



Ofgem: Treatment of white label providers in the domestic retail market

Consultation response from the ESRC Centre for Competition Policy

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Date: 5 November 2014

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The support of the Economic and Social Research Council is gratefully acknowledged.



An ESRC funded Investment. The views and statements expressed are those of the authors and do not necessarily reflect the views of the ESRC.

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Consultation Response

Context

Consumers, tariffs and competition

Before responding to the specific questions in the consultation, we offer some thoughts about consumer choice, tariff limits and competition. Ofgem's RMR limitations on the number of tariffs which can be offered by each supplier are based on an assumption that consumers find it easier to make good decisions if they face fewer choices. This implies that increasing the number of competitors, usually seen as beneficial for consumers, has some detrimental effects because there are more options available, which may cause confusion. This logic implies that the effect of any entry is a balance between the negative confusing effects on consumer choice, which may result in reducing the accuracy of their decision making (or deter them from taking action that would benefit them), and the positive supply side effects of increased rivalry between suppliers, which would generally be expected to result in lower prices, higher quality and/or more innovation.

Viewed in this framework, the assessment of white label products (and appropriate regulatory policy) clearly differs from that for an independent entrant. In particular, as Ofgem's own analysis demonstrates, the competitive constraints on the supply side are much lower from a white label product. It is unclear that such disadvantages on the supply side are compensated by benefits on the demand side, or whether consumers are more likely to engage with the market at all, or find the tariffs of white labels less confusing than those of their supplier partners. Moreover the information on the white label products, and the nature of their links to their partners is often obscure, which itself may lead to greater confusion. If Ofgem's own logic that more tariffs leads to greater confusion is accepted, it is difficult to see how white labels can lead to net benefits. This argument would be strengthened if existing suppliers use white labels as a way to expand their tariff menu to circumvent the 'four tariff rule'.

However, if consumers are not behavioural in the way used to justify the RMR interventions, more choice is beneficial if they are able to provide meaningful competition for existing providers. Under these assumptions, white labels have the potential to undermine some of the adverse effects which the RMR might generate. We discuss these issues further in the following paragraphs.

Discussion

A white label supplier is, according to the Ofgem document, "an organisation that does not hold a supply licence, but instead works in partnership with a licenced supplier to offer gas and electricity to consumers using its own brand" [1.1, p. 3].¹ To understand further the possible effects of the proposals by Ofgem on consumers, it is useful to consider the incentives for both the licenced provider and the white label provider to enter an agreement. This requires an understanding of what each offers the other and in what way this improve consumer welfare.

From the consultation document one learns that these white labels do not:

- Set prices or price structures alone. According to the consultation document: "pricing decisions for white labels are to some extent dependent on their partner suppliers" [paragraph 2.5] and "We consider that white labels have a limited benefit for price competition. This is because white labels tend to decide jointly with their partner suppliers the price of white label tariffs, hence exercising a lower competitive pressure than a new

¹ Apparently this does not have to be an existing organisation but could be created simply for the purpose of being a white label without any pre-existing reputation.

supplier.” [paragraph 2.10].² While not precise about who eventually does set prices for white labels, it is clear that these are determined together with the licenced supplier and in such a way that this does not have first-order effects on the prices of the licenced supplier. It may hence be best to think of this as if licenced supplier and associated white labels constituted a partnership or a mini cartel. The latter fits better where a licenced provider is involved with more than one white label provider, as is the case for one of the Big Six. How exactly is the price and price structure for each white label set? How can innovative tariffs be possible?³

- They are not usually responsible for billing [paragraph 2.5]. Does this rule out white labels offering innovative ways to bill, including design of the bill itself?
- The consultation document mentions product design in paragraph 1.11 but does not shed much light on what this might be. Combined with the two bullet points above, it is hard to see that much innovation is likely; if such innovation is claimed, more evidence would be needed.

According to the consultation document, White Labels do:

- Offer a different brand to the “big-6”. To the extent that this is a brand which consumers trust, they may be more likely to switch than if the same offer was made by a “big-6” firm and to the extent that the brand name is valuable, the white label provider has an incentive not to debase its brand name so that trust gives rise to more trust.⁴ This is predicated on an expectation that the white label provider uses its own brand name. Is that guaranteed?

This also raises the question of whether consumers understand what part of the supply chain the energy the white label provider is responsible for and hence which part of the transaction the trust can relate to. This is particularly pertinent if white labels are uninformative about their licenced provider, as is currently the case for several of them. Ofgem offers a very clear answer in its tariff proposals: “the supplier must present text setting out the brand name used for marketing the tariff, followed by the registered company name of the licensed supplier in brackets. For white labels, this means that they must name the partner supplier.” [Consultation document, paragraph 3.8]. While this is reassuring because it makes behaviour which hides such details, and might be thought of as deception, a violation of trading conditions, it also raises an important question: To what extent is the consumer offered anything new [other than some flash marketing]?

- Offer more choice. But more choice of what? Behind the white label is another, mostly big-6, supplier so is this a real choice or merely repackaging? As Ofgem has actively intervened in this market to limit choice, one would imagine that Ofgem does not subscribe to the idea that more choice is necessarily better.
- Offer better marketing. This begs several questions: How is “better” marketing defined? Why, and if so when, is better marketing desirable? What prevents the big 6 from upping their game in terms of marketing [beyond mere brand extension considered above]?

² The “white labels tend to decide jointly with their partner suppliers the price of white label tariffs” part of the quote is disturbing because of its apparent violation of rules against price-fixing.

³ The answer: that innovation is possible because the licenced provider is constrained by Ofgem to offer a limited set of tariffs would not appear to be a comfortable answer.

⁴ Interestingly two of the white label providers do not have a big-6 firm as the licenced supplier.

- Offer “nicer” customer service. Why could a big-six firm not emulate this if consumers really do want pay extra for this? Is the reputation of the licensed providers in some cases so bad that it cannot be remedied? Is it not possible to introduce a premium brand under the parent company’s name? What work has been carried out to establish a preference for customer service which is based on consumer behaviour rather than survey responses?

When considering the potential role of white label providers in the energy market it is also important to remember the diversity of business models employed by the actual white labels observed in the market. Only two, M&S Energy and Sainsbury’s Energy, use an established brand name which consumers may trust from other settings to market their energy (National Trust no longer works in partnership with npower). Ebico effectively offers a particular type of pricing plan, one without a standing charge or direct debit discount but which is the same for prepayment meter users, to enable a marketing strategy based on themes of fairness, non-differentiation and subsidising the fuel poor. Another white label specifically targets the agricultural sector. Lastly, and perhaps most interesting, is Oink Energy which is owned by the “non-big 6” supplier Green Energy. Oink Energy appears to offer little beyond a particular pricing plan and a rather distinctive form of marketing; being owned by a new entrant itself means it neither facilitates new entry nor does it use a “trusted” brand to overcome consumer disengagement. This diversity means there may be a need to consider the possibility that some white labels offer real benefits to consumers while others do not. This then raises the question of whether the proposals’ potential to curtail the activities of white labels providing little clear benefit outweighs the downside of placing additional burdens on white labels with genuinely different business models.

Benefits to the licenced provider

At various points, the consultation document talks about white label entry as a precursor to more independent entry once the white label provider has “learned the ropes”. The following examples give a flavour. “Entering the energy market as a white label might provide a testing ground for organisations that may later choose to become licensed suppliers, hence lowering the barriers to entry.” [paragraph 1.17]. In recounting the motivations to start as a white label provider: “respondents flagged that a white label arrangement gives an organisation the opportunity to learn about the energy market at a lower cost and with less risk than if it entered the market as a supplier. The white label might later decide to become a licensed supplier.” [paragraph 2.4]

The thought appears to be that licenced provider may be harbouring a cuckoo. First note that a licenced supplier does not have to accept a proposal from a potential white label supplier. Hence the licenced supplier may be able to pre-empt this potential future threat to itself. The ability to do so must to some extent depend on the level of competition between the licenced suppliers [better the cuckoo you have trained yourself?] but if the white label provider is mainly eating into the group of consumers loyal to the licenced provider, then a white label entrant from a big-6 competitor may not provide much future adverse effect on profitability.

A potential white label supplier shares some of the characteristics of a firm organising a collective switching deal. By offering the licenced supplier a set of consumers with a particular set of characteristics, making a special deal for those consumers [in this case indirectly through the agreement with the white label supplier] may be profitable for the licenced provider. As the consultation document puts it: “a white label with a strong brand might be well placed to engage previously disengaged consumers, which reduces the barriers to expansion” [paragraph 1.17]. Providing a different brand with an established brand name is not something which the licenced provider could do, at least in the short run.

Finally, the market has been distorted through a limit on the number of tariffs a licenced provider is allowed to offer. As the white label provider could in theory offer a way to nullify the effect of a regulatory intervention, it is worth considering the motivations for introducing white labels without and with the distortion.

Possible effects without the “max-four” restriction of the market.

Without any regulatory interventions, why might we observe the co-existence of white label and traditional brands? The most obvious answer would be market segmentation. This could simply enable the exploitation of differences in elasticities of demand, or it could lead to better provision of services [nice call centres for those who value this] leading to more cost reflective offers, or both. Will this be welfare enhancing?

Unless the white label suppliers can offer a segmentation mechanism which leads to profitable price discrimination, the strategy of selling through an established brand does not appear commercially sensible. Just as with collective switching programmes, if the collective is not attractive as a group, a good deal will not be forthcoming. This depends partly on how much is known about the energy characteristics of the collective.

Depending how behavioural consumers are expected to be, they could potentially be exploited by the new arrangements. Having already intervened in this market on the basis of consumers being prone to behavioural biases, Ofgem surely has to maintain its assumption about the “average” or “representative” consumer in all its analysis. Behavioural biases may play a role when it comes to white labels. For example, as some of the white labels are offered by supermarkets, will energy be sold as a loss leader, in which case active consumers will benefit, or will they replace the chocolate at the check-out to catch the bored and captive audience?

Effects arising from the “max-four” restriction of the market.

With its “max-four” tariff intervention as part of the RMR, Ofgem deliberately chose to alter the market. As is well known, once markets are distorted and firms have had a chance to adapt to the new rules, further interventions may be required to maintain the desired effect⁵. With the “max four per firm” RMR rule, another reason emerges, but only if the white label offers do not count towards the four. The market has a tendency to undermine rules which go against its functioning – the max-4 rule clearly does so and has rightly been criticised for this. With the introduction of white labels Ofgem was obviously in a bind – if they were counted as part of the max-4, they would strangle a new set of players at birth, if not the max-4 would be in tatters. The short term solution was that some but not all white labels were exempt from being included in the licenced providers max-4 list. The way this short-term fix was carried out is curious: Deals struck before 1 March 2013 were ok, after they were not. How could a cut-off date be a sensible divider? Was this based on a presumption that the early entrants into the white label market are the better entrants? Was there a need to benefit the brave who stepped in first or to incentivise further entry? The dividing line was arbitrary and ran counter to competition.

The “cheapest tariff measure” [CTM]

In the consultation the following observation about likely restriction of pricing as a consequence of CTM contains at least two rather worrying observations: “Pricing restrictions: the concern is that partner suppliers will restrict the price of white label tariffs to be not cheaper than their cheapest tariff, to avoid presenting white label tariffs in the CTM. We would like to see partner suppliers

⁵ Many of the RMR interventions arose from the effects of the non discrimination clauses, see Hviid and Waddams Price, Waddams Price and Zhu, Littlechild response to RMR proposals

responding to our CTM proposals by increasing their efforts to explain to their customers the value of their tariffs, not by restricting the price of white label tariffs. In any case, we noted previously our view that white labels exert less competitive pressure on existing suppliers than new suppliers, as their pricing decisions are to some extent dependent on their partner suppliers.” [Paragraph 3.23]

The hope that the licenced suppliers would not restrict white label prices might appear rather naïve, if they are acting as commercial firms with the normal private firm interest in profits.

The last sentence of para 3.23 cited above is unclear but potentially problematic, especially if a group consisting of a licenced provider and its white label suppliers can be interpreted as part of a “cartel” of suppliers, setting pricing policies jointly. On one reading, white label providers exert more pressure on entrants than incumbents. On another reading, entrants exert more pressure on incumbents than white labels do. In either case there may be a potential competition problem. If the first reading is correct, there is a danger that white labels become “fighting ships”, mainly there to compete with genuine entrants. Allowing white labels would then offer the licenced providers a tool to restrict competition. By choosing appropriate white label suppliers and their pricing structure, any entrant could potentially be undermined unless consumers look at the information about who the “real” supplier is and are put off by that. On the alternative reading that white labels offer a weaker competitive constraint on the licenced providers than independent entrants, the white label strategy becomes a classic case of filling up the product space. By having household names offering new exciting white labels, it is harder for the genuine entrant to be “heard” and seen by the consumer, making entry more difficult.

Consistent views about consumers

The RMR and in particular the max-4 rule and the CTM is based on a particular view of what behavioural biases (a group of) consumers display in the energy market. It is important that this assumption is maintained consistently throughout the assessment of the policy proposals. How many offers can consumers comfortably choose between? What material can confuse consumers? What decision biases may the consumer suffer from? As an example, consider question 5 below about the information which a white label provider should offer to consumers. Whether or not the consumer might be confused or even misled by such a statement depends on what restrictions Ofgem is considering putting on the form and content of the information provided by white labels.

Answers to the specific questions in the document:

Question 1: Do you agree with our current assessment of white labels? If not, please provide any evidence you have to support your views.

The assessment needs to communicate a much better understanding of what the effect of white labels might be on incumbents, entrants and consumers. What the consultation document offers is very impressionistic. This is a concern because there are good reasons to think that white labels could give rise to competition problems and even have adverse effect on consumers with behavioural biases.

Question 2: What are your views on our tariff proposals? If you do not support our proposals on either the tariff cap or the other RMR tariff rules, please explain your reasoning.

Proposal 1 & 2 essentially negate the “max-4” part of the RMR. It would be better if Ofgem simply dropped this idea and it seems somewhat perverse to be in favour of those two proposals simply because they undo a regulatory decision whose value we question. However if the RMR is retained, then 1 and 2 have a logic to them.

Proposal 3 seems entirely sensible

Question 3: What are your views on our CTM proposals? If you do not support our CTM proposals, please explain your reasoning.

See comments about the CTM above. Some of the proposals are very dangerous and potentially anti-competitive.

Proposal 4 is consistent with previous proposals on licenced suppliers and as such is sensible [if the behavioural motivation is accepted].

Proposals 5 & 6 are potentially dangerous, introducing an element of hub-and-spoke collusion as well as competition dampening information exchange. Ofgem needs to think very carefully about the possible competition problems before going down this route.

Question 4: If you are a partner supplier or a white label, how long do you envisage it will take you to implement our CTM proposals? Please explain the activities and timescales for implementation.

Not applicable

Question 5: Do you think that we should require white labels to publish information setting out the value that they deliver to consumers? If you think so, please outline what information you think white labels should provide.

Surely if the firms thought consumers valued this they would do so unless they were concerned that consumers would simply write the prose off as hype. Is there any other market in which anyone would suggest making this mandatory? Imagine writing this so that it would not attract liability in the cases where the firm is actually not at fault when failing to meet their own standard as communicated to the consumer.

One restricted version of the proposal may be workable and potentially beneficial, namely to require that the white labels set out clearly and briefly how their offer differs from the offers of the related licenced provider.

Question 6: Do you have any comments on our draft of proposed supply licence condition changes in Appendix 3?

No