

Roger Witcomb: the energy investigation one year on

13 June 2017

Speech given by Inquiry Chair of the CMA's energy market investigation one year after publication of its final report.

I feel honoured to have been invited to speak to you today on where we find ourselves now that it's almost a year since we published the final report in the energy market investigation – which was the most extensive review of the industry since it was privatised over 30 years ago.

The title of today's event, 'Re-energising the retail energy market', is appropriate, as this is what we set out to do through our package of remedies – to re-energise competition whilst providing temporary protection to those customers who are currently prevented from fully realising its benefits.

So this morning I will set out for you why I believe the improvements which we have implemented, ordered or recommended will do exactly that: re-energise this market, which matters to virtually every household and business across the UK.

Whilst publishing the final report represented the statutory conclusion of our investigation, it was really just the end of the beginning. Since then, the Competition and Markets Authority (CMA) has pushed ahead with putting in place our remedies, which we believe will be the foundations for the fundamental changes which this market needs.

Before I explain where we are now I'll remind you what those problems are.

Over the course of our exhaustive, and exhausting, 2-year investigation, we found problems in 3 main areas.

On the demand side, we found a widespread lack of engagement on the part of many customers, which energy suppliers, mainly 'the Big 6', have been able to exploit through charging high prices.

On the supply side, we found problems in both the wholesale and retail energy markets, where a combination of unnecessary regulation and technical constraints have restricted competition to the detriment of consumers.

And within the broader regulatory framework, we found problems in the system for regulating the sector which have hindered the timely development of policies and regulations that would be in the interests of consumers.

Overall, we found that over the period from 2012 to 2015 UK customers had been paying £1.4 billion a year more than they would in a well-functioning market. Around 70% of domestic customers of the Big 6 energy firms were on the expensive default tariff, misleadingly called the Standard Variable Tariff (SVT) and could in 2015 have saved more than £300 by switching to a cheaper deal. And it wasn't just domestic consumers, because it turns out that microbusinesses too were paying more than they needed to, to the tune of about £180 million a year.

You won't be surprised to hear that we had some robust discussions with the suppliers about our calculation of detriment. We listened carefully to their arguments, but were, and are, confident that our analysis was sound. Given recent events, about which more later, these figures are again being challenged, which is not surprising not least because our analysis also suggested that only about half of that detriment, which is essentially excess prices, found its way into profit. The rest was swallowed up in inefficiency, although I should say that the companies varied widely in that regard.

I should also tell you that at least one supplier told us that the SVT represented an active choice by consumers, who preferred the excellent customer service of the Big 6 and the smooth variability of SVT to the annual shocks of a one-year fixed tariff, notwithstanding that they were paying 25% over the odds for the privilege. This proposition was not consistent with our customer survey results, and we did not find it convincing.

We were in no doubt that energy customers are losing out to a very significant extent and this demanded that we and others, including Ofgem and the UK government, take extensive action to address it.

The wide-ranging problems we identified were matched by an equally wide-ranging package of solutions.

There are over 30 CMA remedies in total: a combination of orders, recommendations and undertakings designed to achieve 4 over-arching aims:

- to create a framework for effective competition;
- to help customers to engage in the market;
- to protect those who are currently unable to exploit the benefits of competition; and
- to future-proof our remedies by building a robust regulatory framework.

The different elements of the package are mutually reinforcing and taken together will drive down costs by increasing competition among suppliers and helping customers to switch to better deals.

And several of them are well underway.

There is greater price transparency for microbusiness customers, as from June suppliers have been required to publish their prices for these customers, and have been banned from enforcing contracts that lock them into expensive 'rollover' deals.

Meanwhile, customers on restricted meters – Economy 9 and such like – will shortly be able to access more energy packages and have better information to help them pick the right one for them.

In April, acting on a CMA order, Ofgem implemented a price cap for the 4 million households on prepayment meters. It is unacceptable that these households, many of them vulnerable, face higher bills than other customers. If these customers want to switch, their choices are limited – even the cheapest prepayment deals cost a lot more than those available to direct debit customers.

The cap, which we expect will reduce each household's bills by around £80 per year, is now in place and will remain in place until the disadvantages these customers face are addressed by the roll-out of smart meters and other changes we are requiring in the sector.

A price cap by its nature creates a tension with promoting competition and engagement, but we have designed this one in such a way as to minimise that risk. This is principally by (a) clearly limiting its shelf-life – it will fall away when the smart meter regime is up and running, (b) adjusting it every 6 months in line with underlying costs, and (c) incorporating around £30 a year of headroom into the cap, a margin which should allow scope for competition below the cap. We anticipate that as our other remedies take hold and smart meter roll-out progresses, competition rather than the cap will increasingly determine the prices paid by most customers.

On the demand side, we set out to build on the most positive development in the market, namely the rapid growth in the number and market share of independent companies challenging the established providers by offering cheaper fixed deals.

Ofgem has welcomed and is taking forward our recommendations. It has already removed the 'simpler choices' elements of the 2010 Retail Market Review which were introduced in a bid to simplify tariffs but which our investigation found had reduced choice and dampened competition for several types of customer.

We also recommended the removal of the requirement for Ofgem-accredited price comparison websites (PCWs) to display all the tariffs. We made this recommendation because almost all PCWs are essentially retailers. They get their revenue from the companies whose offerings they display. Obliging them to display every tariff runs the risk, and it's a real one, of seriously undermining their business model. If you're an energy supplier, why would you pay commission to a PCW if it had to show your tariffs anyway? The likely medium-term outcome of the 'whole of market' requirement is that PCWs will exit the energy market – and if not that, they will certainly be disinclined to put a lot of effort into developing it. And in our view of the future we believe that entrepreneurial and innovative PCWs will have a key role in promoting customer engagement.

I understand that that is not everyone's view of the role of PCWs. But we are pleased that Ofgem has consulted on a proposal for the partial removal of this 'whole of market' requirement, and I for one will watch developments in this area with interest. I should also add that the CMA is currently carrying out a much broader study of

digital comparison tools. Its final report on this is expected towards the end of September.

Ofgem is also taking forward our remedy to create a database of disengaged customers.

We recommended the creation of a database of customers who have been on the most expensive tariffs for more than three years. This would allow Ofgem and rival suppliers – under strict controls – to prompt these disengaged customers to switch to a better deal, by telling them how much they could save, with figures based on their current tariff and their actual usage, and giving them direct and easy access to much better deals.

Ofgem has been carrying out trials, of both the database and the prompts to customers, and early results are promising.

They show significant increases in switching rates in response to prompts – interestingly they carried out trials both with the prompt coming from Ofgem and with it coming from a rival supplier, and the letters from suppliers outperformed the Ofgem-branded letter. Ofgem is planning more trials of a different use of the database over the summer to make this remedy as robust and effective as possible. The results so far show that we designed a remedy which is effective, and we look forward to Ofgem taking action soon, given the size of the consumer detriment.

We also made a series of recommendations to the UK government, one of which it has already consulted on. This relates to Midata, which is the government-sponsored database of individual information relating to such things as banking, telecommunications and of course energy, data which consumers can make available to suppliers, PCWs etc to help their search for good deals. Our recommendation is that all energy suppliers should participate – participation is currently voluntary; the database should collect a richer set of data, that there should be no institutional barriers to data collection and that customers should be able to give PCWs etc access to their data on a continuing basis – consent is currently for one-time-only access.

We also made a series of recommendations designed to improve how energy policy is developed, by ensuring that the UK government makes policy decisions in a more transparent way.

These recommendations include establishing a clearer boundary between government and regulator, by granting more powers for Ofgem to disagree publicly with the government. And recommendations that the UK government should develop energy policy based on open consultations, so that it can be tested and refined to ensure it will achieve its intended purpose.

But energy policy is evidently a matter of intense public debate, and various other things have occupied the mind of government recently, and we are still awaiting a full government response to our report.

The last remedy I want to talk about is the one we didn't put forward – to wit a broad price cap. It is not yet clear precisely what we can expect in this area, but even with a hung parliament, the most reliable indicator is probably the Conservative Party manifesto. The Conservatives committed to introducing a safeguard tariff cap that will extend the price protection currently in place for prepayment meter customers to more customers. This is intended to protect customers who do not switch against excessive prices, but to do so alongside supporting initiatives to make the switching process easier and more reliable, and so maintain and enhance the competitive element of the retail energy market.

We too thought carefully about extending a price cap to all SVT customers. A large majority of us (4 out of 5) concluded that seeking to control prices for the substantial majority of customers would undermine the competitive process, reducing the incentives of suppliers to compete, reducing the incentives of customers to engage and to switch to better deals, and thus leading to worse outcomes for customers in the long run. There are encouraging signs that competition in this market is already leading to greater engagement and better deals for customers. And we weren't able to find a price control remedy that was both effective in its primary aim and did not create a high risk of stalling the move to greater consumer engagement and a well-functioning competitive market.

But the detriment is considerable and it is entirely understandable that politicians will wish to continue to seek the Holy Grail of a price control that does not undermine competition.

The dilemma is fundamentally about the level of a cap. If you set it too high then it doesn't do much to address the detriment in the short term, and may persuade some customers that they're on a government-backed tariff and so they don't need to shop around.

So, if you want quick and tangible benefits you should set the default tariff pretty close to the competitive tariff. It is likely then that all tariffs will converge on the price cap tariff – any lower tariff is by definition loss-making, and there is very little opportunity to recover that loss in the foreseeable future.

Consumers will quite reasonably figure that they have no need to shop around. Acquiring customers will be an unprofitable activity, and customer churn will fall away.

However, customers will be much better off in aggregate in the short, possibly even the medium, term.

But how do you decide how and when to remove the price control. Everyone agrees that the main problem is one of engagement, and as described, under the operation of the price control, engagement would be worse than before the cap was introduced. So the cap would stay on and competition would wither away further. Such a price cap would also come at just the moment when the conditions for effective competition are most propitious – smart meters, home energy management systems, electric vehicles etc.

We couldn't find an answer to that conundrum, but welcome someone else having another go

Concluding remarks

It is pleasing that one year after the publication of our final report, a number of the remedies are in place and delivering benefits to customers, including the price cap for prepayment meter customers, a better offer for restricted meter customers, better information for microbusinesses and a ban on auto-rollover contracts.

More remedies will come into effect over the coming year, such as locational pricing of transmission losses, which will save around £150 million off energy bills over the next 10 years.

Clearly there is much more to do.

I hope that Ofgem will continue with its programme of work to improve customer engagement. The technological advances of smart meters and the Internet of Things present an opportunity for a step change in customer engagement; an opportunity which must not be wasted.

And I hope that the UK government will take our recommendations for improving industry governance on board.

It is only with the full support and commitment of the regulator, the government, and the industry itself, that we will see a truly re-energised energy market in the interests of households throughout Great Britain.

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