Reforming the energy market

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Areas of investigation

CMA
Competition & Markets Authority

Generation	• Market power in electricity generation leading to higher prices	No
	• Market rules and regulatory framework distorting competition in wholesale electricity markets	Yes
Vertical integration	• Foreclosure in retail or generation	No
	• Opaque prices and low liquidity in wholesale electricity markets distorting competition in retail and generation	No
Retail	• Weak competition arising from inactive customers, supplier behaviour and/or regulatory interventions	Yes
	• The broader regulatory framework as a barrier to pro-competitive innovation and change	Yes

Remedies

- Package of >30 remedies to address the various AECs identified, affecting
  - **Wholesale electricity market**
    - Contracts for Difference
    - Transmission losses
  - **Retail energy markets**
    - Creating a framework for competition
    - Helping customers to engage
    - Protecting those who are unable to engage
  - **Regulatory framework**
    - Enhanced role for Ofgem in code governance
    - Enhanced monitoring of the industry

- Smart meter roll-out underway and due to be completed by 2020

Remedies – Contracts for difference

- Provide support to renewable generation – guaranteed price for 15 yrs
- Costs are significant and are borne by energy suppliers, ie customers
- Government can award CfDs via either a competitive (auction) process, or via a non-competitive allocation
  - Evidence on use of non-competitive process suggests BEIS paid £250m-£310m more per year than if support had been auctioned
  - Where a competitive process used, no clear assessment of how technologies and funding allocated between 'pots'

- Recommendation to BEIS that it should undertake & consult on a thorough impact assessment:
  - Before allocating any CfDs outside a competitive process
  - Before allocating technologies and funding between various pots
- Aim is to ensure that decarbonisation is not more costly than it needs to be

Inactive customers

- 34% of respondents said they had never considered switching supplier;
- 56% of respondents said they had either never switched supplier, did not know it was possible or did not know if they had done so; and
- 72% said they had never switched tariff with an existing supplier, did not know it was possible, or did not know if they had done so.

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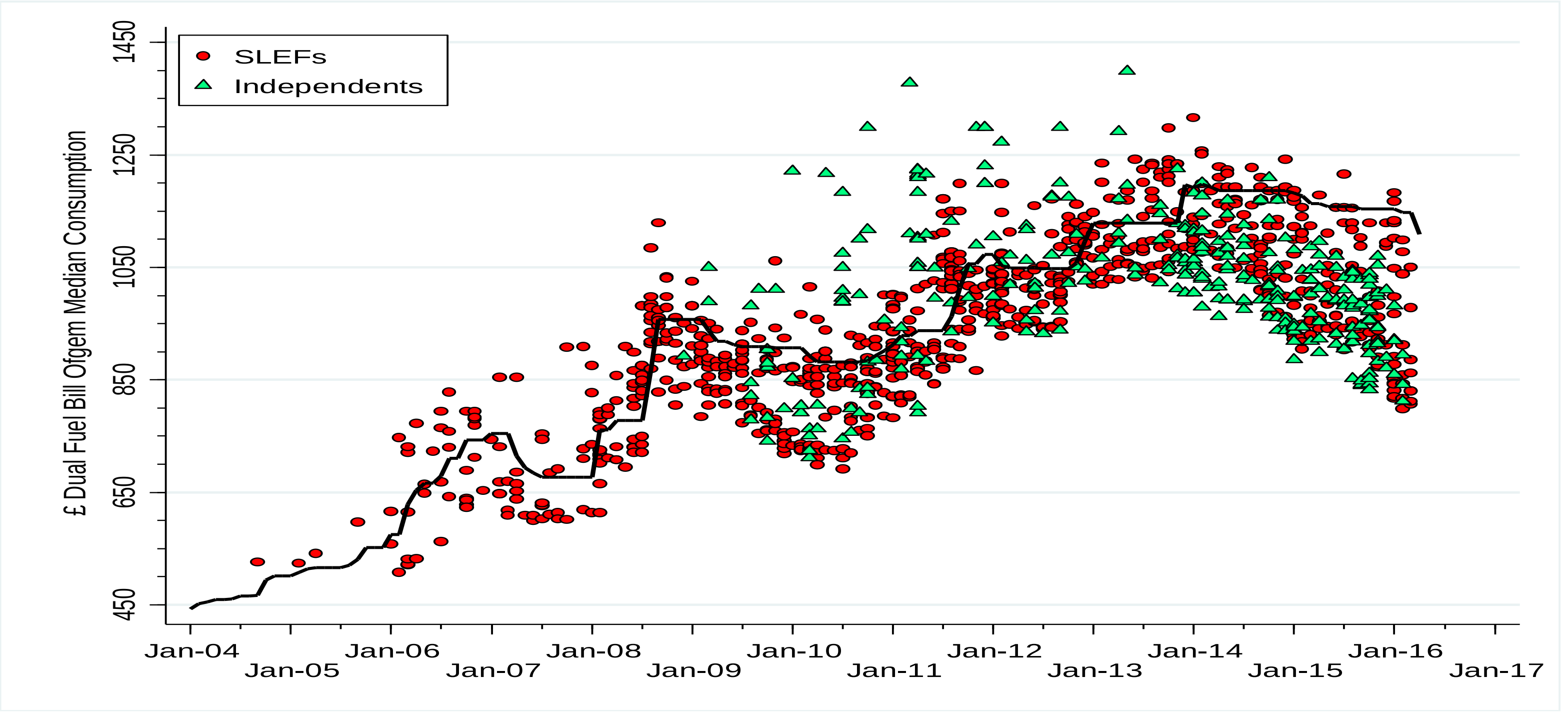
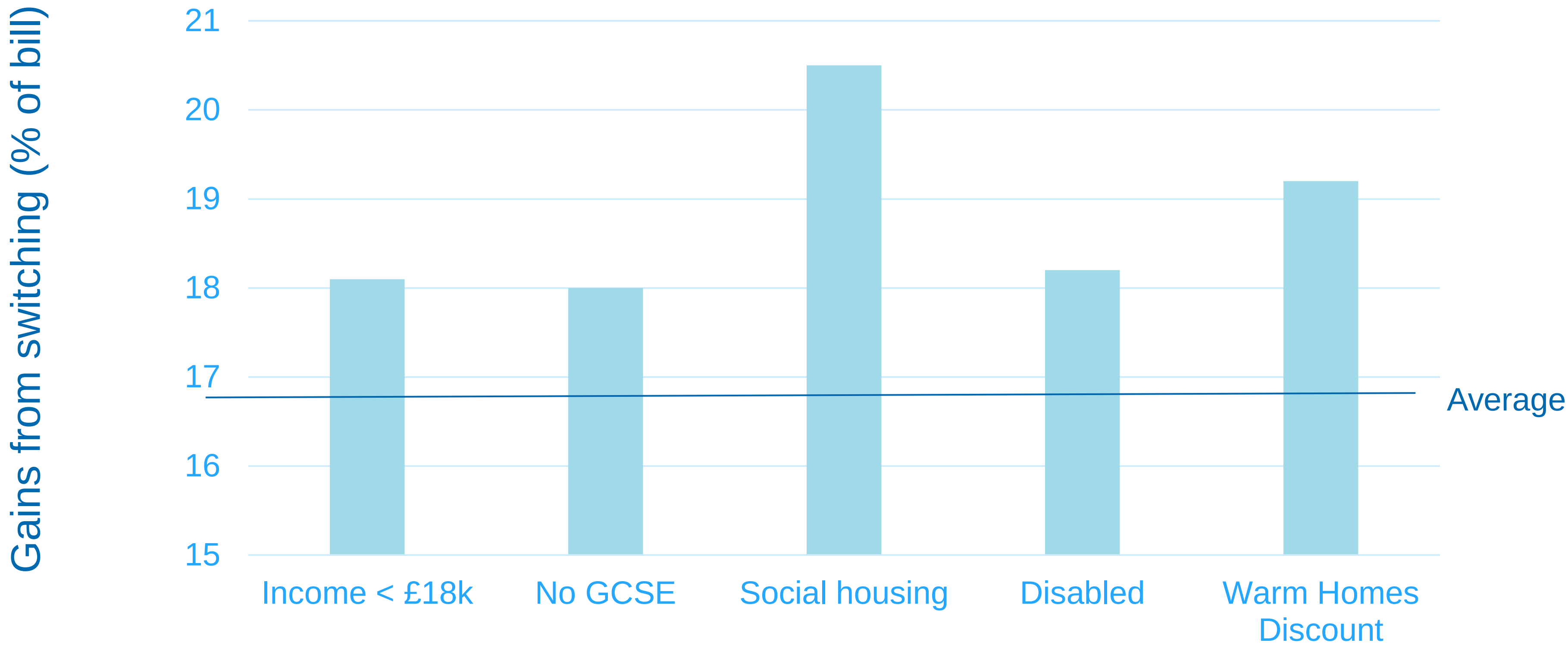
Competition & Markets Authority

Dual fuel bills

Solid line is SLEF average SVT

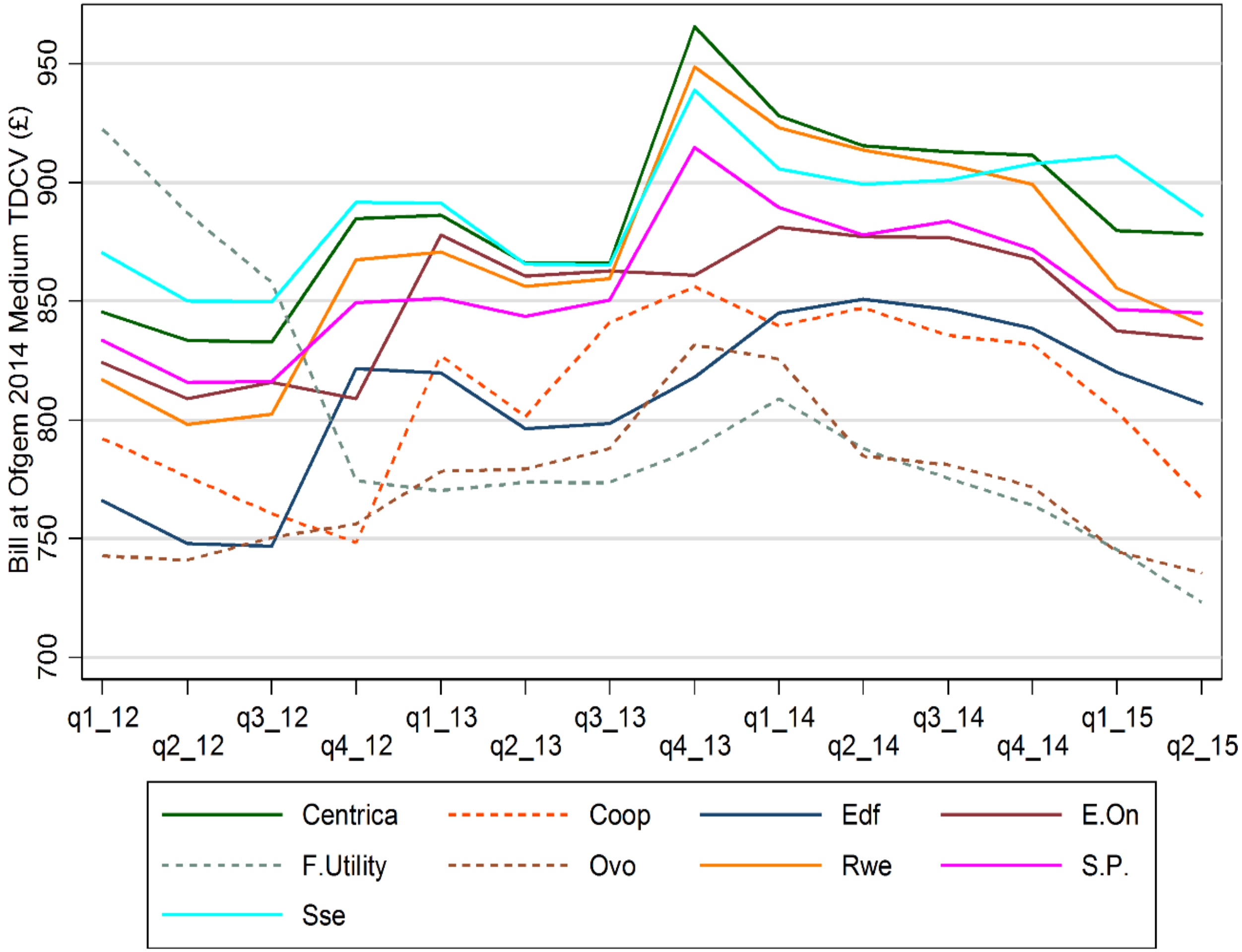


Demographic variability



Consumer detriment

Comparison of average dual fuel bills for medium TDCV domestic customers controlling for network and payment method costs



- The average detriment per customer for dual fuel £90 in 2015
- Grossed up to £2bn for 2015 (average of £1.4bn a year over the period 2012 – 2015)

Case for intervention

- Cheap “introductory” deals followed by migration to higher standard prices are common in many markets – what is different about energy markets?
- We were concerned that the are material numbers of customers who appear to be fundamentally disengaged from the domestic retail energy markets and paying excessive prices
- Regulatory intervention were at best ineffective in helping disengaged customers while at the same time limiting innovation

Remedies – helping customers engage

- No silver bullet – package of measures to encourage engagement, in addition to existing initiatives – smart meters, 1-day switching
- **Prompts** to engage:
  - Ofgem to trial a range of prompts, eg information on bills, Cheapest Tariff Message
  - Customer database – allow suppliers to contact disengaged customers
  - Harnessing incentives of Price Comparison Websites (PCWs) to engage customers
- Facilitating **switching**:
  - PCWs to get access to meter numbers
  - Midata programme extended to give PCWs increased access to customer data to allow them to monitor the market on an on-going basis

Remedies – protecting customers

- Customers on prepayment meters do not have access to competitive prices
  - Competition undermined by a range of supply side features (eg technological constraints arising from prepayment infrastructure)
- Remedies to facilitate entry into PPM / development of tariff offering
  - Eg reallocation of gas tariff pages;
- Price cap to protect customers on prepayment meters
  - Benchmarked against competitive prices
  - Each element of 'cost stack' indexed and rolled-forward
- Price cap in place April 2017 linked to roll out of smart meters and sunset as of 2020

Prepayment households

- 4 million customers on prepayment meters do not have access to competitive prices
  - Competition undermined by a range of supply side features (eg technological constraints arising from prepayment infrastructure)

- Remedies to facilitate entry into pre-payment meter market
  - Eg reallocation of gas tariff pages;

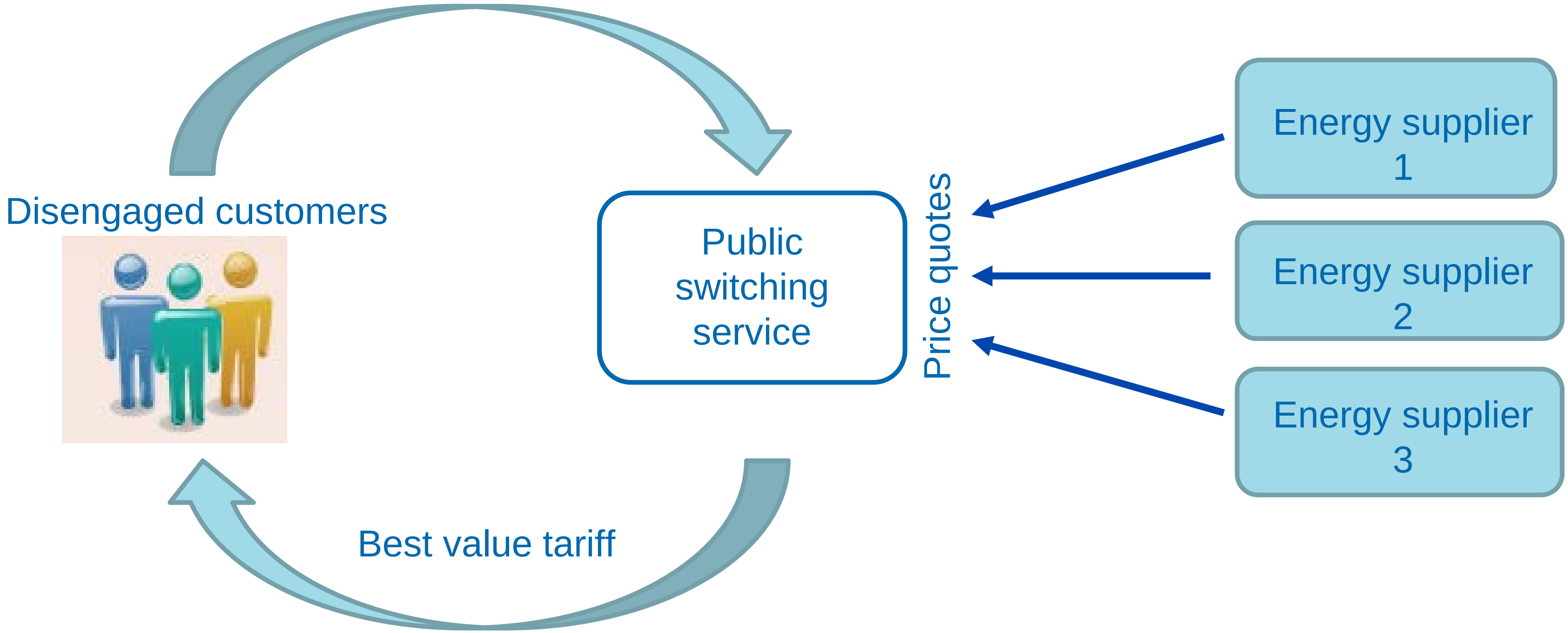
- **Price cap** to protect customers on prepayment meters
  - Will reduce average bill by £75 per year, £300 million per year in total

- Price cap in place April 2017 – end date linked to roll out of smart meters

Restricted meters

- 700,000 Restricted Meters (eg DTS) of which around half are in Scotland (more than 10% of all Scottish customers)
- Between 60% and 90% of customers with Restricted Meters would pay less with the best single rate tariff
- Remedy is to order suppliers to make all their single-rate tariffs available to Restricted Meter customers at no additional cost

Collective switching



- A public switching service seeks quotes from a range of energy suppliers, and manages the switch, on behalf of disengaged customers, via a collective arrangement
- This remedy should ensure that disengaged customers obtain competitive prices

Collective switching

How it would work

- A public body is set up to operate a collective switch for customers
- Customers could be identified via various means, eg
  - Ofgem customer database to identify the most disengaged customers
  - Vulnerable customers identified via DWP databases
  - Citizens Advice could identify customers who require support (ie those who seek advice)
- Proportion of realised switches can be maximised by:
  - Auto-enrolment of certain groups of customers, or
  - Operating a stream-lined sign-up & switching process – “one-click switching”
    - Customers asked to sign-up once, rather than requiring repeated interactions
    - Behavioural Insights Team could design sign-up / switching process to encourage engagement

Collective switching

Pros

- Disengaged / vulnerable customers benefit from competitive tariffs, ie are protected (average prices will be reduced)
- Reduces ability of energy suppliers to keep large numbers of customers on SVTs indefinitely
- Enhances competitive pressure on suppliers (incentives to reduce costs, innovate etc)
- Does not cut across / undermine the competitive market (for engaged customers)
- Collective switching is a well-established and tested means of engaging customers and achieving better prices

Cons

- Risk of customers not participating, although this can be managed via the design of the programme
- Need to set up infrastructure to operate collective switches on an on-going basis

Remedies – regulatory framework

- Regulation of various aspects of energy markets is governed by industry codes
- Codes are managed by energy firms, who have detailed technical expertise but whose interests not necessarily aligned with those of customers
- This arrangement has failed to deliver various reforms required to support innovation and wider policy objective, eg
  - Half-hourly metering & settlement
  - Locational pricing of transmission losses
- We recommended that Ofgem:
  - Set out a strategic direction for code development;
  - Be given the power to initiate and prioritise modification proposals that are necessary for the delivery of the strategic direction;
  - Intervene to take control of ongoing strategically important modification proposals where appropriate.

Overview of the energy market

A **short** overview of the CMA’s findings and proposals:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/531204/overview-modernising-the-energy-market.pdf