

# Department for Business, Energy & Industrial Strategy and Ofgem: Flexible and Responsive Energy Retail Markets

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## Consultation response from the Centre for Competition Policy

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This consultation response has been drafted by the named academic members of the Centre, who retain responsibility for its content.

As an academic research centre, we welcome explicit citation and sharing of this consultation response and the research cited within it. If you would like to discuss the evidence in more detail, please feel free to contact the centre or the named academics.

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## CCP Response to ‘Consultation on Flexible and Responsive Energy Retail Markets’

We welcome the opportunity to respond to this joint consultation by BEIS and Ofgem. We answer questions 1-5, 7, 13, 15, and 17.

### **1. Do you agree with our vision for the future of the energy retail market, the outcomes we are seeking to achieve and our characterisation of the key challenges we need to overcome?**

Our answer to this question responds mainly to sections 1 and 2, the executive summary and overarching approach, with further detailed responses to specific sections below.

We find the vision somewhat unclear, mixing a number of that are not always mutually compatible. There seems to be a wide range of objectives to meet, but many fewer tools identified in terms of the retail energy market. It is unclear in places whether competition is an objective in its own right, or is recognised as a powerful instrument, which may be useful in meeting some other objectives, but has other ramifications for outcomes in the market.

For example, in espousing competitive prices for all (page 15), the document commits itself to prices that reflect the different propensities of consumers to respond to price levels and opportunities to switch supplier, in a market where policymakers have rejected such an outcome by imposing caps on prices charged to unresponsive consumers. In general, the strapline of ‘Putting Consumers at the centre of a smart, low carbon energy system’ seems to imply much more active consumers than recent evidence suggests is likely. The sentence at the beginning of the section on the role of energy retail markets (page 10) appears to be describing a theoretical market rather than the GB experience where prices have been capped for 17 million consumers whose engagement through the energy retail market has been very limited. For more details on the evidence here, please see responses to the relevant questions below. Allowing consumers to take advantage of opportunities does not mean that they will do so, and policymakers should be clearer about the gap between opportunities and outcomes (for example at para 6 p. 8). Indeed the pattern of competitive prices depends on the responsiveness of consumers to prices and opportunities. The statement about no cross-subsidy at p.15 para 3 commits to applying the prices which emerge from such a process.

Some of the objectives themselves are unclear. Which consumers are to benefit from these markets, and how are distributional considerations and those of vulnerability to be considered? While it is difficult to disagree with the statement that vulnerable consumers should receive the service which they need, they are unlikely to do so without more clarity on responsibility for identifying to whom this refers, how their needs are to be recognised and delivered and who is responsible for meeting them.

In general, BEIS/Ofgem are applying the rhetoric of competition (“A dynamic, innovative and competitive retail market will help deliver the energy transition at the lowest cost to consumers”), and the assumption that the default **price cap is temporary**<sup>1</sup>. This assumption is then confronted with the desire to help, in some way, particular classes of consumer, like ‘non-engaged’ consumers, who will not (more or less by definition) be helped by competitive markets alone. At some level, this is recognised within the paper, for example, “We recognise that even if we [increase competition], there is a risk that without effective protection in place, customers do not or cannot engage in the market will not get a fair deal for their energy”. But the paper seems unwilling to accept that a price cap of some form, whether directly or through some collective switching scheme<sup>2</sup>, is likely to be the only way

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<sup>1</sup> See our response to the pre legislative scrutiny of the price cap bill  
<http://competitionpolicy.ac.uk/documents/8158338/16525214/6+CCP+response+to+BEIS+Committee+Energy+Price+Cap+Inquiry.pdf/236d419d-d157-2e0e-2eea-0923d75dd035>

<sup>2</sup> See our report on collective switching  
<http://competitionpolicy.ac.uk/documents/8158338/19064125/Collective+Switching+Report+-+August+2017.pdf/127c78b6-faad-4496-b198-f56862230896>

that non-engaged consumers are going to get a 'fair' deal, as perhaps captured in the phrase "competitive prices for all" (though see above for likely outcome).

## **2. Are there examples of new products, services and business models that would benefit current and future consumers, but are blocked by the current regulatory framework?**

This is a case where a clearer approach would have been to set out competition as the default, but to then examine which of the various objectives (in particular, those around non-engagement, loyalty premia etc) will need alternative solutions. One response may be 'modular' regulation (where energy retail businesses are regulated according to the services they offer) but it is not clear that this sits very well with a starting point about the primacy of competitive markets. See also our response to question 4 below. Moves to open the market for consumers to use comparative smart metering may also raise some concerns around privacy.

One example of new products provided in section 3 (p.18) is increased bundling, eg vehicle purchase and energy for charging. It is not clear why companies have not used equivalent bundling (vehicles and petrol), nor what the regulatory barrier might be. Moreover, on the next page, the dangers of bundling are explicitly recognised (p.19 para 2) and other regulators, particularly Ofcom, have addressed the difficulty of regulating bundled services. Would consumers receive adequate protection if such new products and services were introduced?

## **3. Are there current or emerging harms to energy consumers which are currently out of scope of the regulatory framework? Do these differ for domestic and non-domestic consumers?**

One concern here is that in trying to 'solve' these problems, technology could be excessively (and maybe exploitatively) invasive, and therefore against the interests of consumers. Analysis of this potential trade-off would be helpful. In addition, we note the considerable expansion in statutory and other duties for the energy regulator<sup>3</sup>, and the consequent difficulties in prioritisation, which further expansion would exacerbate.

## **4. Would it be beneficial to allow suppliers to specialise and provide products and services to targeted groups of customers? If so, how can this be delivered while balancing the need for universal service?**

Our question here is to whom this might be beneficial, particularly if it resulted in both increased variety and increased prices. Such specialisation causes concern mainly on competition grounds. For example, if community heating schemes are going to be part of the energy transition, it may be difficult to see answers other than regulated local vertically integrated monopolies (which may, for good measure, also want to be able to compel geographically relevant consumers to take their heat from the monopoly provider). This runs counter to the general enthusiasm for competitive markets in the paper.

Moreover, such specialisation could make it harder for consumers to compare offers in the market and actually perpetuate, or increase, disengagement with the search/switching process.

## **5. Are incremental changes to regulation sufficient to support the energy transition and protect consumers? Or does this require a more fundamental reform, such as moving to modular regulation?**

In terms of industry structure, BEIS/Ofgem focus on the supplier hub model but then spend large parts of the paper enumerating ways in which the model, at least in its current form, is unlikely to achieve

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<sup>3</sup> See Figure 1 p.36 of Fairness in Retail Energy Markets (CCP and UKERC)  
<http://competitionpolicy.ac.uk/documents/8158338/8193541/CCP+economics+book+Final+digital+version+-+colour.pdf/30214557-cace-4b0b-8aac-a801bbde87bc>

their multiple objectives. The thinking is therefore inevitably limited to marginal changes around the edges of this model.

However, some of the proposed tinkering (derogations, geographic licences, supply licence exemptions, limits on universal service obligations, other licences alongside supply licences) may be sensible ways of achieving particular (fairly limited) objectives. A more useful approach would be to analyse more explicitly which objectives would be furthered by competitive markets, and which would require rather different instruments.

### **7. Would removing the thresholds for the Energy Company Obligation and Warm Home Discount help remove imbalances in the retail market, and could this be done without significantly increasing barriers to supplier entry or expansion in the retail market?**

Levying the costs of environmental programmes on energy providers inevitably restricts either entry or expansion. It raises the costs of being an energy supplier, and so reduces the profitability of entry if universally applied; if applied to only some suppliers it clearly creates distortion between them. Recovering these costs from energy consumers, while this may internalise the otherwise unpriced environmental costs, is almost inevitably regressive from a distributional perspective, since the average proportional spend on energy declines with income<sup>4</sup>.

### **13. How could any potential distortions related to high cost-to-serve customers be addressed, for example by the provision of additional support services for customers struggling to afford their energy?**

Customers who are struggling to afford energy will often be struggling to afford other regulated services such as water and sewerage and telecommunications, as well as other basic necessities such as food and housing. Since the source of such difficulties generally lies outside any particular sector, third party support to address such general affordability issues seems appropriate. It would require a major analysis to design appropriate additional services, identify how they would operate and ensure that they truly are in a consumer's interest. The issue lies beyond sector regulation.

The industry itself may be able to help identify consumers in need of additional assistance, and perhaps be involved in delivering such help. In terms of suppliers tailoring their services to avoid high-cost consumers, or those who might become such, a model of 'play or pay'<sup>5</sup> as envisaged when competition was first introduced to regulated sectors, may be appropriate. Suppliers who do not directly incur the costs of high-cost consumers may make a financial contribution to those who do, though this has a danger of perverse incentives and maybe bureaucratically challenging to implement. To the extent that inactive consumers are also high cost, the current outcome of them paying higher prices means that they bear the burden of their own costs. This is clearly a rather random effect and may exacerbate the problems for some consumers who find they are bearing a high burden from this informal 'taxation' system. Moreover, the appropriate policy for those who choose to be inactive may be different from that for those who, either temporarily or more permanently, are unable to be active in the market – see below.

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<sup>4</sup> see figure 5 p. 25 of Fairness in Retail Energy Markets (CCP and UKERC)  
<http://competitionpolicy.ac.uk/documents/8158338/8193541/CCP+economics+book+Final+digital+version+-+colour.pdf/30214557-cace-4b0b-8aac-a801bbde87bc>

<sup>5</sup> see Waddams Price, C., 1996 in Corry, Hewitt and Tindale, Energy '98: Competing for Power, IPPR

**15. What are your views on the measures being considered to address loyalty penalties in different markets? What approach or – combination of approaches – would be most effective in the energy retail market?**

Consumers remain ‘loyal’ to their suppliers for many different reasons<sup>6</sup>. In addressing the concept of loyalty a penalty, it is important to distinguish between consumers who are able to search and switch from those who are unable, for some reason, to realise cheaper offers which may be available. Some consumers may be actively loyal (for example because they prefer green electricity or a particular supplier or because they value their time more than potential savings in the energy market). They are exercising a choice in not taking advantage of cheaper offers and could be regarded as ‘actively’ loyal. They do not require direct protection, and delivering it may reduce their ability to be active in other markets<sup>7</sup>. In contrast, a ‘passively loyal’ consumer may be unaware of the options available and may be the subject of greater government/regulatory concern. Disentangling the different types of loyalty may itself prove challenging. Some consumers may be subject to transactional unfairness<sup>8</sup>, which should be addressed primarily through consumer protection measures rather than through the mechanisms of the market itself.

Once these appropriate protections against misleading information are ensured, those who are unable to reach for better deals in the energy market are likely to have similar issues in other sectors. If competition in the energy market is not to be distorted, the arguments and exploration of protection tools for the ‘passively loyal’ follows similar arguments to those in response to question 13 above.

We note that some consumers are behavioural in a more limited sense – even if they are seeking to switch only to save money, they may make (ex ante) errors and find themselves on a more expensive tariff<sup>9</sup>. The different reasons that consumers may have for inaction mean that any policy remedies which are seen as appropriate need to be similarly varied<sup>10</sup>. Developing some of Ofgem’s current trials to explore collective switching opportunities<sup>11</sup> is one potential avenue for protection of specific types of consumers.

**17. What protections or support may be required to engage consumers in vulnerable situations in the future market?**

We have addressed the difficulty of defining consumers in vulnerable situations in our response to Ofgem’s Draft Energy Strategy<sup>12</sup>. We reproduce this response here written by Tola Amodu:

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<sup>6</sup> see Flores and Waddams Price 2018 and Zhu and Waddams Price 2016 for discussion of different consumer types and reasons for activity in energy markets

<sup>7</sup> see Waddams Price and Zhu 2016

<sup>8</sup> Bruce Lyons and Robert Sugden, ‘Transactional Unfairness and the Regulation of Consumer Price Discrimination’, (discussion paper in preparation). Foundations for their approach can be found in Sugden (2018), ‘The Community of Advantage: A Behavioural Economist’s Defence of the Market’, Oxford University Press. See also their consultation response (Part 1: Transactional Unfairness and Price Discrimination in Financial Services) to the Financial Conduct Authority’s consultation on ‘Fair Pricing in Financial Services’ (January, 2019), available at:

<http://competitionpolicy.ac.uk/documents/8158338/28916580/CCP+response+fair+pricing+financial%20+services.pdf/8503f377-783b-37c2-4527-2bc5be684f66>

<sup>9</sup> see Wilson and Waddams Price 2010

<sup>10</sup> Flores and Waddams Price, 2018

<sup>11</sup> Deller, D., Bernal P., Hviid, M., & Waddams Price, C., (2017) "Collective Switching and Possible Uses of a Disengaged Consumer Database",

<http://competitionpolicy.ac.uk/documents/8158338/19064125/Collective+Switching+Report+%20+August+2017.pdf/127c78b6-faad-4496-b198-f56862230896>

<sup>12</sup> Amodu, T., Brock, M., Deller, D., Harker, M., Tutton, T., Waddams Price, C. (2018) Consultation response to Ofgem's Draft Consumer Vulnerability Strategy 2025, available at:

*‘One significant problem is finding an appropriate definition of vulnerability. This has vexed many academics and led to a raft of programmes – Emory Law School’s Vulnerability and the Human Condition is an illustration. The work of Martha Fineman (e.g. Fineman and Gear, 2016) makes it plain that vulnerability functions at both individual and institutional levels and is a lens from which to view the human situation. In short, all humans are vulnerable but some are more so. From this perspective, vulnerability is the universal human condition as it affects us all in varying degrees. It is important, therefore, to disaggregate consumers in vulnerable situations and vulnerability per se. For the former, the legal response is to identify the characteristics that might make some more susceptible to adverse effects and act accordingly. Economic, health and social factors are important variables but vulnerability can be viewed from both an objective and subjective perspective. This has an interesting echo in the discussion and evidence about objective and subjective measures of affordability – see question 2 below. The objective risk of detriment definition used as a focus for regulatory intervention may not necessarily align with self-perception. This is particularly so with regard to generalizations relating to age or disability e.g. those with health problems may not see themselves as particularly vulnerable whereas the objective bystander might. Perhaps the definition of vulnerability requires an “or” instead of an “and”.’*

**We define vulnerability as when a consumer’s personal circumstances *and* characteristics combine with aspects of the market to create situations where he or she is:**

Personal circumstances might not align with characteristics e.g. mental impairment can lead to a risk of enhanced vulnerability but does the definition require impairment? In short, are circumstances or characteristics independently necessary but not sufficient in themselves?

#### ***Distinction between vulnerable situations and Vulnerability per se***

Again, the two are not the same. For example, while in Ofgem’s consultation (figure 2) not having used the internet is measurable, it is not the same as not having access to it, or indeed not wishing to do so. The same could be said of “people living with cancer” – this could cover a wide range of situations, from end of life, terminal to being treated in remission, etc. Other categories cover similarly broad circumstances for individual consumers, which makes them difficult as identifiers of those in need.

Evidence specific to the energy market indicates why using residential criteria might be an inefficient mechanism for helping truly vulnerable consumers, even using apparently uncontroversial criteria.

Knowing the characteristics of the buildings people reside in, alongside their demographic traits such as age, gender, and environmental preferences would appear to be a sound foundation from which to judge estimations on energy usage. However, in a study conducted at the University of East Anglia (UEA), researchers found that those living in identical buildings and holding near-identical personal characteristics use starkly different levels of energy (Brock, 2015; Brock & Borzino, 2016). Indeed, some residences consistently used treble the energy of their adjacent neighbours on a weekly basis. Furthermore, this was after being provided with explicit information on their relative and absolute usage. This means that, even with a reference point from which to judge behaviour, people’s energy consumption can be hugely disparate.

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[http://competitionpolicy.ac.uk/documents/8158338/28916580/CCP+response\\_OFGEM+Vulnerability+Consultation+Response.pdf/8ab3f247-ebf4-82a4-a5ec-48f42e270979](http://competitionpolicy.ac.uk/documents/8158338/28916580/CCP+response_OFGEM+Vulnerability+Consultation+Response.pdf/8ab3f247-ebf4-82a4-a5ec-48f42e270979)

The study above found even more striking results when it combined energy usage with attitudes to the environment. Specifically, those students who had self-selected to live in a 'green flat' (i.e. a sustainable environment) actually consumed above-average levels of energy throughout the period of the trial, showing that information on residents may not always coincide with their actions. This is akin to the famous intention-behaviour gap (Sheeran & Webb, 2016).

Whilst the study of UEA students does not pertain to vulnerability explicitly, it is easy to envisage how basing vulnerability criteria upon the visible or factual information of individuals might create a false indicator as to whether they are actually vulnerable. Indeed, being situated in a 'vulnerable condition' does not inherently mean that consumers do feel 'at risk' and thus there is a difficult balance to tread regarding how such information should be used to improve overall wellbeing. Perhaps more crucially, this also works in reverse – there could be 'vulnerable' consumers who, on paper, would not live under conditions that would suggest this is so. Thus, through proposing an abstract index one fails to access the vulnerable who are actually in real need of help.

A related point here is that truly vulnerable people may react differently to being identified as so. In just the same way that the aforementioned students responded very differently to being given information on relative energy usage, a study by Longhurst & Hargreaves (2019) identify that people in 'vulnerable circumstances' exhibit very different sets of attitudes, both in terms of their living situation and in their strategies for coping with this.

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