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Energy Market Investigation
Competition and Markets Authority
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Dear Roger

CMA ENERGY MARKET INVESTIGATION: PROVISIONAL DECISION ON REMEDIES

The Scottish Government welcomes the Competition and Market Authority's energy market investigation and acknowledges the huge efforts that have gone into producing detailed findings.

The level of consumer detriment identified in the CMA's Provisional Decision on Remedies is evidence that energy consumers have been let down by successive UK Governments and substantial reform in this area is long overdue.

The Scottish Government's submission to the CMA of 19 December 2014 provided analysis of the Scottish retail market. In the context of a single GB market, domestic energy supply in Scotland exhibits some distinctive features that shape the options available to Scottish consumers and the potential benefits of remedies proposed by the CMA.

The retail energy supply market in Scotland is relatively more concentrated than in GB as a whole and exhibits a number of characteristics which may mean that suppliers are able to segment the market and offer different terms to certain groups for both behavioural and structural reasons. The remedies proposed by the CMA need to be assessed in the Scottish context to determine their potential impacts.

The commentary presented at Annex A highlights some of the key distinguishing features of the market in Scotland and the Scottish Government's analysis of the potential impact of the proposed remedies on Scottish energy consumers. I hope you find this information useful.

We continue to call for a fair deal for Scottish energy consumers and look forward to the panel's final report and effective implementation of remedies. In order to assess the degree to which the remedies will foster a competitive market, that works equally well for all energy consumers, we would welcome further clarity around how success of proposed remedies will be measured, monitored and reported on.

Paul Wheelhouse

Annex A

North Scotland

Several specific issues in relation to consumers in the North of Scotland were highlighted in the Scottish Government's December 2014 submission to the CMA. This includes higher than UK average unit costs for domestic standard electricity across all payment methods, higher levels of domestic consumption and a higher proportion of households who use electricity as their primary heating fuel.

The CMA's findings recognise that market concentration is higher in Scotland compared with the GB average and that in the North Scotland the electricity incumbent has a market share in excess of 60 per cent, while the GB average is closer to 35 per cent. The Panel has considered whether this higher market concentration translates into higher prices but were unable to calculate robust regional average revenue figures for all suppliers due to data issues.

Given the focus of the investigation on the functioning of the GB market as a whole, the differential effect of Scottish specific circumstances is not explored in detail in the analysis underlying the CMA's provisional decision on remedies. We would suggest further detailed investigation of these issues is necessary to ensure that consumers are getting a fair deal.

Prepayment meters

The CMA has highlighted low levels of competition in the prepayment segment as a result of a lack of tariff options and high barriers to switching supplier. The CMA's findings indicate that nearly all prepayment customers are on the relatively expensive default tariff – the standard variable tariff – reflecting the limited choice of non-standard tariffs available. The CMA also recognises the barriers that hinder full engagement by prepayment meter customers with the market – for example, the prevalence of outstanding debt to existing suppliers and upfront costs.

The proposed remedies in this area are of particular interest to the Scottish Government as both South of Scotland (21 per cent) and North of Scotland (19 per cent) have a higher proportion of consumers using prepayment methods for standard electricity than the GB-wide average (17 per cent).

We support the remedy of a transitional price cap to protect households on prepayment meters whose options are comparatively limited. We note that the CMA anticipates the cap will reduce detriment for prepayment customers, which would have a beneficial financial impact on many Scottish households. However, the CMA must ensure that the price cap is formulated in such a way as to avoid unintended adverse consequences; in particular, low energy users must not end up being worse off as a result of any increase to standing charges.

The CMA has estimated overall detriment from excessive prices to domestic customers to have grown to almost £2.5 billion in 2015 alone. The prepayment price cap will address only a portion of that customer detriment. We would suggest further consideration is given to additional measures to prevent detriment to vulnerable inactive customers across all segments of the market.

The devolution of certain consumer and competition powers to the Scottish Parliament will help us to ensure that Scottish consumers' views are represented in the energy sector and that any detriment to Scottish consumers is addressed.

Restricted meters

Scottish Ministers have previously expressed concerns about the potential detriment in the market related to certain types of restricted meters such as dynamically teleswitched (DTS) meters. Restricted meters are typically used for customers with electric heating, of which a disproportionate number are in Scotland.

The CMA's findings confirm that customers on restricted meters face particularly strong barriers to accessing and assessing information and barriers to switching supplier and / or tariff. This has resulted in incumbent suppliers continuing to retain a high market share of the often vulnerable customer base.

We support the remedies aimed at promoting competition and reducing barriers to customers accessing and assessing information in the restricted meter segment. We welcome the Citizens Advice Service's agreement to provide advice to consumers using restricted meters to help inform more complex tariff comparisons. In addition, we endorse the recommendations put forward by the Citizens Advice Service i.e.

- Restricted tariff consumers should have a full range of options, including options to move to Economy 7 tariffs (in addition to proposed option to move to a single rate tariff), as this could offer larger savings depending on individual consumer's pattern of use.
- Suppliers should provide appropriate technical support, including rewiring where appropriate, to allow the electricity meter to be changed.
- Suppliers should proactively identify customers who record no use on their off peak meter (due to changes in heating system) and offer to move them to single rate tariff.

The CMA has identified that customers with restricted meters are particularly disengaged. As is the case with the range of remedies targeting domestic weak customer response, we would advise further consideration is given to implementation to ensure it can be successful in tackling the £40 million customer detriment (in Q2 2015) identified by the CMA. Given the acknowledged difficulties in reaching these customers it would be prudent to ensure that a number of channels will be utilised to promote awareness.

We will look to further explore these issues with the Citizens Advice Service.

Helping customers engage

The CMA's findings recognise that consumers in Scotland are less likely to be active and engaged in the market compared with their counterparts in England and Wales.

To help consumers engage and harness the benefits of competition the CMA has proposed an Ofgem held database to encourage engagement among long term standard variable tariff customers. Concerns raised by stakeholders in relation to the proposed database have included customer data security, the potential for excessive, unsolicited and misleading marketing measures and a general concern around its effectiveness. As this is the main remedy targeted at the 70 per cent of consumers on a standard variable tariff it will be necessary for Ofgem to closely review this measure to monitor its impact and effectiveness.

In relation to the remedy concerning the removal of the simpler choices component of the RMR rules, we note that a broader and more diverse range of tariffs is likely to benefit mainly consumers who are already engaged and have the resources available to make potentially more complex tariff comparisons. It is important to ensure that appropriate safeguards are in place to prevent the increased scope for complexity becoming a further barrier to market engagement. Considering Scotland's characteristic of lower than GB average switching rates between suppliers our analysis suggests that a smaller proportion of Scottish consumers are likely to benefit from more tariff choices, unless remedies to address weak customer response are successful.

The existing inbuilt complexity of the energy market has resulted in many consumers utilising tools such as Price Comparison Websites (PCWs) to effectively navigate the range of suppliers and tariffs. Ofgem introduced the 'Whole of the Market' Requirement in the Confidence Code to increase consumer confidence in their ability to make an informed decision as an energy shopper. The proposed remedy removes that requirement. There is a risk that this will undermine trust in PCWs at a time when consumers will be faced with an even greater range of tariff choices as a result of changes to the RMR rules.

Smart meters

The smart meter implementation programme appears to be central to a number of remedies aimed at addressing customer detriment in the domestic market and we note the transitional nature of some of the remedies in light of the planned full roll-out of smart meters by 2020.

Scottish Ministers have previously been supportive of the aims of the smart meter programme but have expressed concerns over the lower specification of meter currently being installed, delays to the communication platform and technical issues limiting the coverage of the programme particularly in remote and rural areas.

In addition, it is unclear to what extent, and within what timescale, the projected benefits of smart meters will be realised and whether these will address the issues faced by prepayment and restricted meter customers.

Charging arrangements for transmission losses

We welcome measures designed to reduce consumer bills but have reservations about the ability of the CMA's proposal for transmission losses to meet that aim and the effect a change of approach could have on energy deployment.

The proposal to assign 100 per cent of losses to generators will exacerbate the costs faced by generators in Scotland for what appear to be relatively marginal and highly uncertain cost savings – modelled to be worth between £14 million to £31 million over a ten year period. The CMA's own findings acknowledge much uncertainty about the modelled consumer gains that could arise from this proposal. It appears to us that the evidential base is somewhat limited and relatively weak.

Moreover, in the context of an energy market that produces substantial detriment to consumers and where 'unilateral market power' exists in relation to an inactive customer base, there can no guarantee that any cost savings produced would be passed through from suppliers to energy consumers.

We are not convinced that the application of locational transmission losses will deliver the cheapest way of delivering Government decarbonisation objectives. Scotland has some of

the best renewables resources in the UK and this measure would further penalise Scottish generators. We believe that aspects of UK energy policy and regulation have already produced significant negative effects for some Scottish generators and jeopardised security of supply. Anything that could make matters worse must be evaluated fully and be founded on clear evidence.

We are concerned that additional disincentives to generation in Scotland, such as locational transmission losses, could further undermine security of supply which of course could have significant knock-on effects for consumer bills and energy resilience. Scotland's largest power station Longannet was forced to close early in March this year, with its owner Scottish Power citing locational transmission charges as the key determining factor.

We therefore call on the CMA to recommend further detailed scrutiny and analysis of this critical issue. If the proposal for locational losses is to be included in the CMA's final decision, there should be appropriate space for its implications to be fully evaluated – for example, by highlighting the measure as a recommendation for further consideration, within the scope of the existing Balancing and Settlement Code process. This would allow for further and up-to-date modelling to take place and provide affected parties with better information on potential impacts.