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Dear Roger

The new Government Steer to the CMA

When the Coalition Government created the CMA it took power to provide a non-binding "strategic steer" to the CMA. The Steer, published on the establishment of the CMA on 1 October 2013, "includes statements on how the work of the CMA should support the Government's overarching priorities". In particular, it provided guidance on what sectors the CMA should investigate: "the CMA should assess specific sectors where enhanced competition could contribute to faster growth (for example, knowledge intensive sectors, financial services and infrastructure sectors including energy) – working with the responsible regulator where appropriate". (p 11)

Also, and remarkably, the Steer specified how the CMA should approach its task, by making consumer behavioural issues central to its analysis.

> "The CMA should take account of consumer behaviour particularly in markets where there are information problems and asymmetries. Markets sometimes fail to work effectively not because of lack of competition but because consumers struggle to compare products or face costs of switching. The Government considers that these consumer behavioural issues should be central to the CMA's analysis of whether markets are working well, and where relevant, should inform the remedies it puts in place". (p 10)

It would be surprising if the market investigation *Guidelines*, revised in April 2013, did not reflect the Coalition Government's initial thinking on the Steer. Indeed, they introduce and give considerable attention to the concept of weak customer response.

The CMA's *Provisional Findings* and *Possible Remedies* in the energy market investigation have evidently responded to this Steer. Analysis of the retail market has been based firmly on the concept of weak customer response, and possible remedies have sought to change customer behaviour. Presumably these findings supported the then-Government's overarching priorities.

However, on 7 December 2015 the present Conservative Government issued a new Steer. The Government no longer proposes to tell the CMA which sectors it should assess. There is still a recognition that "The CMA should consider consumer behaviour and actions when assessing whether a market is operating properly, looking at issues such as failure to compare products." (p 9) Importantly, however, the new Steer removes the paragraph cited above, telling the CMA that consumer behavioural issues should be central to the CMA's analysis and should inform the remedies it proposes.

The Introduction explains that "This Steer places more of an emphasis on productivity and removing obstacles that prevent new, innovative business models from entering the market place." (p 3) Consistent with that, the Steer begins by declaring that

> "the CMA should ensure that dynamic competition is allowed to flourish, thereby increasing productivity and sustaining economic growth for the benefit of consumers". (p 9)

Then comes a new emphasis not mentioned in the previous Steer.

> "The Government is committed to removing unnecessary regulatory burdens on businesses wherever possible. Using competition tools can often provide an alternative to regulation, and we encourage the CMA to act as a leader in this regard, particularly with sector regulators. The CMA can play a significant role in reducing burdens on businesses and securing better outcomes for consumers by: … partnering with economic regulators to use effective competition tools to promote changes in markets rather than prescriptive licensing conditions and regulatory requirements;" (pp 10-11)

Whether the concept of a non-binding strategic steer, changing with every new Government or even every three years as the Coalition Government intended, is conducive to the effective operation of an independent competition agency is a debatable question. Nevertheless, the new Steer is in place and the CMA is obliged to have regard to it.

We urge the CMA not only to have regard to the new Steer, but to recognise the underlying message reflected in the change from the first Steer to the present one, which has particular relevance to the circumstances of the GB retail energy sector.

The CMA's present investigation represents the fourth set of analyses and regulatory interventions in the retail energy sector over the last eight years. All have been driven by a concern about alleged weak customer response and an intention to change customer behaviour. Of the first three interventions – the non-discrimination condition 2008/09, the Procrustean Bed 2011/12 and the RMR simple tariffs policy 2012/13 - the first two have been abandoned and the CMA has recommended removal of the third because of its adverse effect on competition. All have failed. There has been no reduction in tariff differentials compared to the period before these policies were instigated, customer switching is significantly lower and supplier profits are higher. Customers are worse off, not better off, as a result of these interventions. There is little reason to believe the CMA's possible remedies – other than the removal of the RMR simple tariffs interventions - will have any better effect.

The new Steer implicitly recognises what the evidence from the last eight years is telling us. It is not only the remedies that are at fault. The real problem is the diagnosis that customer behavioural issues are to blame for the state of competition in the market, and that the remedy is to use regulatory interventions to change customer behaviour.

The new Steer also recognises that markets are better than regulators at discovering and providing what customers want and, importantly, incentivising them to engage in the market. This might be by suppliers making attractive tariff offers, by switching sites highlighting opportunities available, by new services offering to take the hassle out of comparing and switching, or by as yet undiscovered new approaches. The most helpful role for regulation now would be to reduce or remove the costs, delays, restrictions and obstacles that have increasingly been imposed on suppliers (and customers) over the last eight years.

The CMA has provisionally found that the regulatory interventions have had an adverse effect on competition. Rather than continuing to focus on alleged "weak customer response" and seeking other burdensome but ineffective remedies for that, and rather than introducing new price controls that are directly at variance with the new Steer, we encourage the CMA to respond to the new Steer by focusing on "removing unnecessary regulatory burdens on businesses wherever possible", thereby "allowing dynamic competition to flourish … for the benefit of customers".

From:

Stephen Littlechild, Director General of Electricity Supply and Head of the Office of Electricity Regulation (Offer) 1989-1998

Sir Callum McCarthy, Chairman and Chief Executive of Ofgem and the Gas and Electricity Markets Authority (GEMA) 1998-2003

Eileen Marshall CBE, Director of Regulation and Business Affairs, Offer 1989-1994; Chief Economic Adviser and later Deputy Director General of Ofgas 1994-1999; Managing Director, Ofgem and Executive Director, GEMA 1999-2003

Stephen Smith, senior executive positions at Ofgem 1999-2002 and 2003–2010 including Managing Director, Markets, 2004-2007 and Executive Board Member, GEMA 2004- 2010

Clare Spottiswoode CBE, Director General of Gas Supply and Head of the Office of Gas Regulation (Ofgas) 1993–1998.