Competition and Markets Authority: Energy market investigation - Provisional decision on remedies

Consultation response from the
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This consultation response has been drafted by the named academic members of the Centre, who retain responsibility for its content.

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CCP Response to CMA Energy Market Investigation - Provisional Remedies Decision

CCP welcomes the opportunity to comment on the provisional remedies proposed by the CMA in relation to its Energy Market Investigation. This response is split into three sections: (i) a general discussion of the size of consumer detriment, the price cap proposal and assumptions regarding smart meters; (ii) a discussion of proposed remedies which are likely to beneficial; and (iii) a discussion of proposed remedies with which we have concerns.

In summary, we broadly welcome the measures the CMA proposes to encourage consumer engagement and make switching easier, however we believe the cumulative impact of these measures is unlikely to be transformational. Given the very high estimates for detriment quoted by the CMA, we are sympathetic to the view, apparently expressed in the dissenting view, that more substantial interventions covering the whole of the market would be necessary if the claimed detriment is taken at face value. Nevertheless we suggest that the quoted detriment estimates probably overestimate the true harm. Also, we disagree with the dissenting view regarding the preferred intervention: rather than a price cap for standard variable tariff (SVT) consumers we suggest that ‘opt-out’ collective switches are probably a better solution for both SVT and PPM consumers. Crucially, rather than supplanting competition with regulation, opt-out collective switches modify the form of competition to one akin to franchise auctions. While preferring broader opt out collective switches, we note that a price cap covering prepayment meters (PPMs) is, in and of itself, a broadly proportionate remedy that offers a reasonable trade-off between expected consumer benefits and potential harm from unintended consequences. Lastly, we are sceptical that the smart meter roll out will be completed on time and will solve the broad ‘problem’ of consumer disengagement identified by the CMA.

Consumer harm, consumer engagement, price caps and smart meters

Extent of Consumer Harm

The CMA states that its headline estimate of detriment from high domestic retail market prices averaged £1.7bn per annum over the period 2012-15 and in 2015 alone was £2.5bn. Even using the indirect method, detriment is estimated at £660m–£1.1bn per annum. If these estimates of harm are to be believed, and they continue in the future, substantial interventions would be justified, even those with large upfront costs and significant ongoing costs, if they reduced prices for non-engaged consumers. For example, if we are conservative and consider the lowest detriment estimate of £660m, an intervention with an ongoing cost of £60m per annum would still have a net present value (NPV) in the following situations:

(i) Actual detriment is only 10% of the estimated detriment and the intervention resolves all of the detriment, or

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2 Paragraph 59, page 14, ‘Energy market investigation: Summary of provisional decision on remedies’
3 Paragraph 64, page 15, ‘Energy market investigation: Summary of provisional decision on remedies’
4 To put £60m into context the total gross operating cost of Ofgem was £87m in 2014-15 while Ofgem’s permanent headcount in the same year was 896. See pages 43 and 77 of ‘2014-15 Office of Gas and Electricity Markets (Ofgem) Annual Report and Accounts’.
5 We recognise that for the statements to be correct the intervention (and its costs) must end immediately if the estimated detriment ceased due to exogenous changes to the energy market, such as the introduction of smart meters.
(ii) Actual detriment is £660m, but the intervention only resolves 10% of the detriment, or
(iii) Actual detriment is £660m and the intervention has a 10% chance of resolving the entire
detriment (here the NPV is positive in expectation).

Of course the CMA should aim to maximise the NPV rather than simply ensure it is positive, but this
reasoning shows that, if the CMA really believes its detriment estimates, very large interventions could
be justified. As a result, the CMA needs to offer clear reasoning, ideally including quantitative
estimates to justify why substantial interventions are not warranted.

While the reasoning above suggests that even with an ultra-conservative view of consumer detriment
substantial interventions, if effective, would have a positive impact on welfare, it is important to
highlight why we believe the headline estimates of detriment reported by the CMA are likely to be
overestimates.

Firstly, if all consumers were ‘engaged’ it is not automatic that all firms would charge prices equivalent
to the ‘competitive benchmark price’. Indeed, if all consumers were engaged (which is very
unlikely), the ‘competitive benchmark price’ could adjust upwards, although it is likely to remain substantially
below SVT levels.

Secondly, and more significantly, the CMA considers all of the difference in price between SVTs and
the competitive benchmark to be a potential welfare gain and therefore consumer detriment. This
seems questionable: some of the difference in price will be offset by the costs of consumers, who do
not currently do so, engaging in the energy market. These costs relate to the time and cognitive effort
required to identify the best deal for the individual consumer (search costs) and then the time (and
possible payment of exit fees) to complete the switch (switching costs). That relatively few individuals
switch suppliers in the energy market can be interpreted as showing that there are substantial costs
to switching and that in many cases these costs are greater than the expected savings quoted to
consumers. While the CMA’s various remedies are likely to reduce search and switching costs such
that some additional consumers switch, the true welfare gain to consumers of a higher switching rate
still needs to be calculated net of any remaining search and switching costs involved.

The vital importance of correctly identifying the costs of consumer engagement is highlighted by the
FCA consultation paper outlining proposed measures to increase consumer engagement in the general
insurance market. In the FCA’s cost benefit analysis of proposed measures to increase consumer
engagement at renewal, the cost to consumers of engaging with the market and the cost to firms of
handling calls from consumers enquiring about different deals/switching, are explicitly estimated. The
annual cost of consumer engagement is estimated at £13.1m and the annual cost to firms of increased
call handling is estimated at £3.9 million. The estimated consumer engagement cost is based on
engaged consumers spending 1 hour on searching/switching and the UK average wage being £12 per
hour. The estimated call handling cost is based on an average call length of 15 minutes with a cost of
approximately £14 per hour. While these figures can provide an approximation for the costs of
customer engagement the fact that there are clear engaged and unengaged groups in the retail
energy market emphasises that there are likely to be considerable variations in the actual
switching/search costs experienced by different consumers. Similarly, the decision not to engage will

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6 Paragraph 58, page 14, ‘Energy market investigation: Summary of provisional decision on remedies’
7 ‘Increasing transparency and engagement at renewal in general insurance markets’, Financial Conduct
   Authority (FCA), Consultation Paper CP15/41, December 2015
8 Table 2, Annex 2, ‘Increasing transparency and engagement at renewal in general insurance markets’
9 Paragraphs 43-46, pages 27 and 28, ‘Increasing transparency and engagement at renewal in general
   insurance markets’
be based on consumers’ expectations of search and switching costs as opposed to their actual values. This difference is a non-trivial issue since Deller et al (2014) provide evidence showing that consumers who did not switch in a collective switch appeared to systematically overestimate the time it would take them to switch compared to the actual time involvement experienced by those individuals who did switch.

Furthermore, in welfare terms, if consumer welfare and profits are given equal weight, the FCA’s cost benefit analysis shows their proposed intervention to have a negative NPV according to the quantified costs and benefits. This is because any increase in consumer welfare from reduced prices, conditional on the quantity consumed remaining fixed, is simply a transfer from firms’ profits. For interventions that increase consumer engagement to deliver a true welfare gain, rather than simply a transfer, it must be the case that the lower equilibrium prices resulting from higher consumer engagement increase the quantity consumed. Given the widely discussed issues of fuel poverty and the under-heating of houses these welfare gains from increased energy consumption are potentially significant.

However, for the welfare gains to be maximised, it is important that it is those who currently significantly restrict their energy consumption who respond to lower prices by increasing consumption. In a market where there is already strong evidence of price discrimination and non-engagement it is not automatic that this will be the observed outcome. We expect that the CMA’s proposed remedies will be more effective in encouraging the semi-engaged to switch more often than in getting the hitherto unengaged to switch for the first time.

Consumer Engagement

As identified above, consumer engagement imposes costs on both consumers and firms. This is why we find the CMA’s statement that, “Engaged customers are an essential component of well-functioning energy markets” concerning. While the statement may be true for a market to operate in a fashion that fits the hypothetical notion of what a ‘well-functioning’ market looks like, the end objective when designing/evaluating a market or mechanism should not be what appears ‘well-functioning’ but what maximises welfare. A potential benefit of opt-out collective switching, or full price regulation, is that the need for active consumer engagement (and its associated costs) is reduced/removed, thereby representing a welfare gain relative to the operation of a liberalised market.

Secondly, the history of many (the majority of) consumers remaining unengaged with the energy market over a prolonged time period, despite regulatory efforts, suggests that engaging the unengaged is an inherently difficult task. Consequently the CMA may be creating a ‘rod for its own back’ by arguing that engaged consumers are essential. Low consumer engagement (and switching) is

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11 Although from a purely environmental perspective there might be concerns about increased energy consumption.
14 This statement refers specifically to a welfare gain resulting from a reduced need for consumer engagement rather than suggesting that overall price regulation or opt out collective switching provide a net welfare gain when all factors are considered.
an empirical fact and can be interpreted as an equilibrium outcome of consumers taking individually rational decisions; as a result low engagement probably should not be seen as a ‘problem’ on the part of consumers. While we believe the CMA’s proposed interventions are likely to raise consumer engagement, we expect the cumulative effect to be at the margin rather than transformative. Our general reasoning for cautioning against expectations of high consumer engagement in utility markets is presented in our consultation response to BIS’s proposed ‘Switching Principles’\(^{15}\). In essence, utility markets are more akin to markets for financial services than markets for consumer goods sold in supermarkets. In utility markets consumers have to deal with extensive written information rather than being able to utilise visual cues, and have to grapple with the challenges of price\(^{16}\) and consumption uncertainty.

Furthermore, CCP research provides direct evidence of a subset of UK energy consumers’ decisions not to switch when presented with substantial monetary savings in a benign set of circumstances for switching. Deller et al (2014)\(^{17}\) report that even when presented with estimated annual savings of £200-300, only 36-42\% of participants in an ‘opt-in’ collective switch\(^{18}\) changed supplier. This finding comes from ‘The Big Switch’ run by Which? where, compared to the market as a whole, participants are likely to be relatively knowledgeable consumers who, by signing up, also indicate that they are relatively ‘engaged’\(^ {19}\).

This evidence suggests that even after all of the CMA’s interventions it is likely that a significant proportion of consumers will remain unengaged and on suppliers’ SVTs. At the core of the CMA’s ‘direct’ detriment estimates is the difference in price between SVTs and the ‘competitive benchmark’. If the main impact of the CMA’s remedies is to cause marginally unengaged consumers to become more engaged and switch, the average extent of disengagement among those consumers remaining on SVTs post-intervention is likely to increase. Since the average strength of SVT consumers’ disengagement will have increased post-intervention, energy firms may even choose to increase the prices of their SVT offerings relative to the competitive benchmark. Thus while post-intervention the proportion of consumers on SVTs should fall, there is a chance that the price gap between the ‘competitive benchmark’ and SVTs may even increase.

Overall we find it surprising that the majority of the CMA panel does not feel that stronger interventions are justified if they believe their detriment estimates are robust. Either the CMA has substantially overestimated the detriment of non-engagement or the majority of the panel are being extremely optimistic about their ability to raise consumer engagement.

\(^{16}\) By price uncertainty we primarily refer to consumers with variable price contracts that allow the energy supplier to alter per unit price, or running rate, after the contract has been signed. It is also true that if energy is priced according to a two-part tariff and there is consumption uncertainty, the average price per unit that a consumer will pay is inherently uncertain.
\(^{18}\) Unlike an ‘opt-out’ collective switch, an ‘opt-in’ collective switch requires individual consumers to: (i) sign up to the scheme, and after a winning firm is identified, (ii) take a positive decision to switch to the winning supplier. The requirement for consumers to take positive decisions means ‘opt-in’ collective switches are unlikely to solve issues around unengaged consumers.
\(^{19}\) When signing up individuals had to provide a similar quantity of information as that required by price comparison websites. However, when shown the estimated saving offered by the winning supplier, minimal additional information or input was required for a participant to complete a switch.
Price Caps and ‘Opt-Out’ Collective Switches

If the CMA’s estimates of consumer detriment are believed (or indeed if a conservative reduction of the estimates is taken) three stronger interventions present themselves: (i) full price regulation; (ii) a price cap incorporating headroom and covering all SVT consumers; or (iii) opt-out collective switches. Regarding (iii), separate auctions could be run for both SVT customers and PPM customers. We note that when choosing to take an interventionist route a philosophical choice favouring paternalism over individualism is made due to the inherent uncertainties regarding what a consumer choosing not switch actually indicates. As explained in Deller, Hviid and Waddams (2015) it is very difficult (probably impossible) to separate those individuals who consciously choose not to switch due to satisfaction with their existing supplier from those consumers unable to take advantage of the market mechanism. Since the CMA is happy to propose a price cap for PPM customers it is clear that the CMA is willing to take a paternalistic stance, at least in relation to a subset of energy consumers.

Of the three more significant interventions suggested above we favour opt-out collective switching for both SVT and PPM customers. In particular we note that price caps risk unintended consequences for the wider market, while full price regulation is likely to be less effective in establishing the true cost of service provision than an auction mechanism as used in opt-out collective switches.

We are pleased that in its evaluation of a potential price cap for all SVT consumers the CMA is aware of the challenges presented by price caps. Broadly speaking there are four:

(i) Identifying the correct level of the price cap such that it protects consumers who do not engage while providing sufficient room for effective competition for active consumers;
(ii) Reduced incentives for consumers to engage with the market;
(iii) The price cap acting as a focal point enabling tacit collusion;
(iv) If the price cap is explicitly linked to ‘competitive offers’ in the market, that firms will have an incentive to increase the prices of their ‘competitive offers’.

The design of the price cap proposed for PPM consumers and considered for all SVT consumers demonstrates awareness of issues (i) and (iv). By proposing a price cap based on the CMA’s existing competitive benchmark analysis with adjustments linked to movements in exogenous cost indices, it would appear that the risk of perverse incentives for firms to adjust their ‘competitive’ prices in response to the establishment of the price cap is limited. However, it is much harder for a price cap to tackle points (ii) and (iii). With regard to (ii) it is important that, while the reassurance and reduced gains from switching from a price cap are likely to reduce consumer engagement, the protection offered by the price cap is only partial. The need to incorporate headroom (estimated at £50 for a dual fuel customer) to allow for competition in the rest of the market also means that those households receiving a price capped tariff will be paying above the ‘competitive benchmark’ by an amount equivalent to the headroom.

That a price cap is likely to reduce consumer engagement results from the very purpose of the price cap which is to reduce the difference in prices between ‘competitive offers’ and SVTs/PPM prices. A

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20 The same uncertainty mean that choosing note to intervene also implies a philosophical choice, but in the direction of individualism over paternalism.
21 Paragraph 4.128, page 213, ‘Energy market investigation: Provisional decision on remedies’
22 The qualification to this conclusion is if energy firms adjusted their ‘competitive’ prices in advance of the CMA’s decision (which is possible given Labour’s previous policy proposal to freeze energy prices) or if the cost indices used are not truly exogenous of firms’ actions. Problems may also arise if the exogenous cost indices do not correctly reflect all the significant cost changes experienced by firms.
23 Paragraph 4.131, page 214, ‘Energy market investigation: Provisional decision on remedies’
smaller price difference implies that the potential gain to an unengaged SVT consumer of switching supplier to a ‘competitive offer’ is reduced. A robust and consistent finding from CCP research is that larger monetary savings increase the probability of switching, after controlling for a wide range of other variables. This finding is identified in Waddams Price and Zhu (2016)\textsuperscript{24}, Deller et al (2014), Flores and Waddams Price (2013)\textsuperscript{25} and Giulietti et al (2005)\textsuperscript{26}. Not only may a widely applicable price cap reduce the incentive for unengaged consumers to become engaged, it may also reduce the incentive for currently engaged consumers to remain engaged at the end of their fixed term tariffs.

Since the central cause of detriment which the CMA identifies is consumer disengagement, and there are costs to consumers engaging with markets, a competitive mechanism that does not require consumer engagement is intuitively very attractive. One such mechanism which avoids the identified downsides of a price cap is an ‘opt-out’ collective switch.

In an opt-out collective switch the opportunity to supply large blocks of SVT/PPM consumers would be auctioned. The winning firm would be the one offering the lowest price of supply subject to minimum quality criteria. The system would be similar to the auctions used for rail franchises. The main advantage of this approach over a price cap is that unengaged consumers will benefit from the full force of competition without incurring the costs of searching and switching, while unintended consequences on the rest of the market should hopefully be limited\textsuperscript{27}. Crucially, before the auction takes place, consumers would be sent a letter giving them the option to opt out of the auction so that they could either remain with their existing supplier or conduct their own search of the market. The opt-out and auction process could then be repeated for each group of consumers perhaps once every two years. Such an intervention is probably the most direct solution to the problem of persistent consumer non-engagement identified by the CMA.

We should be clear that this scheme would be a very significant intervention. However the compulsion imposed on consumers is limited by the opt-out mechanism and, as the CMA is willing to impose a price cap for some consumers, it is clear that the CMA does not consider intervention per se to be a problem. Also, while the auction process will involve significant setup and ongoing running costs, the scale of harm identified by the CMA is such that these costs are likely to be outweighed by the potential gains\textsuperscript{28}.

\textsuperscript{27} We do recognise that there are risks of opt-out collective switches affecting the wider market. For example, if the vast majority of consumers did not opt-out one might be concerned about the size of the non-collective switch market remaining viable over the long-term. Similarly it is possible that tariff structures selected for the collective switch auction might then become the norm in the wider market, although the impact of this on consumer welfare is unclear.
\textsuperscript{28} Actually measuring the realised gains from introducing opt-out collective switches is likely to be involved. A first approximation for the transfer from producers to consumers of the new mechanism could be obtained by comparing the SVT tariffs existing immediately before the intervention with the tariffs obtained in the first round of the opt-out collective switch auctions. Estimating the welfare gain from increased energy consumption is more challenging as not only will the tariffs experienced by consumers have changed post-intervention but so will other exogenous factors, such as weather, which influence energy consumption.
Opt-out collective switches have been implemented in the USA and the proposed process has similarities with the ‘single buyer’ model in Italy. One disadvantage of opt-out collective switches, given the CMA’s general argument, is that they are likely to have a relatively lengthy implementation timescale. Implementation would require the detailed design of the auction process and some need for a consensus, possibly political, regarding the acceptability of the opt-out mechanism. However, the desire for a rapid roll out results directly from the CMA’s strong assumption that any significant interventions will be temporary since completion of the smart meter roll out will result in the ‘problem’ of consumer non-engagement disappearing.

The CMA argues that “Given the scale of the detriment we have identified, we believe that it is vital to ensure that our remedies are implemented as rapidly as practicable. To assess the effectiveness of the proposed remedy package… we have considered the timescales over which these remedies are likely to be implemented.” While it is correct to implement proposed remedies as rapidly as possible, to suggest that the size of detriment means that remedies that can be rapidly implemented are per se more attractive is highly questionable. The correct method to assess the relative merits of different interventions is to assess their full costs and benefits over their lifetime i.e. to compare their NPVs. The CMA’s approach risks selecting interventions delivering rapid solutions over those that give greater benefits over the long term.

While smart meters undoubtedly introduce considerable uncertainty (see the following subsection), it is probably unrealistic to assume that they will solve all the current issues in the retail energy market. Also, there is no reason why a collective switch auction could not be applied to tariffs that utilise the functionality of smart meters. If franchise auctions can be designed for contracts as complex as rail franchise agreements it is unclear why an auction process could not be applied to smart meter tariffs. Even if an auction mechanism could only be applied to a restricted range of smart meter tariffs, the presence of an opt-out mechanism should enable tariff structures that offer significant benefits to consumers to still attract custom.

We recognise that the scale of the change associated with adopting opt-out collective switches leads to implementation risks that would need to be carefully managed. In particular, the precise design of the auction mechanism is likely to have significant influence on the winning deal and price differentials between consumers are unlikely to be fully removed. Nevertheless, the scale of detriment claimed by the CMA would suggest that radical long-term solutions, such as opt out collective switches, deserve suitable attention.

Finally, when compared to price caps, opt out collective switches have the advantage of being in line with the CMA’s objectives to promote competition. While price caps explicitly limit the extent of the competitive process, the auction mechanism at the heart of collective switches simply represents an alternative form of competition to atomistic markets rather than a restriction on competition.

Although the above argument focuses on the benefits of opt-out collective switches over price caps, we do not oppose the introduction of a price cap for PPM consumers. The CMA’s argument that PPM

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30 Equally the CMA considers an opt-out mechanism to be acceptable with regard to its Disengaged Consumers Database remedy.
31 Paragraph 4.88, page 203, ‘Energy market investigation: Provisional decision on remedies’
32 If an alternative tariff structure offers sufficiently large benefits to consumers, the consumers would be willing to opt out of the collective switch and engage with the rest of the market to obtain the alternative tariff structure.
consumers require additional protections due to the extra barriers to competition in this segment of the market is persuasive. Additional protection for this group may also be warranted due to this group containing a disproportionate number of individuals who are vulnerable and/or in a precarious financial position. Restricting the price cap to a small section of the market also limits the potential for unintended consequences along the lines of points (iii) and (iv) above. However, we question the conclusion that a PPM price cap will be temporary: once introduced there is likely to be considerable consumer and political pressure for the price cap to remain in place, with potential consequences for the feasibility of long-term competitive solutions for PPM consumers.

**The Introduction of Smart Meters**

Central to the CMA’s argument that many of the proposed remedies are temporary and that rapid implementation of remedies is required is the assumption that the smart meter roll-out will be complete by 2020 and will be transformational in increasing consumer engagement. We fully accept that smart meters offer a considerable array of new technological options, including increasing the ease of switching between credit and prepayment mechanisms. Similarly we expect smart meters to resolve the confusion for consumers resulting from the need to reconcile the monetary sums they pay to energy firms with their actual energy use as recorded by their ‘dumb’ meters. However we believe that smart meters introduce considerable uncertainty regarding the future development of the energy market, rather than necessarily offering a clear solution to CMA’s identified problem of consumer disengagement. This uncertainty takes two forms: (i) the impact that smart meters will have on consumer engagement and (ii) the timescale with which smart meters are introduced.

The CMA admits that there is little evidence to support its view that smart meters will have a significant positive impact on engagement: “There is limited evidence on the impact of smart meters on engagement in domestic retail energy markets – and our review of the international experience of smart meter roll-out.....did not identify any studies that have specifically addressed this question”\(^{33}\). The CMA appears to base its conclusion that “fully functional smart meters are likely to have a substantial, positive impact on both competition and engagement”\(^{34}\) on a series of descriptive statistics from the ‘Smart energy outlook’ survey. These descriptive statistics relate to smart meter customers reporting greater understanding and/or information regarding their energy bill and ability to make energy supply choices compared to non-smart meter users\(^{35}\). We are concerned that this is rather weak evidence on which to base such an important element of the argument regarding which interventions are proportionate.

While we have not investigated the methodology of the ‘Smart energy outlook’ survey, we have several concerns regarding the quoted statistics. Firstly, given our understanding that smart meter installation is optional, the higher reported understanding of smart meter users may result from a difference between the users of smart meters and other meter types rather than resulting from the smart meters themselves. It may be that more active and informed consumers are choosing to have smart meters installed rather than that the installation of smart meters causes consumers to become more active and informed. Since the present smart meter users are ‘early adopters’ they may have a particular preference for technology and ‘gadgets’ compared to the population as a whole, rendering the reported statistics unduly flattering. Thirdly, as the statistics relate to consumers who have had smart meters installed fairly recently, consumers’ long-term levels of engagement with smart meters may be overstated. The act of installation and the contact with an installer may provide an initial and

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\(^{33}\) Paragraph 4.75, page 200, ‘Energy market investigation: Provisional decision on remedies’

\(^{34}\) Paragraph 4.77, page 200, ‘Energy market investigation: Provisional decision on remedies’

\(^{35}\) Paragraph 4.76, page 200, ‘Energy market investigation: Provisional decision on remedies’
temporary boost to engagement with smart meters. \(^{36}\) Lastly, the statistics quoted by the CMA do not provide a direct measure of market engagement, rather they merely state that a greater proportion of smart meter users have the necessary information to make a hypothetical product choice.

Regarding the timeline for the delivery of smart meters the CMA appears to accept DECC’s timeline that the smart meter roll-out will be completed by the end of 2020. While it is possibly difficult for the CMA to directly investigate and critique the plausibility of this timescale, the long history of UK infrastructure projects suffering repeated delays suggests that greater discussion of the implications of delays in the roll-out is warranted. This is particularly the case given that the obligation suppliers are under is simply “to take all reasonable steps to ensure that a smart metering system is installed on or before 31 December 2020”\(^{37}\) which seems to provide a reasonable amount of wriggle room for installations not to be complete. Similarly, the CMA notes that for the 3.5% of households requiring “alternative home area network” solutions the timetable for receipt of a working smart meter is “currently unclear”. \(^{38}\)

Concerning the implications of delays to the smart meter programme the CMA simply notes that “the impacts and benefits accruing from these (transitional) remedies would be expected to increase”\(^{39}\). In and of itself, this statement is probably correct; however, it does not tackle the point that by focusing on ‘transitional’ remedies, which by definition need to be delivered quickly, the CMA rules out more fundamental and longer lasting remedies that have longer implementation timescales but potentially greater benefits, such as opt-out collective switching.

Potential downside risks regarding consumer engagement from the introduction of smart meters should not be forgotten. Smart meters will increase the amount of information available to consumers by a substantial amount but, as experience of energy bills shows, such increases in information do not always generate increased understanding or improved decision making. This is particularly the case given smart meters’ potential to enable tariff structures involving much greater complexity. Given the inherent uncertainties surrounding smart meters and the recommendation that Ofgem should produce more robust annual market monitoring reports\(^{40}\), we suggest that Ofgem also be recommended to conduct a detailed review of the domestic retail energy market 3-5 years after the smart meter roll out is complete. Such a review could assess whether the CMA’s positive view of smart meters on consumer engagement is matched by reality; whether smart meters lead to unanticipated consequences; and whether amended or additional interventions are required.

Remedies that are likely to be beneficial

**Removing RMR rules and, in particular, the four tariff rule**

Ofgem’s simpler choices rules have not increased consumer engagement to the extent hoped for, in particular, the current four tariff rule seems to have had little positive impact.\(^{41}\) It restricts choice without delivering any significant boost to consumer engagement. This limited impact is not surprising

\(^{36}\) For example, paragraph 35, page A5.1-13, ‘Appendix 5.1: Smart meter roll-out in Great Britain’ states: “The House of Commons received submissions that within a year of the installation of smart metering equipment, almost a third of in-home displays were being switched off by customers.”

\(^{37}\) Footnote 262, page 201, ‘Energy market investigation: Provisional decision on remedies’

\(^{38}\) Point (d), paragraph 4.80, page 201, ‘Energy market investigation: Provisional decision on remedies’

\(^{39}\) Paragraph 4.95, page 205, ‘Energy market investigation: Provisional decision on remedies’

\(^{40}\) Paragraph 182, page 40, ‘Energy market investigation: Summary of provisional decision on remedies’

\(^{41}\) Waddams, C. (2013) in her consultation response to the Department Energy and Climate Change’s ‘Ensuring a better deal for energy consumers’ document highlighted the potential for a limit on the number of tariffs to restrict innovation and potentially make co-ordination between firms easier.
since there are still 150+ tariffs on the market, despite the per firm cap. While academic research may show that increased choice reduces switching in specific situations, this does not necessarily translate into workable policy prescriptions. To reduce the number of tariffs to a level that would make the market appear ‘simple’ to most consumers would require a restriction of choice which would probably prove unpalatable. Rather than restricting choice, a better solution is to provide a regulatory framework which ensures that tools which simplify the energy market, such as price comparison websites (PCWs), work in the best interests of consumers.

While we support the removal of the RMR restrictions, we note that new issues may emerge if there is a complete removal of restrictions on tariff complexity. For example, there might be a risk of deals emerging which deliberately exploit consumption uncertainty: a firm might offer a tariff which is very competitive if a household consumes a quantity of energy identical to their previous year’s consumption, but which is very expensive if consumers increase or decrease their consumption by 5%. Such tariffs may well be controlled through Ofgem’s new principles based regulations as they might fall under a principle for firms not to unduly exploit consumers. Nevertheless, it will be interesting to observe whether general regulatory principles will be sufficient to protect consumers against this type of issue or whether there will be pressure, political or otherwise, for a return to more prescriptive rules. Indeed, Ofgem decisions regarding what does and does not adhere to specific principles may over time establish a cumulative set of precedents that ultimately are only marginally different to prescriptive rules.

**Increased powers for Ofgem to conduct research experiments in the market**

We fully support this measure as it should enable better ‘road testing’ of proposed interventions, thereby improving the quality of regulation and increasing knowledge of consumer behaviour. As the CMA highlights, randomised control trials (RCTs) offer a clear means to understand the effectiveness of different ‘prompts’ in encouraging consumers to switch suppliers. RCTs involving sufficient granularity will be needed as CCP research shows that consumer behaviour in energy markets can often be complex and varied. For example, while the time taken to complete a switch may deter some consumers, spending increased time searching for a better deal generally does not. Additionally, Flores and Waddams Price (2013) find that consumers can be grouped by their differing attitudes to markets and that the responsiveness of consumers to particular factors, such as monetary savings, varies systematically across these groups.

The initial list of interventions to be investigated by Ofgem’s research programme as proposed by the CMA, including studying the effectiveness of bill information, messaging for SVT customers and customer communications in the database remedy all sound sensible. We suggest that when evaluating these interventions success should not just be measured by the quantity of switching but also by the quality of switching. By quality we primarily mean the predicted size of saving achieved by a respondent switching to their chosen supplier relative to the cheapest deal on the market that satisfies their stated choice restrictions. The objective of any remedy should be to increase the welfare of consumers rather than to increase engagement per se.

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42 Without using a PCW, a choice of anything more than 3-5 tariff options is likely to be ‘complex’ for an average consumer. If consumers are using a PCW, it is unclear why the number of tariffs on the market matters at all since the whole purpose of a PCW is to identify the ‘best/cheapest’ deal on the market.

43 Waddams Price and Zhu (2016)

44 Paragraphs 6.13 and 6.15, page 328, ‘Energy market investigation: Provisional decision on remedies’

45 While domestic energy supply is generally considered a relatively homogenous product, we cannot rule out the potential for rational consumers to select more expensive suppliers on the basis of non-price
To fully understand the consequences of different interventions it is important to have a substantial and representative sample of consumers on which interventions can be trialled. The need for a representative sample of consumers across different companies means that the power for Ofgem to oblige companies to take part in the trials is sensible. However, from CCP’s own research involving commercial partners, it is very clear that for effective research to be produced in a timely fashion it is essential that there is ‘goodwill’ on the part of the commercial partner. There would seem to be myriad opportunities for an unwilling partner to frustrate/delay/limit the scope of Ofgem’s research in ways that would be hard to prove were deliberate obstruction.\textsuperscript{46} Profit making companies are likely to have an inherent incentive to limit switching by their own customers and so their incentives may not be aligned with Ofgem’s when these RCTs are carried out. Indeed, research to identify ways to increase switching may also identify factors that hinder switching and it is unclear how Ofgem would stop firms from using this new knowledge to their advantage in their wider communication/marketing activities.

Lastly, we welcome the CMA’s recognition that not all interventions are amenable to RCTs. Since the decisions of actual consumers are being manipulated, the tested interventions need to be easily reversible\textsuperscript{47} in case unintended consequences (including consumer harm) are observed.

**A clear process for Ofgem to comment on government policies**

For a regulator to be effective it must maintain a reputation for competence and retain the confidence of market participants and other stakeholders. The highly political nature of the energy market means there is a temptation for politicians to ‘shift blame’ for failed or unpopular policies on to Ofgem or other market participants. Without a clearly defined process for Ofgem to make formal and impartial comments on government policy it may not be obvious to outside observers who is responsible for particular policies and their consequences. In turn, this may distort the policy agenda and possibly result in government and Ofgem being unduly cautious around policies that attract widespread political attention. The need for clarity around the role of government in influencing energy prices is important, particularly when government policies increase prices.\textsuperscript{48} As a result, we fully support moves to formalise Ofgem’s ability to comment clearly (and probably publically) on government policies prior to their implementation.

**Enabling PCWs to continually monitor the market on behalf consumers**

This sounds like a very attractive proposition for consumers and one which may be a precursor to even more advanced market monitoring services once smart meters become commonplace. However, we note that at least one firm is already offering this type of service for a fee\textsuperscript{49}, suggesting that the existing barriers to the provision of these services may not be prohibitive. Also, there is a danger that consumers may be falsely reassured regarding the competitiveness of the deal they are receiving through such a service if a PCW providing this service only monitors a subsection of the market.

\textsuperscript{46} Any research partnership will be characterised by significant asymmetries of information.

\textsuperscript{47} Paragraph 6.36 point (e), page 33, ‘Energy market investigation: Provisional decision on remedies’

\textsuperscript{48} Paragraph 172, page 38, of ‘Energy market investigation: Summary of provisional decision on remedies’ states DECC estimates climate and energy policies will add 37\% to the retail price of household electricity by 2020.

\textsuperscript{49} See http://flipper.community/
Making single rate tariffs available to those on restricted meters

We fully support any moves that increase the ease of switching for consumers at a reasonable implementation cost. Introducing this flexibility as a stop-gap until smart meters are introduced seems a sensible measure. The CMA’s proposed remedy should enable consumers with non-standard meters to benefit from the full range of competitive tariffs. Our only note of caution is that careful communication of this remedy may be required as it may involve consumers losing ‘features’ provided by their meter which energy firms have previously extolled. While it is understandable from an economic perspective why energy firms and PCWs do not serve small ‘niche’ markets involving non-standard meters, the consumers with these ‘niche’ meters may nevertheless feel that the market is failing if the tariffs available do not allow the technology in their homes to be fully utilised.

Prohibiting unduly restrictive auto-rollover contracts for microbusinesses

As long as the contract terms are clear, auto-rollover contracts per se are not a problem, and may well enhance welfare by ensuring customers receive a continuous energy supply. Where there is an issue is if the circumstances when a consumer can complete a switch away from their existing supplier are unduly restrictive. Given that the time between entering into a contract and wanting to switch to an alternative supplier may be measured in years, requiring microbusiness customers to terminate their energy supply contract on a specific day each year is an obvious, and probably unfair, contractual barrier to switching. This is particularly the case if the energy supplier only puts this contractual term in the ‘small print’ and does not draw consumers attention to it. Prohibiting such contractual terms should help those firms that wish to change their energy supplier to do so.

Unresolved issues and remedies with risks

Database of SVT consumer details

One of the CMA’s primary interventions is to establish a Disengaged Domestic Customers database for consumers who have remained on the SVT for three or more years. We have significant misgivings about this intervention as it appears to take increasing engagement per se as the primary objective rather than raising consumer welfare. It also presents significant potential downside risks.

Firstly, taking the CMA’s desire to boost engagement per se at face value, we have a number of doubts about the effectiveness of this remedy. Firstly, if the underlying reason for limited switching are high switching costs rather than high search costs, it is unlikely that this remedy will have much impact. Since mailing offers of deals to consumers is an information remedy it can only address search costs. Secondly, there is potentially the risk of ‘prompt’ overload for consumers if consumers are deluged with letters offering energy savings, they may quickly learn to ignore of all the offers including those that are good deals. Similarly, does increasing the number of prompts (postal offers of savings) necessarily increase engagement? It would seem sensible to investigate this specific point as part of Ofgem’s proposed RCT research programme. Thirdly, data protection laws require consumers to opt in to receive electronic communications, i.e. email prompts, so the effectiveness of the remedy will be biased towards those individuals who respond to postal information. CCP research shows that a mechanism requiring a consumer to actively opt-in will lead to the participants disproportionately involving those who are already active and engaged.

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50 Page 25, ‘Energy market investigation: Summary of provisional decision on remedies’
51 Paragraph 6.257, page 403, ‘Energy market investigation: Provisional decision on remedies’
The second part of the critique of the consumer database remedy relates to the potential for negative outcomes. While the opt-out mechanism from the customer database\(^{53}\) may mitigate some of these risks, it is unlikely to remove them entirely.\(^{54}\) As has been widely discussed in relation to charities seeking donations, continual contact by organisations seeking a financial commitment from householders creates a significant ‘hassle’ factor, annoyance and anxiety for some consumers. This means the remedy carries considerable reputational risks for the CMA and Ofgem, at a time when a lack of confidence in the regulatory system is one of the key factors impacting negatively on the perceived performance of the energy market.

Related to this point is the potential for an individual facing multiple, and uncoordinated offers\(^{55}\), to be confused or overwhelmed. This risk should not be underestimated since the fact that consumers on the database will not have ‘engaged’ with the market for at least three years is evidence that they have a weaker understanding of the energy market compared to engaged consumers. While the proposed remedy is likely to increase the quantity of switching to some extent, it may prejudice the quality of switching. There is no guarantee that the marketing material which a consumer first receives/looks at will involve the best deal on the market for them. The quality of the switch, in terms of the monetary saving achieved, is likely to be lower than if a consumer was shown the results from a PCW which had ordered the deals from a range of suppliers by saving size.

We recommend that there should be a monitoring and reporting mechanism which accompanies the Disengaged Consumer Database that considers both the quantity of switching stimulated and the ‘quality’ of the switches in terms of the expected monetary savings.\(^{56}\) If negative outcomes are widely observed, Ofgem should be willing to modify or even end the Disengaged Consumer Database. Similarly, when assessing the benefits achieved by this remedy, the CMA/Ofgem need to be conscious that while the database may motivate consumers to switch once there is no guarantee that they will remain fully engaged after this point. For those households which are activated by the remedy a plausible pattern is that while they switch to a better fixed term deal initially which will revert to the new supplier’s SVT at the end of fixed-term deal and will remain on the SVT until they are returned to the Disengaged Consumer Database.\(^{57}\)

If there is no limit on the number of letters received by a consumer within a set period of time\(^{58}\), there is the risk that for a small number of consumers (especially those who are ‘vulnerable’) there will be a feeling of undue pressure to act. In this group individuals might choose to switch simply to stop the flow of marketing materials rather than after making a considered decision about their energy supply. To guard against this potential risk of harm we suggest that on the first page of any marketing

\(^{53}\) Paragraph 6.252, page 401, ‘Energy market investigation: Provisional decision on remedies’

\(^{54}\) With any opt-out mechanism one cannot be sure that those individuals who do not opt-out have made a full and conscious decision to remain within the scheme. We recognise that this issue is equally applicable to our proposal for opt-out collective switching.

\(^{55}\) The sequential receipt of marketing materials from multiple suppliers, at what might appear to be ‘random’ intervals to householders, is likely to seem considerably more confusing than an ordered list of offers as provided by a PCW.

\(^{56}\) As already noted, only an approximation of switching quality can be obtained since consumers may switch for non-price reasons and consumption uncertainty means a consumer can only select a deal providing the highest expected savings.

\(^{57}\) If suppliers understand the potential for this pattern, and consider it to be a realistic probability, it is likely to affect both the fixed term deals and subsequent SVT offered to consumers on the Disengaged Consumer Database. Firms are likely to offer highly competitive (possibly even loss making) one year fixed deals on the basis that they will make a decent profit over the long-term as consumers revert to their SVT.

\(^{58}\) Paragraph 6.252 (a) (ii) simply states that restrictions limiting the amount and/or content of communications could be introduced by Ofgem.
materials utilising the database there is a clear statement of how to stop additional marketing materials being received. This statement should be in plain English and include a telephone number and postal address as well as a web/email address.

A final point to consider is what the implications for policymakers are if significant numbers of SVT consumers do not switch, even after being sent a large number of letters and prompts to switch. Is the conclusion that consumers are happy with their existing supplier and happy to pay ‘high’ prices; or that consumers dislike being sent large quantities of direct marketing which would suggest that the remedy had not been effective?

**Assistance for vulnerable consumers who do not possess PPMs**

While we hope that the proposed remedies to encourage switching have a positive impact on the engagement of ‘vulnerable’ consumer groups, vulnerable groups may have inherent characteristics which limit their ability to engage effectively with the energy market. These characteristics may fundamentally constrain the effectiveness of the proposed remedies in boosting engagement among vulnerable groups. The PPM price cap remedy is justified in part by the fact that PPM users are disproportionately vulnerable and are more likely to face severe financial constraints. But many consumers with the same characteristics, or in the same financial position, do not use a PPM.

We believe there are two issues affecting this wider group of non-PPM vulnerable consumers to which the CMA may wish to give further thought. Firstly, we understand that there is no automatic mechanism for a consumer on the priority services register with one supplier to be placed on the priority services register of a new supplier. This appears to be an additional barrier to switching (an extra phone call, letter or email is required) that specifically affects vulnerable consumers and would be desirable to remove if data protection issues can be overcome. Secondly, the CMA places a lot of emphasis on PCWs and other intermediaries in making the energy market work for consumers, however, these services are predominantly web-based tools. Is it acceptable that there is likely to be a group of consumers without Internet access (or access via a friend/relative) who cannot access most of these tools, when this group is likely to include disproportionately vulnerable households? This issue is likely to become more severe if the roll out of smart meters generates complicated tariff structures that can only be compared with the aid of computer algorithms.

While the CMA states that the government already provides Citizens Advice with funding to support individuals with issues relating to the energy market, there appears to be no evaluation of whether these services, and the funding to support them, are sufficient to address the scale of the need.

**Rejection of a central information-only PCW**

The CMA has rejected an Ofgem run, information only, PCW on the grounds that Citizens Advice already provides such a service.⁵⁹ We agree that duplicating such a service would be unnecessary, but we have some concerns about the long-term ability of the Citizens Advice service to provide ‘whole market’ coverage. This is because of the CMA’s proposal that in the future PCWs will not have to provide whole market coverage, but will simply have to state the extent to which they cover the market. The CMA notes that the Citizens Advice service uses a commercially compiled tariff list provided by Energylinx⁶⁰. At present, with whole market coverage being a regulatory requirement, it may be relatively cheap and easy for Citizens Advice to procure a whole market comparison from a

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⁵⁹ Paragraph 105, page 24, ‘Energy market investigation: Summary of provisional decision on remedies’

⁶⁰ Paragraph 6.139, page 368, ‘Energy market investigation: Provisional decision on remedies’
commercial provider, but if this regulatory requirement is removed there must be some uncertainty about whether a whole market comparison will be available from any commercial provider.

We believe that there is a sound argument to guarantee a comprehensive and accredited whole market list of tariffs to: (i) provide a sound evidence base for regulatory/policy interventions; (ii) provide a comprehensive comparison service for professionals acting on behalf of vulnerable individuals; (iii) provide reassurance to very engaged consumers regarding the competitiveness of the deal they have received, and (iv) provide a basis for stakeholders to monitor the market. Currently Ofgem and the CMA seem to take the output of commercial PCWs at face value and use it as an unbiased view of the market rather than taking a more critical view. It is important to recognise that PCWs are market participants with their own particular incentives and that evidence obtained through them should be appraised accordingly.

While we encourage the CMA to ensure that there is an independent (non-transactional) whole market PCW that has long term viability, we do not view the current Ofgem PCW accreditation scheme as perfect. The existing PCW accreditation scheme requires each PCW to maintain its own list of tariffs to receive an accreditation. This has required unnecessary duplication of the tariff list with inevitable costs, and there seems little economic rationale for duplicating the collection of identical information.

**An effective framework of rules, monitoring and enforcement for PCWs**

Regardless of whether or not there is an information only PCW offering whole market coverage, the CMA’s clear desire to embed PCWs and brokerage services at the heart of the retail energy market’s operation suggests that an effective framework of rules, monitoring and enforcement for PCWs and brokerage services is warranted. Since the CMA emphasises the future potential of smart meters, establishing such a framework at an early stage would seem highly advisable. In particular, the CMA’s encouragement for Ofgem to analyse and, ideally, implement half-hourly settlement for domestic electricity consumers raises the prospect of time of use tariffs that are so complex that only computer algorithms could perform a true price comparison. We do not believe that consumers need to know whether a PCW or other intermediary is receiving a commission from a particular energy supplier, or the size of the commission, if there is a robust verification mechanism which ensures individual PCWs accurately perform the comparison which they claim. As laid out in a previous consultation response, the monitoring mechanism simply needs to verify that the deal ‘at the top of

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61 We do recognise that some safeguards may be required to stop such an information service being utilised to facilitate collusion, although, given that Ofgem already requires whole market coverage this risk should not be overplayed.

62 For example, paragraph 41, page 11 of ‘Energy market investigation: Summary of provisional decision on remedies’ states that “We (the CMA) also conducted a search on a price comparison website (PCW) in order to look at the most recent pricing data”.

63 Paragraph 11.5, pages 739 and 740, ‘Energy market investigation: Provisional decision on remedies’

64 If, and it may be a big if, time of use tariffs are introduced with a different price for each half-hour of electricity consumption a full annual price comparison would involve comparing 17,520 consumption data points.

the list’ is the cheapest on the PCW, where cheapest\textsuperscript{66} is within the subset of tariffs that satisfy a consumers stated preferences.

We have been led to believe that the current assurance framework involves audits where PCWs are given advance notice of an audit occurring. A far more robust system, and one which we recommend, would involve a mystery shopping exercise occurring at random intervals in time and using random consumption bundles\textsuperscript{67} which are not made public\textsuperscript{68} ensure that the exercise cannot be gamed. If the deal identified as cheapest by a PCW does not correspond to the cheapest available through the PCW (allowing some margin/frequency of error might be appropriate\textsuperscript{69}), there should be a harsh penalty.

In discussing the appropriate monitoring framework for PCWs we recognise that assuring the accuracy and reliability of PCWs is an issue that extends beyond energy to multiple other markets. This means that careful thought needs to be given to selecting the organisation which is best placed to conduct the monitoring and enforcement roles with respect to PCWs at least cost. Secondly, it is necessary to justify why additional rules and monitoring for PCWs in relation to energy price comparisons are warranted. The justification takes three forms: (i) greater consumer protections on a variety of dimensions already exist in utility markets and are warranted due to the essential nature of the services being provided; (ii) the limited range of tariffs and service providers in energy (utility) markets mean a low-cost monitoring system is feasible; and (iii) the only way to compare estimated bills when using time of use tariffs is likely to be through an automated price comparison tool. Concerning (ii), even if several thousand tariffs are on offer, establishing the ‘cheapest’ tariff seems simpler than verifying, say, the cheapest hotel room in a large city given the much smaller number of suppliers involved and the low frequency with which energy prices are changed. Also, regarding (iii), it remains plausible in hotel and consumer goods markets to manually compare prices, it is simply that it involves far greater time on the part of a consumer.

\textsuperscript{66} While various groups have expressed concerns that PCWs over-emphasise price relative to non-price characteristics, we focus on verifying the price ranking since ranking non-price features is likely to be far more subjective.

\textsuperscript{67} A random consumption bundle would not just involve a random quantity of energy to be purchased, but also random selections regarding payment method, meter type and dual fuel tariffs etc.

\textsuperscript{68} At least prior to the mystery shopping exercise being carried out.

\textsuperscript{69} While there may be technical issues that may explain errors, claims of technical explanations should be treated with a suitable degree of scepticism. The burden of proof should lie with the price comparison website to prove why errors cannot be reasonably avoided.