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Spectrum Analysis

Balancing Fairness and Competition in the Retail Energy Market

The case for and against a relative price cap

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1 The Issue

On 18 April 2017 prime minister Theresa May announced there would be a general election[1] on 8 June. The prime minister stressed her desire to strengthen the UK's position in the Brexit negotiations as the primary reason for calling the election. However, the move comes at a time when it is widely expected that the government would announce further intervention in the domestic energy retail market.

A day later, on 19 April 2017, Business, Energy and Industry Secretary Greg Clark told MPs the government would publish its response to the Competition and Markets Authority (CMA) energy report "very shortly" and that it would take "very decisive action" to address continuing concerns over prices. He added that the government was reviewing whether its energy price plans "can be finalised in time" to come out ahead of the election.[2]

Brexit may well be the dominating theme of the 2017 general election, but it seems that energy markets, particularly how "fairly" they treat vulnerable and disengaged consumers, will also have their place in the spotlight. The political attention has recently been heightened by EDF Energy's second standard variable tariff (SVT) increase announcement – an average dual fuel price increase of 7% from mid-June. It marked the sixth price move by one of the Big Six since the start of winter, with only Centrica committing to a price freeze until September.

Even before the second EDF Energy announcement, the issue of domestic energy pricing had already been re-politicised. A green paper on markets that don't work in the interests of consumers has already been promised, and the chancellor sign posted the political importance of this initiative in his 2017 Budget speech.[3]

While we have seen various interventions in the energy retail market over recent years, this time round though those in support of action include several newer entrants. Much speculation concerns the merits of extending the new cap on prepayment tariffs mandated by the CMA to all consumers on standard variable tariffs (SVTs) as well as a proposal by Conservative MP John

Penrose for a "relative" price cap. Penrose's proposal would limit suppliers to a 6% band between the price of their cheapest and most expensive tariffs.

In this *Spectrum Analysis* we review the implications of extending price caps on energy tariffs, especially through a relative price cap. We hope that it provides a valuable contribution to the debate on the issues as any proposals are finalised and that it helps inform the coming electoral process.

[1] See Link
[2] See Link

[3] See Budget speech 2017 Link

2 Higher Prices and Fairer Markets

2.1 Price rises

Politicians are once again attempting to reconcile fairness with a market-based system in energy. While switching levels have been at recent record levels, a third of domestic customers are supplied by their historic supplier[4], and 71% are served by SVTs[5].

The latest round of SVT price changes has seen 15 increases and just two falls since the start of winter (see Figure 1). Some suppliers, notably EDF Energy, have raised their tariffs twice. Others have levied double digit percentage increases against a market background in which wholesale energy prices have been largely stable.

Figure 1: Supplier announcements on standard variable prices

Supplier	Dual fuel change	Electricity change	Gas change	Comes into effect:
Co-operative Energy	3%			01-Oct-16
Ecotricity	6%			14-Nov-16
EDF Energy			-5%	06-Jan-17
Ovo Energy	5%			10-Jan-17
Breeze Energy	-8%			22-Feb-17
EDF Energy		8%		01-Mar-17
Good Energy	11%			01-Mar-17
Npower	10%			16-Mar-17
Ebico	-5.5%			27-Mar-17
Scottish Power	8%			31-Mar-17
Co-operative Energy	5.0%			01-Apr-17
First Utility	9.7%			01-Apr-17
Robin Hood Energy	17.0%			22-Apr-17
E.ON UK	9%			26-Apr-17
SSE	6.9%			28-Apr-17
EDF Energy	7.2%			21-Jun-17

[4] Those electricity accounts supplied by the home area supplier plus British Gas gas accounts expressed as a proportion of total domestic electricity and gas accounts. There are 16mn of these accounts in a total market of 50mn household electricity and gas accounts. Source Cornwall domestic energy market share survey 31 January 2017.

[5] Source Ofgem, December 2016 Link

2.2 Prepayment price cap

The price rises have once again raised the prospect of intervention, following quickly on the heels of the prepayment price cap, which was implemented on 1 April. This cap already applies to approximately 15% of the domestic market[6]. It was originally envisaged that the cap could have broader application, but the CMA changed its final recommendation to apply to PPM tariffs only.

The prepayment cap was proposed by the CMA because it felt that features of the market acted in ways that were "reducing suppliers' ability and/or incentives to compete to acquire prepayment customers". These included the technical restraints of prepayment meters and low incentives for suppliers to actively compete for these customers. Actual and perceived barriers to switching were also cited as higher for these customers by the CMA.

Technically the CMA directed that suppliers ensure that "annual bills paid by prepayment customers do not exceed a specified cap, for a period until the end of 2020". It suggested that the cap could save consumers £300mn each year. Typically consumers on prepayment tariffs pay more for their energy than other customers given the higher costs of prepayment meters and systems and limited competition among suppliers to provide this type of service.

The prepayment cap works by obliging electricity and gas suppliers to ensure that the aggregate charges to relevant PPM customers for supply activities do not exceed the Relevant Maximum Charge (RMC) over each Charge Restriction Period (CRP). The cap itself is set by Ofgem having regard to expected costs of supply plus an allowed margin.

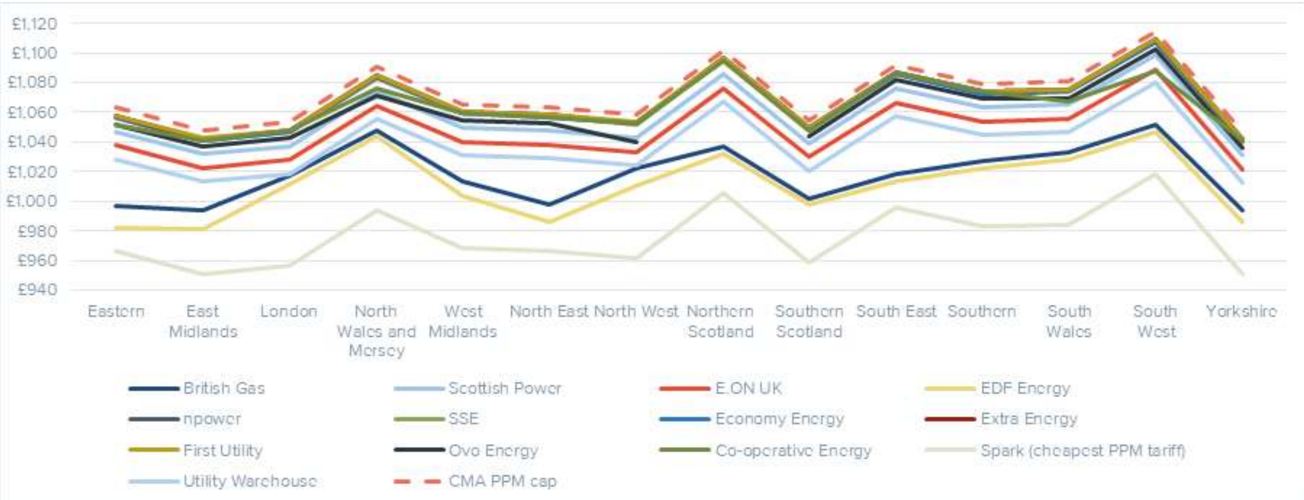
We observed cuts in prepayment tariffs of up to £150/year in the run up to the introduction of the cap from 1 April 2017 at a time when other tariff costs were generally increasing.

Since then suppliers have moved into line with the CMA price cap. Suppliers must now offer tariffs lower than £1,067/year for a dual fuel customer, which has forced 14 to reduce their tariff costs.

While there continues to be competition under the cap, the highest savings available to a switcher based on Ofgem's calculations are now reduced to £80/year as Figure 2 illustrates. It plots regional dual tariff costs from selected suppliers.

In the context of this paper, all large and several medium suppliers' SVT rates are now more expensive than PPM rates.

Figure 2: Supplier PPM tariffs in April 2017 (Cornwall)



[6] According to BEIS, in Great Britain 14% of standard electricity customers, 22% of economy 7 electricity customers and 14% of domestic gas customers were on prepayment meters at December 2016. See Link

2.3 Other interventions

There are other CMA remedies that have been adopted but not yet implemented, including:[7]

- an Ofgem-controlled database of disengaged customers. Suppliers will be required to disclose to Ofgem details of customers who have been on SVTs for three or more years, so rivals can approach them with alternative deals
- beefing up the role of price comparison websites (PCWs) by allowing them access to industry data on consumption and allowing them more freedom to strike commercial deals with suppliers, and
- speeding up industry rule changes to improve settlement so suppliers are better able to innovate and differentiate themselves.

These remedies have not been universally welcomed by suppliers, especially the first. However, they have barely had the chance to get off the drawing board before we see the prospect of further intervention.

2.4 Mounting concerns

The political concern this time round is that those who are the least engaged with the market and don't switch supplier pay the most regardless of whether their disengagement is through choice. For an essential service like energy, users should not be penalised because they cannot buy it on the most favourable terms. Worse, the fear is that those that cannot or do not engage in the market are paying high prices to subsidise those that can, even though many of them are probably poorer than those whose good deals they are funding.

The National Audit Office (NAO)[8] recently highlighted the work regulators need to do to support vulnerable consumers in regulated markets like energy. It said such consumers were "particularly susceptible to bad outcomes or experiences from regulated services such as energy, water, communications and financial services" through "disproportionately high bills, lack of access or choice, and debt".

Specifically on bad tariff deals, the NAO commented that "regulators' duties to protect vulnerable consumers can conflict with other measures designed to benefit consumers in general, and regulatory interventions alone can be insufficient to protect all vulnerable consumer groups. For example, intervening to prevent large price differences between deals might adversely affect competition, but many vulnerable groups are substantially less likely to switch to cheaper deals."

Underlining what seems to be the new policy perspective, as Theresa May put it in a speech in January to the Charity Commission: "This means government supporting free markets as the basis for our prosperity, but stepping in to repair them when they aren't working as they should".[9]

The proposed green paper on markets that don't work for customers has emerged out of these concerns, and speculation was increasing ahead of the general election announcement that proposals would be published possibly by the end of April.

2.5 The Penrose proposal

While the government is believed to be considering the merits of a wider cap again as part of the green paper process, another proposal is attracting attention, and seems to have captured the prevailing mood. It was proposed by Conservative MP John Penrose during a 16 March House of Commons debate. It is for a "relative" price cap that limits suppliers to a 6% band between the price of their cheapest and their most expensive tariffs available at any one time.[10] As the most expensive tariffs are generally suppliers' SVTs, the proposal is squarely aimed at "customers being systematically ripped off by big energy firms"[11]. As Penrose explained in the debate: "for toothpaste, coffee and almost everything else, loyalty and inertia work in the customer's favour; they are on our side. That does not apply to energy. If we relax, they will have us".

In his opinion, while smart meters and other innovations built up momentum to make engagement easier, a relative price cap would act as "a stopgap – a temporary solution". Acting as "a maximum mark-up between each energy firm's best deal and its default tariff" it would ensure that "if someone forgot to switch to a new deal when their existing one came to an end, they would not

[7] See CMA Link
[8] See NAO Link
[9] See Charity Commission Link
[10] See Hansard Link
[11] Johnpenrose.org, 16 March 17 Link

be ripped off too badly, but people would still be able to save plenty of money when they got round to switching again, so it would always still be worth their while to become engaged and take that additional action, should they be so minded."

Suppliers, in Penrose's opinion, would "still be able to compete on price – they could still decide whether they wanted to be the Aldi or Lidl of the industry, or the Waitrose or Marks and Spencer – and could still have as many tariffs as they wanted, so there would be plenty of customer choice". A relative price cap would be "a lot better than a normal price cap. A relative cap would mean that each energy firm could still adjust its prices whenever the wholesale price of gas or electricity went up or down, but a normal cap would mean that Ofgem had to approve any changes, which inevitably would be slower and create work for lawyers and lobbyists".

This time round though the coalition in support of intervention includes several small and medium suppliers (SaMS). Three suppliers joined John Penrose and made media statements in support of the relative price cap. Ovo Energy Founder Stephen Fitzpatrick said the cap was a step towards "long-term fair pricing for all", adding that it would "drive more innovation and ultimately lead to lower bills for millions of people". Utility Warehouse CEO Andrew Lindsay said the cap would help "protect customers who have little desire to switch supplier on a regular basis", while Octopus Energy Founder Greg Jackson said "for far too long the practice of 'tease and squeeze' pricing has been used by the Big Six to bamboozle and exploit millions of loyal customers".

2.6 An emerging response

In his remarks during the debate, Penrose mentioned that "ministers and regulators understand this problem", and in the lead up to the 16 March debate there was escalating political pressure to take action. "The time is up for these companies [who offer high SVTs]" was a comment made as part of a parliamentary answer given by Business and Energy Secretary Greg Clark on 14 March in response to Labour MP Ian Wright, when he questioned the government's pledge "where markets are not working we are prepared to act"[12].

There has been cross-party support for Penrose's proposal – Labour MP Caroline Flint said the government needs to "introduce price protection", adding that "consumers need nothing less than some sort of regulated maximum charge" [13]. The SNP also joined the debate, as MP Patricia Gibson said "doing nothing is not an option" [14], while Lib Dem leader Tim Farron also added his support[15].

The rhetoric increased at the end of the debate on Penrose's proposal. Energy Minister Jesse Norman confirmed that the government would "shortly" set out proposals aimed at ensuring consumers received a better deal in the energy market in its green paper.

Indeed later that week Theresa May told the Conservative Party's Spring Forum that the energy market was "not working as it should". Pledging to set out plans for the sector "very soon", May added: "Our party did not end the unjust and inefficient monopolies of the old nationalised energy corporations only to replace them with a system that traps the poorest customers on the worst deals."

Dermot Nolan, CEO of Ofgem, commented on 12 April, in response to the latest EDF Energy price rise: "Ofgem and the government are working on a raft of reforms to ensure fairer treatment for consumers and to make the market smarter and more competitive. Today's announcement is further evidence of the need for change". Media reports elsewhere suggested the prime minister was to "announce a cap on rip-off energy bills within weeks". While the announcement of the general election has introduced another variable, it is still possible that the government will "do something" ahead of the dissolution of Parliament and the issue of energy supplier behaviour will remain an issue at the hustings.

So the key questions we now address are:

1. Can further intervention improve competition and at the same time make vulnerable consumers better off?
2. And what form will it take?
3. Is the relative price cap the silver bullet?
4. How is it likely to influence the market and competition between suppliers?

[12] BEIS oral questions in the Commons on 14 March 17 Link
[13] Parliament.uk, 16 March 17 Link
[14] Parliament.uk, 16 March 17 Link
[15] The Sun, 12 March 17 Link

3 Winners and Losers

The idea of a competitive energy market with winners and losers is something that has never quite been reconciled against the concept of energy as an essential good. In particular, the competitive market doesn't align with wider government policy when vulnerable consumers are often also those that are disengaged[16].

3.1 SVTs vs. fixed tariffs

Over recent years the "winners" have been engaged consumers finding online or collective switching tariffs, commonly priced more than 10% below the average SVT[17]. As a market based system it is natural that those engaged most find themselves the best deals, placing competitive pressure on suppliers to lower prices and offer a variety of services. The discipline of dealing with engaged consumers should in theory also improve the way that suppliers deal with all customers. The "losers" in the market are typically those disengaged customers on SVTs (including many vulnerable customers), priced above the cheapest market rates.

In late 2015 and 2016, fixed rate tariffs were particularly attractive compared to SVTs as wholesale energy prices were falling. Effectively this trend widened the disparity between the engaged and disengaged segments of the customer base and potentially placed a higher burden of cost on vulnerable consumers. The argument grew that suppliers with high SVTs were cross-subsidising low fixed deals.

Suppliers have different proportions of engaged consumers (or those on fixed tariffs), depending on their business model, legacy customer base and rates of attrition. Ofgem, see Figure 3, shows that it is generally the six largest suppliers frequently referred to as the Big Six that have high proportions of customers on SVTs.

3.2 A segmented market

Just because a customer is supplied on an SVT does not mean that of itself the SVT is expensive. One trend of late is for some new entrants to promote SVTs that are priced at or near the level of the most competitive fixed price deals. But, however they set their prices, there appears to be a much greater competitive discipline on the SaMS than on the largest suppliers.

More recently, price differentials have become a bigger concern to many SaMS as their collective share in the domestic energy market has risen from 2.7% in 2013 to 16.5% in Q1 2017. By their very nature, their customers are those that are more engaged in the energy market because they have already switched away from the Big Six, often switching based on price, but this also creates more difficulties for the newer entrants with regard to customer retention.

Figure 3: Proportion of customers on standard variable tariffs (Ofgem)

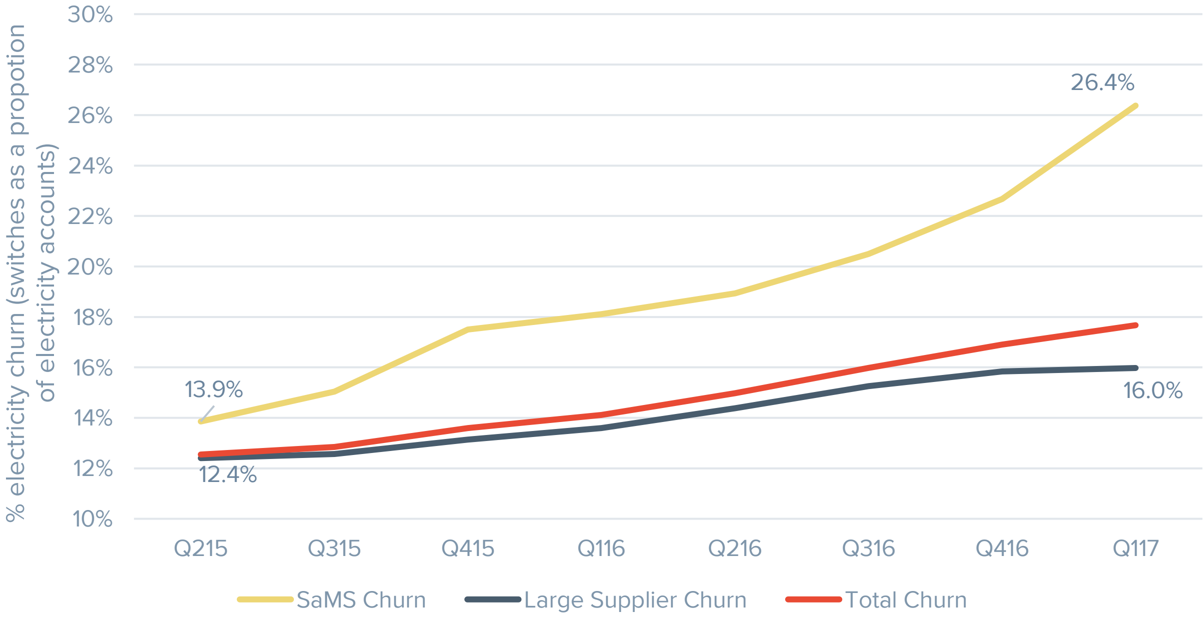
Supplier	Supplier type	Proportion of customer base on standard variable tariffs
Utility Warehouse	SaMS	94%
SSE	Large	91%
British Gas	Large	74%
E.ON UK	Large	73%
Npower	Large	59%
EDF Energy	Large	56%
Scottish Power	Large	50%
Co-operative Energy	SaMS	42%
Ovo	SaMS	35%
First Utility	SaMS	19%
Extra Energy	SaMS	14%

[16] CMA: Energy Market Investigation: Final Report, Paragraph 135, 24 June 2016. Customers who have low incomes, low qualifications, living in rented accommodation or who are above 65 are less likely to be engaged in the domestic retail energy markets Link

[17] Average of SVT compared to average collective switching fixed tariffs offered over the four years to March 2017.

Using Energy UK's domestic electricity switching statistics[18] and our own assessments of customer numbers by supplier group, we estimate attrition rates for SaMS on average reach 26% for electricity (with some expected to be significantly higher than this), compared to the large suppliers at 16% (Figure 4). In other words SaMS on average lose one in every four customers that they acquire, while the large suppliers have churn of one in six. The markets served by SaMS and the large suppliers appear different, with price being the main factor that shifts customers between the two.

Figure 4: Electricity attrition rates by supplier segment (Cornwall)



The practice of some large suppliers of offering discounted tariffs but maintaining high SVTs has therefore proved controversial, especially as bigger brand names often attract high numbers of customers given similar offers on PCWs. This issue of cross-subsidisation is one that has been raised numerous times over the last couple of years, brought to the forefront largely by some of the new challenger brands.

The CMA addressed the concern in its 2015 updated issues statement[19], stating that it had "observed that the [Big Six] have consistently charged higher prices for the SVT for gas and electricity compared with non-standard tariffs, which provides some support for the view that these suppliers can segment the market and price discriminate".

In response, First Utility said the disparity between engaged and disengaged customers was exacerbated by "the ability of the Big Six to cross-subsidise attractive entry tariffs with SVTs, a strategy which allows them to win engaged customers on price, who then fail to maintain their levels of engagement and revert back to SVT tariffs".

The increased use of discounted tariffs has also resulted in a higher proportion of large supplier customers on fixed tariffs. Across the large supplier group, those on fixed tariffs has increased from 30% to 34%[20] in the nine months to December 2016. This, in theory, means the pool of customers being cross-subsidised has grown, while the number of those who may be bearing the burden has contracted.

[18] See Energy UK Link
[19] See CMA Link

[20] Ofgem standard variable rate tariff information at March 2016 Link and BEIS Regional variation of payment method for standard electricity at 30 March 2017 Link

3.3 Effect of a relative cap

Proponents of the 6% relative price cap have suggested that the primary goal of large suppliers is to maintain high SVT prices while holding customer numbers steady. Therefore the cap should limit the discounts offered on fixed tariffs, and resulting in possibly lower SVTs than would otherwise be the case. The benefits currently offered to a few savvy customers in big discounts would thus be smeared over a greater number of customer.

In any case the cap would limit of any cross-subsidy from high-priced to low-priced consumers. If the primary goal is to maintain the SVT, the relative price cap would pull a deeply-discounting supplier with a high SVT out of the most competitive price-sensitive area of the market.

Consumers who wanted a discounted deal would have to choose another supplier, boosting competition.

3.4 Other remedies

The relative price cap is just one measure that has been proposed in the wake of the CMA investigation to reduce detriment to vulnerable customers.

The first to take effect is the temporary CMA-designed cap on prepayment tariffs, which began on 1 April 2017 and which will stay in place until end 2020, when the roll-out of domestic smart meters is due to be complete. The regulator will reset the cap every six months, with the first reset taking place from 1 October 2017.

Other ideas include one from First Utility, which has called for Warm Home Discount (WHD) customers[21] to be moved onto the supplier's cheapest deal[22]. This proposal echoes calls for the prepayment price cap to be extended to cover the remaining customers that fall under the WHD – approximately 1.4mn. However, concerns about cross-subsidising would remain in this instance, with some industry participants arguing that non-WHD disengaged customers on a SVT would see increases as a result.

First Utility and others have also called for customers that have been on their supplier's SVT for three years of more to be moved to their supplier's cheapest tariff. Its call for a switch away from SVTs echoes arguments made by Centrica and Scottish Power during the CMA investigation in 2015 for customers to be migrated to fixed term contracts. That call by those two companies was made when the CMA was beginning to structure its prepayment price cap.

In deriving the PPM cap, one proposal outlined but rejected by the CMA was a price cap on all SVTs, which ultimately it decided to reject although it said that its final decision was "balanced". The CMA concluded, after initially supporting such a move in its provisional decisions, that the disadvantages of attempting to address the detriment of all customers on the SVT through a price cap would likely be "disproportionate". It said that, even for a transitional period, an SVT cap would "run excessive risks of undermining the competitive process, likely resulting in worse outcomes for consumers in the long run", by potentially "reducing the incentives of suppliers to compete, reducing the incentives of consumers to engage and an increase in regulatory risk".

21 WHD offers qualifying consumers £140/year of their electricity bills as a one-off discount Eligibility is based on access to certain social security payments. See Link

22 First Utility press release, 16 March 2017, Link

4 What Would a Relative Cap Mean?

It is feasible that the government may be considering one or more of these options but it is the relative price cap that is making the running in terms of media and political interest. In terms of pricing, based on March 2017 prices, it would have significant effects for some suppliers but they would be minimal for others.

4.1 Price impacts

Figure 5 below shows at 1 April 2017 the difference between the SVTs and cheapest tariff for a selection of twelve suppliers. One supplier's cheapest fixed tariff is more expensive than its SVT.

A 6% relative price cap would force at least 11 suppliers to adjust the price of their fixed or variable tariffs, as they currently have more than a 6% difference in price (see Figure 6).

Figure 5: Difference by supplier by region of SVT against cheapest tariff in the market (April 2017) (Cornwall)

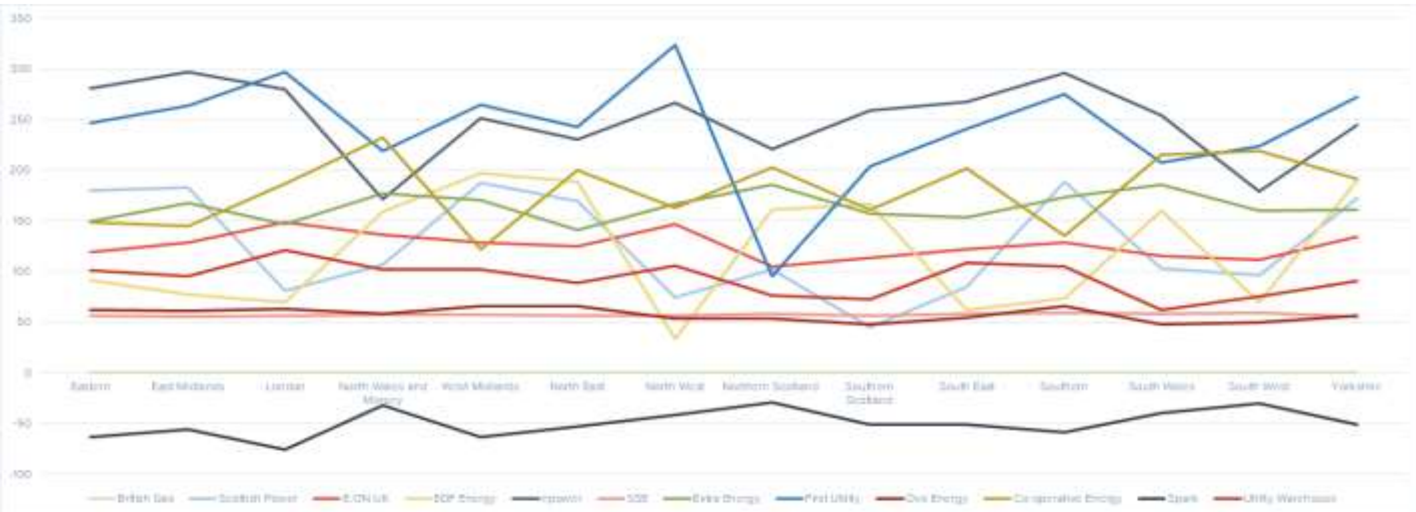
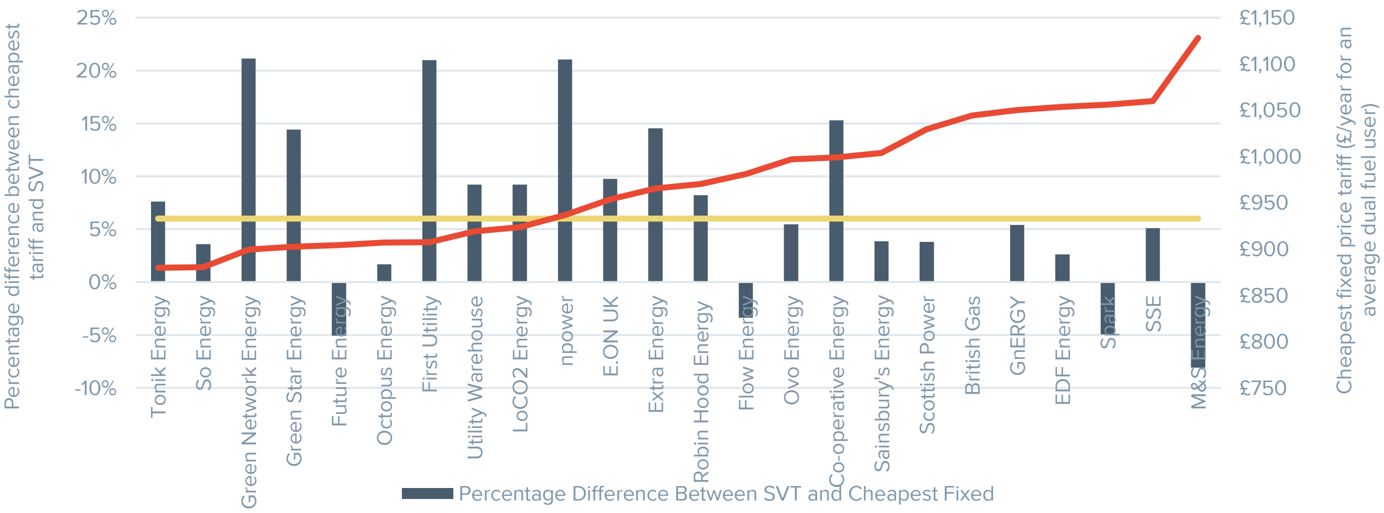


Figure 6: Relative 6% price cap compared to difference between SVT and cheapest fixed at March 2017 (Cornwall)



For large and perhaps some medium suppliers with a high proportion of customers on SVT, we would expect in most cases that the cost of the fixed tariff would be increased to within 6% of the variable in order to pass through significant changes in wholesale or policy costs as they arise. This would reduce the number of low price options available to engaged consumers from the best-known brands.

But crucially, because of the number of new entrants in the market today, there would still be more low-priced options for price sensitive consumers to choose from than at any other time in the history of the liberalised market. If these switchers were to engage based purely on price, it is likely that the smaller supplier group would grow faster than it has over the last four years, providing they can sign up and administer all their new contracts with tariff customers.

4.2 Practical considerations

Historically, faster acquisition rates have created growing pains for smaller suppliers, especially if they have occurred without the sizeable investment in customer service and billing. Complaints recorded by Ofgem and Citizen's Advice demonstrate which suppliers have taken on high numbers of customers without mechanisms in place to handle them. Successful growth of the customer base over a longer period of time relies on price, but also managing the customer relationship, which is particularly poignant as the customer reaches renewal.

Under a relative price cap, there may be more movement in market leading tariffs than we see currently, in order to manage the volume of customers joining smaller companies (although this will also depend on changes around the Whole of Market Requirement[23] for PCWs).

However, it may well be that we will see a mixture of reactions from suppliers, benefitting disengaged as well as engaged customers. Historically suppliers, especially the large companies, have sought to minimise the frequency with which they change their SVTs. Price changes must be communicated to customers in a very formal way with 30 days' notice and, if they are increases, often attracting considerable media and political reaction. The publicity is not only bad for their reputations, but more importantly exposes them to significant losses as some customers at least look for another deal.

More recently a small number of suppliers have entered the market competing on SVT terms for new customers; they may take a different approach to the traditional approach of high SVTs. Octopus Energy believes[24] consumers will continue to make savings from switching under a price cap reflecting efficiencies and strategies of the various players.

But we cannot ignore the rise in activity from current market participants. From switching sites to suppliers, the domestic energy sector is much more competitive now than it has ever been. The total number of electricity customers actively taking part in the switching market (both internal tariff switching and switching supplier) has reached around 40% each year[25], with over 500,000 customers switching in March 2017 alone[26].

One would hope that the sheer number of suppliers offering domestic energy contracts would continue to encourage new and innovative measures of engagement through social media, TV advertising, collective switching, exclusive deals and bundled tariffs. This is before the other remedies proposed by the CMA have been implemented.

4.3 Other commercial impacts

If pricing is constrained, non-price competition will surely become more important. This form of competition may well reward those suppliers with bigger budgets and greater customer awareness. In a market where customer loyalty has traditionally not been rewarded, we are beginning to see a shift in focus towards retention from large suppliers already. British Gas launched its Rewards programme in April 2017[27], offering loyalty deals for energy, with larger discounts for customers who have been with it longest. Other large

[23] The Whole of Market Requirement in Ofgem's Confidence Code for PCWs requires them to display for any consumer using them price comparisons for all suppliers and not just those with which they have commission arrangements. PCWs typically allow consumers to choose from this "whole of market" option and offers from the supplier panel with which they have commercial arrangements. See Ofgem Confidence Code.

[24] Death of "tease and squeeze"? Octopus Energy, 16 March 2017 Link

[25] Energy UK electricity switches, Ofgem internal tariff switches Link, Cornwall Domestic Market Share Survey

[26] http://www.energy-uk.org.uk/press-releases/370-2017/6100-over-530-000-consumers-switched-supplier-in-march.html

[27] See for example British Gas, Npower, E.ON UK, SSE

suppliers like E.ON UK, Npower and SSE have also offered value-added energy and other services or products and discounted prices to long-standing customers.

Under a relative price cap, it may be tempting for other large and medium suppliers to follow a similar path, as their attention will naturally shift towards retention if their fixed tariffs were priced less competitively at renewal.

4.4 Competitive detriments

If the relative price cap leaves consumers with a choice of lesser known cheap deals and an overall narrower range of prices, it is feasible that a relative price cap could dissuade consumers from engaging in the market, reducing the competitive discipline enforced until now. This is a real risk in our opinion of many of the detriments that were feared by the five former regulators in their article for the *Daily Telegraph* last month.[28] They also referenced the decline in engagement — measured through a slide in switching to just 12% a year—in the wake of previous interventions by Ofgem in the wake of its 2008 Energy Market Probe.[29]

At that time the domestic market had minimal competition from outside of the Big Six, so the Probe prescribed the way that large suppliers could price in and outside their home areas to limit any potential for disengaged home area customers to cross-subsidise good deals for out-of-area customers. As the regulators commented: “the price differentials disappeared–but by increases in the lower prices, not reductions in the higher ones”.

Rising energy bills are a function of external network, wholesale and policy costs as well as their own costs, and supplier profits are not excessive so the regulators argued “it is no use shooting the messenger. Competition is increasingly forcing all suppliers to be more efficient and to pass these benefits to customers.” The former regulators cited new technology, reinvigorated doorstep selling, high levels of new entry, innovation by suppliers and PCWs as amongst the evidence for their claim, and then they concluded with a clear warning “the temptation to intervene further should therefore be resisted. The evidence is clear: regulatory interventions have been counter-productive. Retail energy price controls would have an adverse effect on a market that is working better than is generally realised – and would have ominous implications for other markets.”

Their warning is a reminder once again the political rhetoric that has played out during the beginning of 2017 has done nothing to encourage trust in the sector, and that further introduction of a price cap may push consumers further away from engagement.

4.5 For and against

While several SaMS have come out in favour of a relative cap, not all are in agreement.

Those making the case for the relative price cap tend to argue that:

1. Retail price intervention of this kind does not specify absolute price levels. Therefore it should not inhibit innovation in tariffs, in particular in a “smart” world and better more cost reflective products
2. Expensive suppliers would need to reduce their SVTs or face losing customers. If SVTs were reduced, then millions of households would be better off
3. Consumers will no longer roll-off a lower-priced one year tariff onto an expensive SVT. This should stop one of the major sources of consumers being disillusioned with energy companies, and
4. Energy is an essential service and is not like other industries. Deemed rates are often the highest priced (SVT) and bills vary seasonally making it harder for consumers to understand what they are paying for and why. Controlling SVTs will give them more confidence that they are at least not being unduly disadvantaged

[28] See Link

[29] See Ofgem

Those against make arguments including:

5. Limiting suppliers' ability to compete must by definition limit the benefits they are able to bring to consumers. Fewer benefits will mean less engagement, and this will play in to the hands of incumbents companies, in this case large suppliers with many SVT customers who are the main targets for the intervention in the first place
6. Suppliers will behave in expectation of how the intervention will work rather than how to meet the needs of their customers. Energy will be spent second guessing the intervention that could more usefully be spent delivering better services to customers
7. Intervention begets intervention. After nearly a decade of actions intended to benefit the disengaged consumer, or at least stop them losing out too much to the engaged consumers, we are still considering making further changes that will distort the market by distracting suppliers from full competition, and
8. The minister not the market will become the price setter as the political temptation to intervene again to stop further distortions becomes stronger. There is of course the political risk, which we think should not be underestimated, that the minister and not the market could end up taking the blame for price changes.

4.6 Further questions

We believe the following issues are worthy of exploration in the development of a relative price cap (or any other further intervention that may be under consideration):

1. How would prices be reported and monitored given that households have very diverse energy consumption profiles? A 6% margin between two tariffs at one consumption level may be very different at another consumption level
2. How would a relative cap on SVTs link in to existing and expected CMA remedies, especially the transitional prepayment price cap? What is the linkage if any with the database of disengaged consumers?
3. Switching rates are increasing indicating an increased level of engagement. Price caps have the potential to reduce engagement and switching, but also reduce suppliers' incentives to market to "protected" customers, lowering market engagement further. What are the success factors that any intervention should be expected to deliver for consumers, suppliers and other stakeholders?
4. Should the future success of the retail market be driven by interventions or consumers driving competition via switching?
5. A cap, following the CMA investigation, reduces trust in the sector for consumers but also for investors and new entrants. Will further intervention disincentivise new entry and reduce overall competitive pressure?
6. Some suppliers have articulated to us concerns that price interventions are not always introduced as intended (notably the prepayment cap as implemented is different from that outlined in the CMA's proposals). There is a danger that a 6% cap may be further reduced for short-term political gain
7. Is there an option for the market to provide solutions (for example through an automated switching services or bulk buying on behalf of groups of dis-engaged consumers). Here the regulatory regime should ensure sufficient consumer protection is in place, and that such brokerage models do not push suppliers into non-compliance
8. Are there other options that should be considered, such as the Scottish Power/Centrica proposal to transfer in an orderly manner SVT customers to fixed tariffs (effectively withdrawing evergreen tariffs from the market)?
9. Are there other ways of creating incentives for suppliers to move customers from SVTs to cheaper tariffs?

For further information on Cornwall's extensive research reports on market share and competitive activity in the GB retail markets, both domestic and non-domestic, contact Anna Moss on a.moss@cornwall-insight.com..

For examples of some of the reports used in this analysis, such as our monthly Tariff report, contact Elliott Dransfield on e.dransfield@cornwall-insight.com.