

Non-discrimination clauses in the retail energy sector

BACKGROUND

- The British energy market consists of a number of well-defined regional sub-markets, each characterised by the presence of both incumbents and entrants. Each entrant in a region is also an incumbent in another region.
- The market is characterised by the presence of strong brand loyalty for incumbents. In 2008, a decade after competition was introduced, it was found that brand loyalty had enabled retailers to charge around 10% more to consumers in the home region than to consumers in regions where the retailer was an entrant. Prices also differed across other dimensions such as payment method.
- The British energy regulator, Ofgem, was concerned that the regional price differentials resulted in higher bills for those who had not switched supplier, and that non-switchers included a larger than average proportion of consumers in vulnerable groups.
- In September 2009, Ofgem imposed non-discrimination clauses on energy retailers with the aim of eliminating regional and other price differences.
- The non-discrimination requirement was implemented for three years in the first instance and will shortly be reviewed by the regulator.

METHODOLOGY

- Salient characteristics of the British energy market are matched to models of price discrimination in order to explore the effects of the non-discrimination clauses on prices and profits, and on the group of consumers that Ofgem is charged with protecting.

KEY FINDINGS

- The theoretical literature predicts that the most likely net result of prohibiting geographical discrimination on prices is to raise all prices. Rising levels of both gross and net margins since the non-discrimination requirement was introduced provide some evidence that this has occurred.
- The net effect of non-discrimination rules with respect to payment method is likely to be positive and provide downward pressure on prices.
- The interaction between the two non-discrimination clauses is less obvious. It may be conjectured that the ban on regional price discrimination may have an adverse effect on the benefits from the ban on payment discrimination.
- Even with the most optimistic view of the possible effects, the effect of the non-discrimination rule on vulnerable consumers is ambiguous.
- Other factors, including the falling level of wholesale prices, will have contributed to greater profits. However, the regulator will want to take the adverse effects on competition into account in reviewing the non-discrimination requirement.

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ABOUT THE AUTHORS

- **Morten Hviid** is a Professor of Law at the UEA Law School and a faculty member at CCP.
- **Professor Catherine Waddams** is Director of the Centre for Competition Policy. She has published widely on privatisation, regulation and the introduction of competition, especially in energy markets, in the UK and elsewhere.