



Competition and Markets Authority: Energy Market Investigation - Statement of Issues

Consultation response from the ESRC Centre for Competition Policy

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The response has been written by Prof Waddams and has been edited by Dr Deller. The document has been written following discussions held in the Centre and has the broad agreement of all contributors.

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Response:

We welcome the statement of issues from the CMA, in particular its broad approach, including regulatory action, and its focus on theories of harm which have potential remedies associated with them.

While the paper acknowledges many changes and potential changes to the market, it might include the political environment, given the sector's political sensitivity and the potential for political interventions. It would also be good to know that a wide range of remedies might be considered, including a single buyer.

One theme throughout the paper (and other discussions) is that of 'trust', and we would welcome more granular analysis of what this encompasses, and the implications. We can identify at least four aspects to 'trust':

1. between customers and operators, for example that lower costs are not reflected in prices, and that suppliers behave opportunistically. As long as suppliers are not contravening competition law, this is perhaps what consumers should expect, and it may be appropriate for a competition authority to cultivate a healthy scepticism among consumers, so that they remain active in the market.
2. a feeling that the price is set at an 'unfair' level - if suppliers do not possess market power, consumers should have the ability to counteract such behaviour, and should be encouraged to do so.
3. a lack of trust in the (relative) stability of the market, with apparent gains not being consistent through time so that consumers have to change supplier frequently.
4. a lack of trust in the process of competition, so that it is seen as essentially unfair. This is distrust in the process rather than necessarily in the outcome.

Clearly the nature of the distrust affects whether it is a symptom of an AEC, and if so what the appropriate remedy might be.

We have some comments on the details of the paper, which are presented in the order of the statement:

Paragraph 11: while we appreciate the reasons for excluding retail supply of large businesses, we wonder whether information from this market could be used to provide a comparator for the other parts of the market. In particular, if Ofgem (and the CMA) regard this market as working well, does this provide some metrics against which other parts could be judged and/or (at a later date) for assessing the effectiveness of any remedies imposed, in the event of an AEC finding?

Paragraph 16, first bullet: Would it be helpful to mention specifically that steep short-run supply curves are likely to lead to very high short-run prices at some peak times?

Paragraph 16, third bullet: It might be worth including the role of other renewables, and particularly of feed-in tariffs, in terms of constraints on system balancing.

Paragraph 16, sixth bullet: the note addresses the issues of sustainability and the environmental agenda, but not specifically that of affordability, except to the extent that a focus on consumer benefits would do so. In this bullet it might be appropriate to include acknowledgement of the political sensitivity over fuel poverty and affordability for vulnerable groups.

Paragraphs 18 and 19: the obvious response to how to take into account uncertainties is to undertake a sensitivity analysis. This might also help in assessing the effect of some of these uncertain factors. Some determinants may be changed by the inquiry itself, including consumer behaviour. The (relative) upsurge of switching in the fourth quarter of 2013 shows the sensitivity of consumer activity to outside influences (in this case intense political and media interest in energy). One likely future pattern of consumer behaviour, particularly in light of the new influence of social media, may be spurts of activity followed by periods of inactivity, which make analysis of the market more complex than steady consumer engagement in the market.

Theories of harm:

Paragraph 35: we are not convinced that public mistrust is necessarily harmful, see our comments on this above. Increasing transparency can distort the market, particularly if it facilitates co-ordinated effects, and we are cautious about its benefits.

Paragraph 36: given these changes one problem here is knowing what the counterfactual should be in the market analysis being performed.

Paragraph 50: we wonder whether the reluctance of existing suppliers to participate in collective switching auctions may be a symptom of not wanting to 'upset the apple cart', and of co-ordinated effects in the market.

Paragraph 52: we welcome the emphasis on assessing the effect of potential remedies, since there is a danger that intervention to help one group may merely shift the detriment to another. In general the distributional implications of potential remedies are particularly sensitive in this market.

Paragraph 55: how far is pre-announcement required, in order for consumers to know the price they are paying? If companies do not respond to each other's pre-announcements, then this is unlikely to be a facilitating practice for tacit collusion. However we welcome the CMA's analysis of this aspect, to see how far the price pre-announcements are signalling to competitors. In this regard, it would be informative to consider any differences in the patterns of announced price decreases and price increases. Companies may also divide the market by using price structures, as there is evidence that they did this in the early years of the competitive market (Davies et al., 2014).

Also, price competition will be limited partly by capacity constraints, which limit the need for tacit co-ordination. Unless a supplier initiating a large price cut has significant spare generating capacity or can be confident of obtaining sufficient capacity through the wholesale market, an aggressive price cut may be unattractive due to uncertainties about being able to meet the increased retail demand.

Paragraphs 58 and 59: we welcome the assessment of the regulatory interventions on tariffs (see Hviid and Waddams Price, 2012 and Waddams Price and Zhu, 2015 on non-discrimination clauses) and the consideration of the competitive effects of social and environmental regulations.

We agree with the omission of wholesale gas markets, gas interconnection and storage and regulated transmission and distribution revenues.

References:

- Davies, S., C. Waddams Price and C. Wilson (2014), 'Nonlinear Pricing and Tariff Differentiation: Evidence from the British Electricity Market', *The Energy Journal*, 35(1), pp. 57-77
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- Waddams Price, C. and M. Zhu (2015), 'Non-discrimination clauses: their effect on GB retail energy prices', *The Energy Journal*, forthcoming