

# Retail electricity competition

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# Outline

- The origins of retail electricity competition
- Opening the market
- Progress since then and Ofgem's Probe
- The non-discrimination condition
  - Extent of problem
  - Price competition
  - Non-price considerations
- An alternative policy?
- Conclusions

# Origins of retail competition

- Oil & Gas Act 1982, Electricity Act 1983
  - Common carriage would enable independent generators to access Area Boards and large customers – hence competitive pressure on CEGB.
  - But no independent generators appeared.
- 1983 discussions of electricity privatisation
  - C&L: break-up CEGB & contract with monopoly ABs
  - W Marshall: instead of AB monopolies, expand CEGB's right to sell direct to large users & abolish restrictions on undue preference

# SCL advice to Treasury 1983/4

- Problem: AB inefficiencies & government pressure
- Privatisation would increase efficiency but exacerbate use of monopoly power & might preclude uneconomic but socially desired services
- Regulation? social obligations & limit prices
- But “a very real danger that new entry will be prevented or hindered by regulation (partly as a result of capture) and that efficiency will be discouraged by a cost-plus approach to profit or pricing.”
- Explore ways of increasing competition in distribution – “competition for customers”. “At the very least this will increase the effectiveness and reduce the burden of regulation, at best it may obviate the need for it.”

# Retail competition for all

- “At present common carriage is a dead letter since supply by private generators is negligible. But if CEGB restructured into several generation companies this would allow *any* customer to purchase direct.”
- “Perhaps only large customers would initially find it worthwhile to buy direct from a generating company. But the principle could be extended to groups of adjacent consumers (e.g. businesses on an industrial estate or households in a particular street or neighbourhood). Indeed, it might be possible for non-adjacent customers to form a group to purchase power on more favourable terms than the Area Board offered. Trade associations might organise such groups, or electricity “brokers” might develop, specialising in a knowledge of market conditions of supply and demand.”
- Quaint? But brokers in SME market, & Ohio ...

# Electricity privatisation 1988/9

- Feb 1988 White Paper – competition large users
- Sept 1988 Govt envisaged 5 – 10 yr contracts between ABs & NP, PG (and with British coal)
- But what about supply competition?
- Jul 1989 No problem, competition from Day 1, and ABs can drop contracts if they lose customers
- Aug 1989 industry said too risky, if supply competition can't sign long contracts or with B Coal
- Sept 1989 industry proposed permanent monopoly franchise < 1MW, govt agreed to 8 year franchise
  - In the event, B Coal refused to sign long contracts, max 3 yrs
  - Shows retail competition constrains companies & govt

# Opening the market

- 1990, 1994 competition for large users
  - teething troubles (metering) but policy accepted
- 1998 – is it worth it? will anyone come?
  - 1989 Yellow Pages? “It will never happen”
- Need retail price controls in case not
- 5-10% switching? 15% in 6 mos of full open
- Competition developed well, now over 50%
- 1994 retail price controls removed
  - non-discrimination provisions also removed

# Progress to date

- Ofgem June 2007
  - All segments of market remain highly competitive
  - Vigorous price competition for all customers
  - Suppliers innovating to retain and win customers
  - Customer service improving
- 16 Jan 2008 market is sound Ofgem assures Chancellor
  - “Confirmed Britain’s competitive market in energy is working”.
  - “However, bills are being driven up by rising global energy costs (oil, coal and gas), the cost of curbing climate change, increased investment in the energy networks to ensure safe and reliable energy supplies for customers and a lack of market liberalisation in the rest of Europe.”

# Rethinking

- 21 Feb 2008 Ofgem launches Energy Probe
  - The decision to conduct the probe is in response to public concern about whether the market is working effectively.
- 6 Oct 2008 Initial Findings
  - Transition to competitive markets well advanced
  - Some areas where it now needs to be accelerated
  - Consulting on package of measures (20)
- 1 Sept 2009 Non-discrimination condition
- Oct 2009 other retail market remedies

# Prohibit undue discrimination

- Main economic controversy on one issue
  - In area prices about 10% higher than out of area
  - Ofgem: against interests of those who don't switch
- Ofgem generally supported by customer groups and some small suppliers
- Big 6 (Centrica?) & “3 academics” argued that it would reduce competition, not accelerate it
  - “3 academics”: a CC member, the former DGFT and Ofgem member who resigned over the issue

# Extent of problem?

- Ofgem Probe gives good survey of market
  - But tends to see the glass half empty
- Customers could have chosen to switch
  - Over 50% are now with non-incumbent
  - Under 25% have not switched any energy supplier
- Premium of incumbent over median competitor only about 6%, tho' wide range
- Competition has provided significant protection? Adequate in other markets?
- Concern about “fairness” not competition?

# Price competition

- Clause will reduce competition in principle
  - Lower in area price less attractive for competitors
  - In area customers less interested in switching
  - More profitable to exit out of area than lower prices?
  - Hence likelihood of increased prices over time?
  - Demsetz(?) price discrimination may be a first step from monopoly to competition, better than nothing
- How significant will clause be in practice?
  - Most prices now adjusted, competitors still there
  - May still be adequate margin even though lower?
  - Might reveal & remedy under-pricing out of area?
  - Retail competition ought to work even without in-area premium

# Non-price effects

- Non-discrimination clause will blunt speed and extent of competitive reaction
  - Suppliers need more care & time in checking new proposals
  - Equalising margins will make offers less attractive to customers or to suppliers
  - Range of new offers will be closer to existing offers
  - Safer to avoid “material” changes (to which clause applies)
- Competition will be distorted - away from standard offers and towards allowed exemptions
  - “time limited or ‘initial’ offers, innovative offers or new customer acquisition targeted offers are likely to be objectively justified”
  - “Innovative non-discriminatory tariffs will not be challenged”
  - Eg fixed price tariffs, green tariffs

# Regulatory burden

- Added time & cost to ensure compliance
- Burden of providing information to customers
  - “stating on each bill the name of their tariff, their annual consumption and illustrated projected cost for the following year; and sending each customer an annual statement “
  - “providing each consumer prior to any sale with a written estimate expressed in cost per year in pounds and, in certain circumstances, a comparison with the consumer’s current deal; and providing additional information at or shortly after the point of sale.”
- Costs will ultimately be borne by customers
- Danger of customer information overload?
  - New offers just thrown in the bin?

# Regulatory risk

- How will Ofgem implement the new condition?
  - Much depends on Ofgem's view, and processes
  - What will be 'objective justification' "in Ofgem's discretion"?
- New yellow card scheme
  - Opportunity to revise prices after Ofgem concern
  - Better for suppliers? But more latitude to regulator?
- Increased subjectivity and regulatory discretion
- How & when will Ofgem intervene in future?
  - E.g. How will Ofgem interpret "vulnerable group" in future?
  - Statutory defn? or literacy, language, bank a/c, internet access?
- Regulatory burden & risk discourage innovation
- They also deter new entrants into domestic market

# Role of regulation

- Should customers look to regulation or the competitive market to serve their needs?
- Danger of encouraging further lobbying of government, parliament and regulator
- Rather than building customer relationships
- Is this policy conducive to market stability and to the development of competition?
- Or to what Beesley called “meddling”?

# Alternative policies?

- Fair to acknowledge pressure on Ofgem
  - And it recognises the risks to competition
- What else could it have done?
- Reference to CC?
  - Would have cleared the air, but
  - Time consuming, costly, unpredictable & freeze competition
- 16 Dec 08 suppliers agreed to address concerns
  - “Ofgem probe has £0.5 bn pounds in its sights for customers”
  - Including £181m for in-area price reductions
- Ofgem could have quit while ahead?
  - Non-discrimination condition could have remained as threat

# Conclusions

- Retail competition better than expected in 1980s
  - Achieved main aims: customer choice, incentive to efficiency and innovation in retail supply (and in generation)
  - Growing exploration how customers and suppliers share risks
- Ofgem's regulation has mainly been supportive
  - And addressed transitional in-area monopoly concern
  - but still able to hinder competition and deter new entry by increasing regulatory burden and regulatory risk
- Hope condition removed in 3 years as promised
- Meanwhile Ofgem's Jan 2008 statement spot on
  - Real determinants of price increases are global energy costs, costs of climate change policy, increased network investment, lack of liberalisation in EU
- Britain's competitive market in energy is working