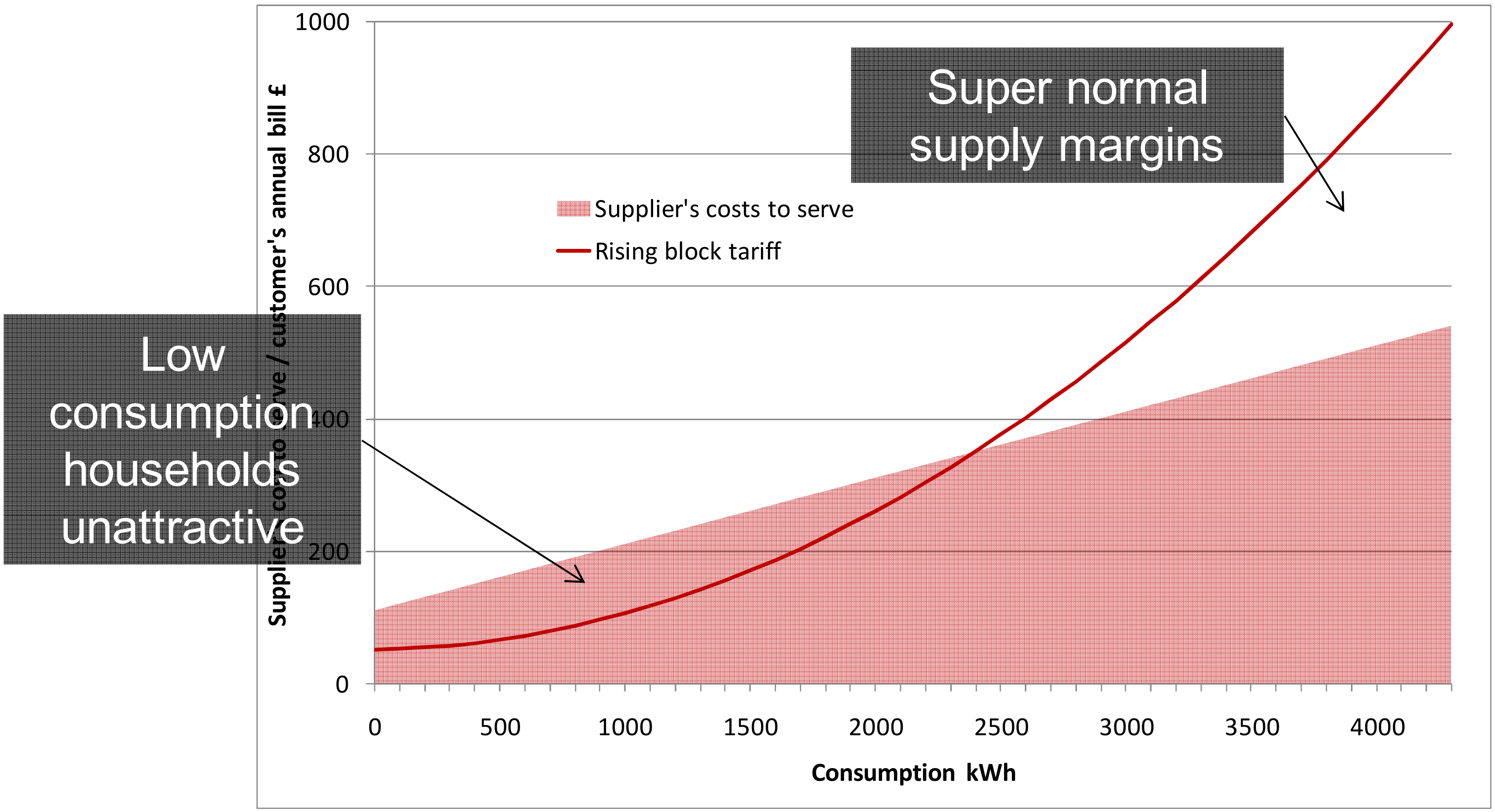
- What's so special about energy?
  - Relation to income
  - The new energy agenda
- From Consumer Protection to Competition
- Concepts of Fairness
- Regulatory and policy responses
- From Competition back towards Consumer Protection?

Energy and income distribution

- Demand for energy increases with income, but less than proportionally
- If price ***levels*** rise, the rich pay more in absolute terms, but the poor pay more as a proportion of their income
- Some costs of supply are energy related, and some are consumer related: distribution line, metering, billing
- Introducing/increasing a per consumer charge to reflect costs hurts low consumption (income) consumers and helps the rich
- Removing a lifeline tariff has the same effect

Lifeline/ Increasing block tariffs make low consumption (income) households unattractive for competitors

CENTRE FOR COMPETITION POLICY



The New Energy Agenda
….and competition

- Sustainability, security, affordability
  - Sustainability - include true cost of carbon
    - Competition with better cost reflection
  - Security: investment in renewed and new format generation and distribution
    - Competition with clearer policy/market signals
  - Affordability: price rises will affect low income most
    - Competitive markets lower price levels but don't distinguish between individual consumers/groups

Affordability has risen up the agenda

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- Energy prices have risen after a period of reduction, posing particular problems for low income consumers
- Confusion about cause of price rises – ‘promises’ of competition bringing cheaper energy
- Energy highly politicised: may require compromise with those who never ‘bought in’ to the competition story

From consumer protection to competition…

- All retail price caps removed in 2002

Competition has delivered

- Better understanding of costs
- Lower margins initially (during fight to survive)
- Tariff innovation

...but concerns about effectiveness of competition

Tariff innovation seen less as increased choice and more obfuscation/confusopoly

and post consolidation (02-03) resulted in ‘Big 6’ firms (British Gas, EdF, E.ON, NPower, S&S, Scottish Power) with blunted rivalry (some evidence from tariff structures and retail margins)

Little effective new entry to challenge this group

Concerns that vulnerable have not had a fair deal

Traditional concept of Fairness

- All consumers charged the same price, regardless of cost
  - Accords with old view of non discrimination (nationalisation Acts);
  - superceded by importance of cost reflectivity

- Inconsistent with competition if there are cost or demand differences between consumers

Fairness with competition?

- Consumers charged according to cost of supply
- Those who exert effort to find better deals are rewarded (incentivised) through lower prices

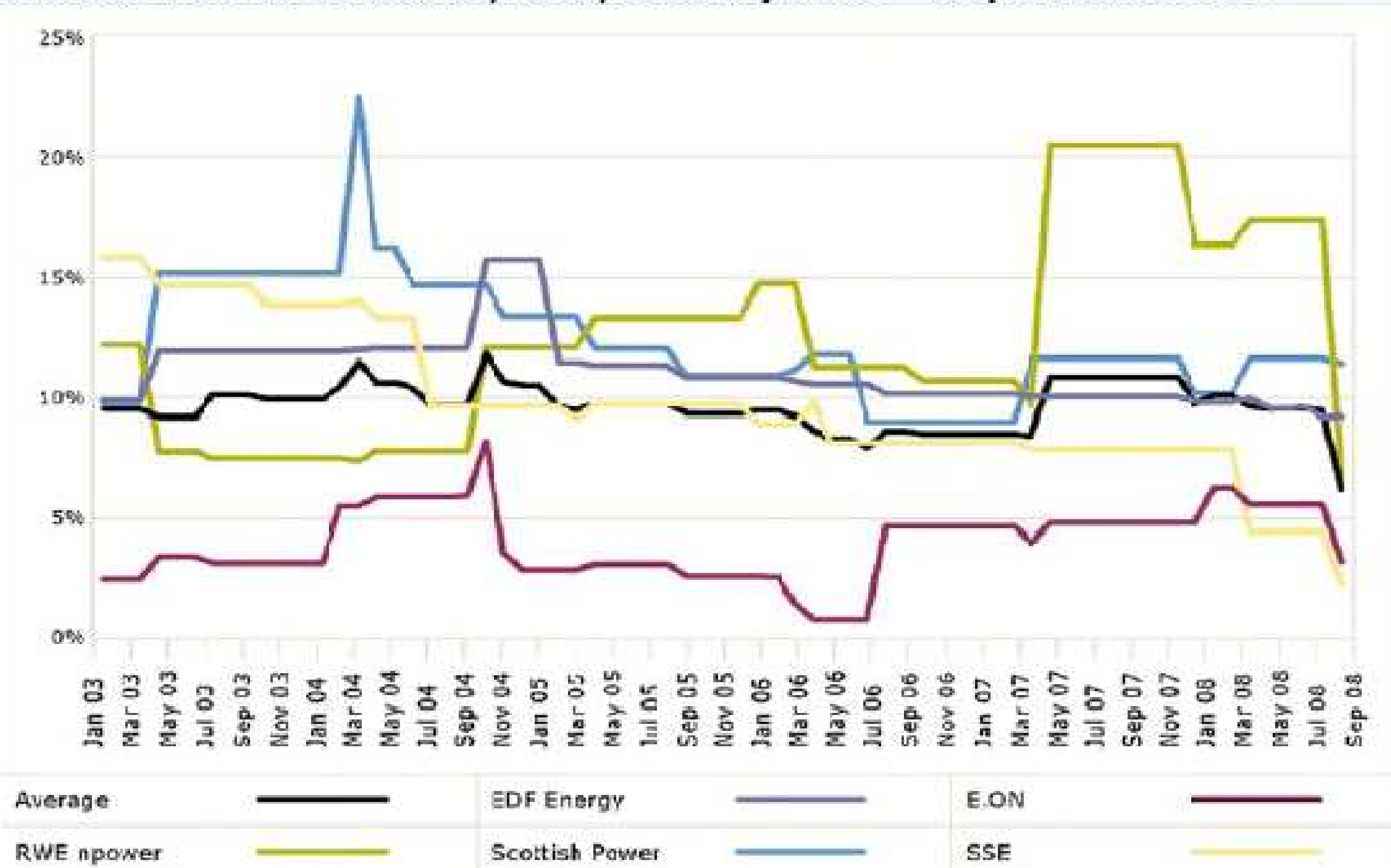
- Problems if low income consumers are:
  - Higher cost
  - Less responsive to price changes and/or less likely to switch

Vulnerable consumers may not have benefited as much from competition

- Often benefited from cross-subsidies before competition (prepayment, low standing charge)
- Some groups switch less than average
- Because of inertia, each supplier was able to charge more where incumbent (to non switchers) than where entrant (to switchers) …
- …those who didn’t switch paid (on average) 10% more for their energy

Suppliers charged more to those who hadn't switched…

Figure 7.4: Average percentage difference between in-area and out-of-area standard credit electricity bills, January 2003 – September 2008



Source: Ofgem

And vulnerable groups are over represented amongst non switchers

Vulnerable group	Incumbent	British Gas	Entrants
Over 65	46	28	26
Low inc	47	31*	22
Disabled	44	28	28
Rural	60*	20*	20
Low educ attain	52*	27*	22*
At least one	**47***	**29***	**24***
All consumers	*42*	*32*	*26*

From 2005 CCP survey

*Significantly different from non vulnerable at 1%

Regulatory response

- Non discrimination clauses from September 09
  - companies could charge no more (relative to costs) where they were incumbent (to non switchers) than as entrants (to switchers)
- Aim: to protect non switchers
- In practice reduces the competitive pressure on all suppliers (including British Gas)
- Likely higher prices for everyone, withdrawal from active marketing for new consumers by the 'big 6'
  - offering lower prices as entrant requires lower prices for the larger (and more profitable) home market

And the consequence was….?

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- Very difficult to measure changed levels against counterfactual

but retail ***margins*** have increased recently

- Gap between incumbent price and best offer in market has decreased significantly Jan 08-Jan10 from £53 a year to £39 a year for electricity with standard offers

- Surprise that the gap remains at all?

Resolving the tension between competition and protecting (some) consumers

- Competition may deliver equal prices, but imposing equal prices hinders the competitive process
- Regulator shows strong preference for immediate fairness, even if all consumers are worse off as a result
- Striking change in emphasis
- Is this the right trade off and who should make it?

Government response

- Energy Bill recognises that competition may not always be the most appropriate instrument for the regulator, given the various objectives
- Identifies the government as the body to mandate social tariffs, not the regulator
- (though companies still to implement)
- Recognition of appropriate duties

Alternative instruments?

- Deliver social benefits through regulated distribution monopolies
- Would maintain retail competition
- But concerns of
  - administration for companies/effectiveness
  - international competitiveness for UK
  - poverty trap for consumers

From competition to protection?

- Delivering social outcomes may require co-ordination among players
  - difficult to combine co-ordination with competition
  - withdrawal to regional strongholds one route
- Political sensitivity of sector and need for good will to deliver other objectives may over-rule competition:
  - eventual need for price caps
  - interesting European implications
- But welcome start to open-ness and acceptance of responsibilities as basis for the debate