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Response to CMA Energy Market Proposed Remedies

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By Email

Introduction

On 7 July 2015 the CMA Group conducting the energy market investigation issued its provisional findings and proposed remedies. In line with the usual CMA approach applying the narrow canon of neoclassical economics, the Group identified a total of 18 'adverse effects on competition' (AECs) and presented 23 proposed remedies (including options and variants) to address these AECs. More than half of these proposed remedies relate to the treatment of electricity network transmission losses and of CfDs, to relatively minor modifications of the regulatory framework, to some vague modifications of regulatory decision-making and to a more efficient modification of industry codes of governance. Some of these proposed remedies touch on, but, unsurprisingly, do not engage effectively with, key dysfunctional features of energy and climate change policy and regulation. None of these proposed remedies are likely to have any meaningful impact on final prices in the retail markets. However, almost half of the findings and the proposed remedies relate to the

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Beginning with significant involvement in gas market liberalisation in Great Britain – including advising the gas regulator and the then Monopolies and Mergers Commission (subsequently re-configured, via the Competition Commission, as the Competition & Markets Authority) - the geographical scope of his work has expanded and he has considerable international experience throughout Europe, Africa, the Middle East, Russia and East Asia. He has provided advice to the European Commission on its gas market liberalization programme and evaluated gas interconnection and storage projects under the European Energy Programme for Recovery. He has worked for gas market participants throughout the EU in the context of gas market liberalization and is involved in the development of the EU's Gas Target Model being facilitated by the Directorate-General for Energy of the European Commission (DG ENER), the grouping of national energy regulators for the Member States (ERGEG) and the Agency for Co-operation of Energy Regulators (ACER). He has written a paper which sets out a basis for developing the mandated Entry-Exit pricing of gas transmission in the context of the EU Gas Target Model:

http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG23-Entry-ExitTransmissionPricingwithNotionalHubsCanItDeliverAPanEuropeanWholesaleMarketInGas-PaulHunt-2008.pdf phenomenon of weak customer response in the context of blatant profiteering by the energy suppliers and the existence of lower priced offers. A survey commissioned by the Group found that (1) around a third of households have never considered switching supplier, (2) around a third of SVT customers have been on the default tariff with their supplier for over five years and (3) there are substantial gains from switching that currently go unexploited. This, of course, is very difficult, if not impossible, to explain when one's view is blinkered by the application of the narrow canon of neoclassical economics. The Group comes very close to describing the large number of household consumers who refuse to shop around and switch between suppliers as being stupid.

For example, the Group makes much of its contention that electricity and gas are homogenous goods. From this the Group correctly infers that energy suppliers don't compete to offer services that are clearly differentiable from those offered by others. This is true simply because they can't. The same electricity comes out of a household's sockets and the same gas enters a household's internal pipework irrespective of who the supplier is. The Group goes on to infer that competition between suppliers will focus on price. Not surprisingly, the Group is puzzled that so many households fail to switch to lower priced offers either from their current supplier or from other suppliers.

There are combinations of factors which the Group was either unwilling or unable to consider that could solve this puzzle. First, from the perspective of many household consumers their demand for electricity and gas is primarily a demand for utility services. Households have a continuous demand for a variety of varying combinations of heating, lighting and motive power. There are three possible implications of this. One is that some household consumers may place more value on the 'utility' of being able to choose desired combinations continuously over time and ignore or discount the cost, since the cost is not continuously brought to their attention. A second is that many household consumers may have had a bad experience as a result of switching or simply believe that the opportunity cost of switching is too high or are justifiably suspicious of the offers being made. And a third is that many household consumers, in particular older consumers, grew up being supplied by regional electricity and gas boards. Most never explicitly voted at the polling booths to empower governing politicians to change these energy supply arrangements – and quite a few may have voted for politicians opposed to any such changes. As a result, many may be content to continue being supplied by the incumbent, dominant supplier in their region.

Secondly, the savings which the Group estimates final consumers would make if they were all to shop around and to choose the cheapest offer available are totally illusionary. Since the energy suppliers don't compete to offer services that are clearly differentiable from those offered by others, they compete to gouge as much revenue as they can from final consumers. If all consumers attempted to switch to the cheapest offers the savings estimated by the Group would rapidly vanish as the supply firms would increase their tariffs to protect their revenue recovery and profitability. It would be an interesting survey question to seek to establish what proportion of consumers recognise that a primary objective of the energy supply companies is to gouge as much revenue as they can from them. And it would also be interesting to assess the extent of the recognition that even if savings are available the more they might seek to capture these savings the faster they will evaporate. Given the fines amounting to hundreds of millions of pounds that have been imposed on energy supply firms it would be surprising if a high proportion of final consumers are not well aware of the consumer-gouging behaviour of these firms.[2]

[2] From the perspective of individual consumers the fines imposed by Ofgem may appear to be enormous. However, in the context of the annual cash flows generated by these firms the fines are little more than 'flea-bites'. Not surprisingly, most firms appear to treat these fines

In these circumstances, the behaviour of most consumers may not be perfectly rational from the perspective of a neoclassical economics blinkered observer, but it is perfectly understandable. It is not the consumers who appear to be stupid; nor are the members of the Group stupid. But the latter's determination to believe that the body of theory and analytic tools available to them do not permit them to analyse what is blindingly obvious – the aggressive gouging of disengaged consumers - and to contemplate an appropriate remedy is an example of a politically convenient stupidity.

Most of the remedies that the Group propose to address this weak customer response appear to lack both substance and efficacy. And, perhaps, recognising the likely total ineffectiveness of these proposed remedies, the Group finally comes up with Remedy 11 – A transitional 'safeguard regulated tariff' for disengaged domestic and microbusiness customers. But the Group appears to have no idea how this concept would be devised or implemented and the questions intended to solicit responses from interested parties appear to comprise a fishing expedition to garner ideas.

It beggars belief that the Group feels compelled to contemplate the introduction of this concept. It makes no sense to contemplate the co-existence of genuinely competitive activity and the application of this 'safeguard regulated tariff' in the energy retail markets. It is almost certain to provoke vociferous opposition from most, if not all of, the energy supply firms, from the army of advisers and consultants they retain and, surreptitiously, from the politicians and officials who have been captured to some extent or other by the energy supply firms. Even if something that fits the bill is devised and implemented, it will be gamed ferociously by the energy suppliers at the expense of final consumers. The irony is that the need to contemplate as remedy of this nature provides compelling evidence of the abject failure of the British model of competition and regulation in the energy sectors, but all those who exercise power and influence – and all those who benefit from the exercise of this power and influence – not surprisingly appear to be determined to ignore this evidence.

The next section proposes an alternative more effective remedy.

A National Electricity and Gas Buyers' Collective (NEGBC)

A more effective remedy to prevent energy supply companies exploiting apparently disengaged consumers is to establish a statutory National Electricity and Gas Buyers' Collective. All household consumers on SVTs and on prepayment meters would be contacted and would be automatically opted in unless they expressed an explicit preference to opt out. The energy suppliers using an agreed protocol would migrate details of the opted in consumers on their databases to a centralised consumer database operated by the NEGBC. The NEGBC would then assemble and analyse consumption data for the opted in consumers. Prior to a legislated appointed day – preferably the start of a month and at the beginning of beginning or end of the heating season – the NEGBC would publish the total number of electricity only, gas only and dual-fuel consumers by electricity and gas distribution network and an estimate of the normal temperature year volumes of gas and electricity required to supply them. The energy suppliers would bid to supply specific volumes and numbers of household consumers by distribution network. The estimated volumes demanded would be filled up starting with the lowest priced bid until all were filled. The NEGBC would calculate and apply a weighted average price for electricity only, gas only and dual-fuel supply for each distribution network. This would be very similar to the 'regulated safeguard tariff' proposed by the CMA Group, but, instead of being set by a regulator or the CMA for an indeterminate number of consumers, it would be derived from competitive bids by energy suppliers to supply a precise number of consumers. The

simply as a cost, and not a significant cost, of doing business. The deterrent effect appears to be negligible.

NEGBC would invoice and receive payment from the opted in consumers and pay the energy suppliers in relation to their bid prices.

Obviously, additional protocols would be required for consumers opting in and out and for balancing purposes, but the essential features appear to be straight forward. Over time, as smart meters are rolled out, as consumers have access to more information to manage their consumption and to choose among suppliers and suppliers are able to make clearly differentiable service offers, more and more consumers may decide to opt out of the NEGBC. Its ultimate success would be its winding down.