

Mr Roger Witcomb
Chair, CMA Energy Market Investigation Panel

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Dear Roger

Gap between Standard Variable Tariffs and Fixed Tariffs: the impact of RMR

There has been some discussion and concern about an increased gap between Standard Variable Tariffs (SVTs) and Fixed Tariffs, and some suggestions that a new regulation should be brought in to limit the extent of this.

How far there is such a gap is not entirely clear: for some suppliers the gap is now very low.¹ There must also be several contributory factors, including movements in wholesale prices and supplier hedging policies, which obviously change over time and vary between suppliers. These factors might suggest that the "problem" is not a significant one, but alternatively that a new regulation would be useful "just in case".

This brief note is to highlight another factor that does not seem to have been much discussed.² Certain RMR regulations have limited the ability of suppliers to compete using SVTs. The appropriate remedy is therefore to remove those regulations, not to introduce an additional regulation.

At one time suppliers could and did compete using SVTs. For example if wholesale costs fell a supplier could close to new customers its SVT which it had hedged at the higher wholesale prices, and offer a new SVT at a lower price to attract additional customers. But the RMR prohibition on Dead Tariffs now precludes this: the supplier would be required to move all its customers from the more expensive dead SVT to the cheaper new SVT. This of course would mean a reduction in revenue from all its existing SVT customers, and a lower or possibly negative margin relative to the higher costs at which the supplier would have hedged the original SVT. This makes it unprofitable to offer a new SVT at that low price.

Alternatively, the supplier could reduce the price of the existing SVT at a slower rate, to reflect a blend of previous and present costs. This could maintain the supplier's margin, but the resulting SVT price would not be as low as otherwise, and the SVT would not be as effective at winning new customers.

In consequence, suppliers wishing to compete effectively are driven by RMR regulations to use fixed tariffs rather than SVTs.

A supplier is technically allowed to have two or more live SVTs with different terms – for example one geared to larger users and one to smaller users. But RMR regulations require the

¹ E.g. "The rising price of loyalty to the Big 6", Ovo Energy, posted 17 June 2015

² Although it is referred to in Summary of Hearing with SSE, 6 March 2015, para 51

supplier to calculate the Supplier Cheapest Tariff (SCT) for each customer. I am told that the cost of the time and effort required to make these calculations means that the option of multiple SVTs is no longer viable for a supplier.

Unfortunately, this is yet another example of well-meaning and simple-sounding regulations having unintended consequences. The economics were not properly thought through, or not acknowledged. There was a fallacious belief that imposing regulations on suppliers would have no adverse impact on the range of prices offered in the market. The requirements to close Dead tariffs, and to advise customers of the supplier's "best" tariff, both reflect this fallacy.

Another example is the recent requirement on suppliers to inform their customers of a lower price on any white label product they offer. It may sound like a good idea for customers to be better informed. But encouraging its customers to move to a lower margin white label product, and raising questions about the reasons for any difference in price, is more likely to deter a supplier from offering lower priced white label products in the first place. In other words, the well-meaning regulation actually restricts rather than promotes competition, and makes customers worse off.

Thus, if there is a concern about an increasing gap between Standard Variable Tariffs and Fixed Tariffs, a sensible way to reinstate competition using SVTs, and thereby to reduce the present gap, is to remove the RMR regulations that presently hinder suppliers from competing using SVTs, viz the prohibition on dead tariffs and the requirement to advise SVT customers of each supplier's best tariff.

I hope that the CMA's provisional findings will appreciate the significance of this point, and propose removing the RMR regulations that are presently restricting competition via SVTs. At the very least, I hope the provisional findings will fully explore the impacts of the RMR regulations before proposing yet another regulation.

Sincerely

Stephen Littlechild