

Pricing in the UK retail energy market, 2005-2013

KEYWORDS: energy market, regulatory intervention, non-discrimination clause

December 2013

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BACKGROUND

- Following their pioneering deregulation at the end of the last century, UK governments and the energy regulator have shown increasing concern about the health of competition in the residential energy market.
- In its 2008 Energy Supply Probe, the regulator identified price differences between regions as a symptom of competition concern and a major problem for fairness. They introduced a new license condition, the non-discrimination clause, to prevent companies charging higher mark-ups to consumers in their home regions than in other regions.
- Competition had developed from a base of electricity monopoly in fourteen regions by each electricity company (who became the Big Five through mergers and acquisitions) entering the thirteen regions where it was not monopolist. The national gas incumbent also entered each of the electricity regions, and constitutes the final member of the Big Six companies active in the market.

METHODOLOGY

- The authors explore the changes in companies' pricing behaviour which followed the introduction of the package of reforms arising from the 2008 Energy Supply Probe and the non-discrimination clauses.
- The effect of the intervention is explored by analysing the pattern of pricing behaviour amongst the Big Six companies for their 'standard' electricity customers. This is the tariff paid by customers who are off-line, using average quantities, and paying by direct debit. It is the main tariff used by dual fuel customers, particularly those who are likely to switch supplier.
- Data are taken from price sheets published by Consumer Focus which show the main tariffs for the Big Six.
- The effect of the non-discrimination clauses is explored by dividing the data into two sub-samples, before and after the introduction of the clauses.

KEY FINDINGS

- The study finds a change in the behaviour of the companies before and after the introduction of the non discrimination clauses which is consistent with the concerns that they might soften competition between the large players in the market. While they seemed to be putting some constraint on each others' prices before the introduction of the clauses, this effect is absent or much weaker afterwards. The Big 5 seem to have 'retreated' to their home regions, leaving each regional market closer to a duopoly between the national gas incumbent and regional incumbent. Combined with the regulator's own figures on profitability, and a halving in the number of consumers switching energy suppliers between 2008 and 2013, this suggests that compliance with the clauses has resulted in higher rather than lower prices.
- The authors find that the nature of competition in the industry has changed for the tariff under analysis, with less effective rivalry between the regional incumbents and large regional competitors following the introduction of the non-discrimination clauses. Companies seem to have 'retreated' to their home regions, leaving a market where pricing behaviour resembles more closely a duopoly between British Gas and the regional incumbent.

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- Before the introduction of the non-discrimination clauses, the best priced 'majorsaway' (large companies with regional electricity incumbency regions operating outside their home areas) were broadly constraining regional incumbents' price increases. But the constraint on incumbent price increases has weakened: after the clauses were imposed, the best priced majorsaway's prices were much closer to the incumbent, so that if the incumbent accelerated its price increases, the best priced majoraway would follow.
- In the period before the non-discrimination clauses, the evidence strongly suggests that British Gas was the price leader of both the best majoraway and the incumbent. But after the non-discrimination clauses, while the best priced majorsaway continued to follow British Gas, the price leadership by British Gas of the incumbent is less strong. In five out of fourteen regions, the incumbent is leading British Gas, and in another five British Gas is leading the incumbent.

POLICY ISSUES

- The regulator did not renew the non-discrimination clauses after their initial three-year period but has since severely limited the number of tariffs which each supplier may offer, which will have some similar effects. Analysis of the data confirms that this particular regulatory intervention was not successful in lowering prices, and that the companies' response by increasing the complexity of special offers may have caused consumer confusion and reduced participation in the market. This itself has led to further regulatory intervention. The findings of the paper present a cautionary tale both for this particular policy and for the dangers of well-meaning intervention by regulators or governments.

THE CCP

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