The price cap for prepayment customers: creating a fairer market?

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A fairer market?

- What effect will the new cap have on the way suppliers deal with prepayment customers?
- Has the cap been set at an appropriate level?
- Should the price cap have been extended more widely than prepayment customers?
- Managing the transition: what are the steps to a fully functioning prepayment market?

Prepayment prices: (de)regulation surprising developments

- Initial evidence that companies charged a higher mark up for prepayment over other payment methods as an entrant than as a regulated incumbent

- Ratio of prepay to direct debit charges by electricity companies

	In home region (regulated)	Average as entrant (unregulated)
1999	1.08	1.16
2006	1.06	1.09

If cap effective, the attractiveness of the prepayment market to suppliers declines

If effective, cap may slow (not prevent) competitive offers

Profitability of market curbed, so companies less likely to enter and compete vigorously, may discourage prepay use

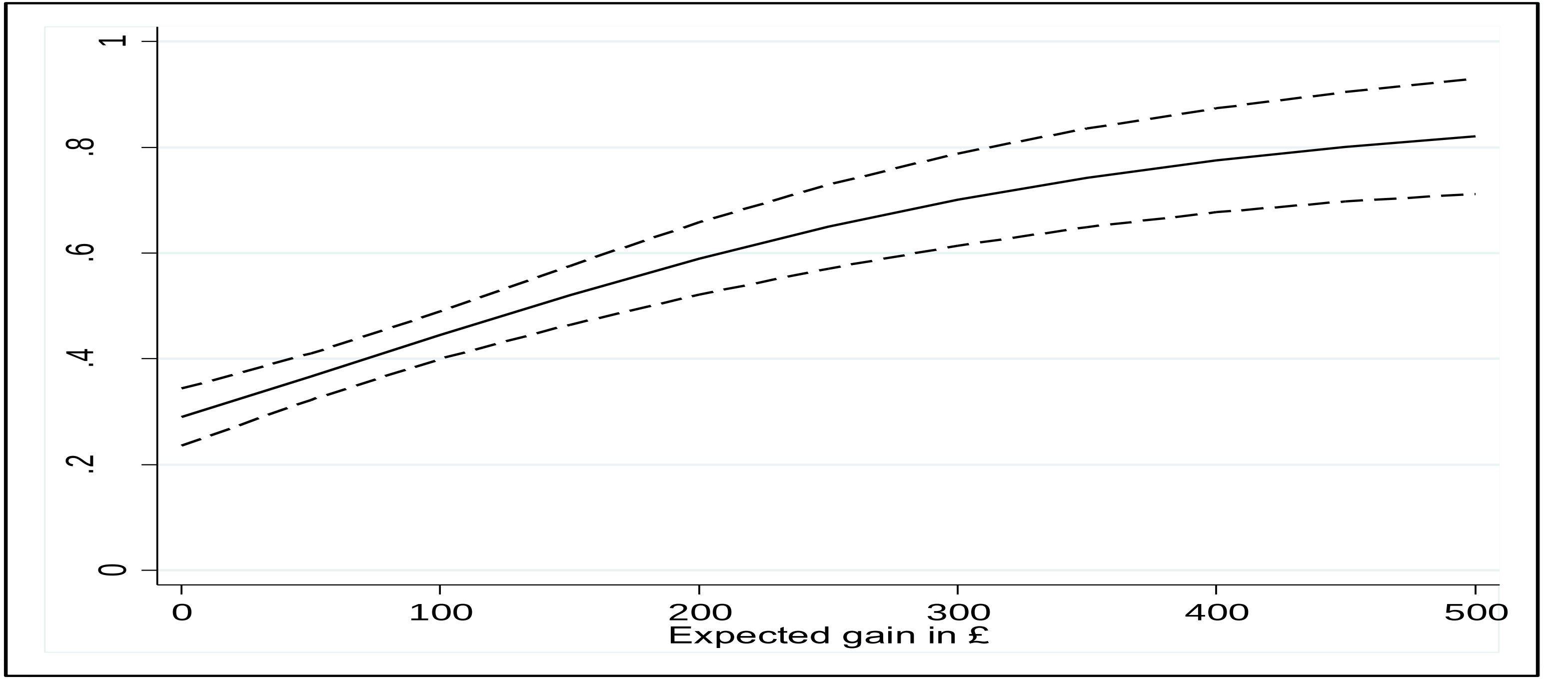
Access to good offers likely to decline (problematic for those who do not face barriers now)

Price cap protects outcome for prepayers – what about access and response?

Access, including information: Will less good deals be available/advertised in the prepay market? Especially if companies discourage use of prepay meters (despite statutory requirements)?
CMA emphasises cost/inconvenience of PPMs, but valued by many consumers for budgeting

Response? Will consumers be de-incentivised from exercising choice between suppliers because of lower rewards or sense of protection?

Response depends on potential gains: fewer gains mean less switching, competitive pressure



Waddams Price and Zhu, 2016

Price cap designed to avoid gaming

CMA explains painstakingly how based on ***past*** prices: combination of new entrants for level, big 6 for standing charge

Inflated by cost index ***outside*** influence of suppliers

Trade off between removing detriment (lower prices) and not covering efficient costs, incentivising supply (higher costs)

Given the potential downsides, compromise reasonable

Structure may be skewed– standing charge probably below costs given history and analysis

Transiting from regulation to well-functioning prepay market

How likely is smart meter roll out to be on time? How much 'smarter' will consumers be?

Will it be difficult to remove the protection? What evidence will CMA/Ofgem look for to do so?

Removing price caps 2002 much easier because energy costs falling (favours entrants without legacy contracts) – similar conditions would help, but how likely?

Will the focus be on lower average prices or protecting a particular group?

Which group? e.g. lower emphasis on 'pensioners'

A wider cap? The dissenting report

Regulation is a story of unintended consequences – eg non-discrimination clauses, Retail Market Review

Focuses on outcomes, regulators generally unimaginative, ensures particular people protected

Competition focuses on process, encourages innovation (where it benefits companies) blind to who gains and loses

Difficult to combine the two both conceptually (do we want to control process or outcome?) and in practice (price caps reduce profits and incentives for innovation)

What do we want for the energy market?

What is a well functioning energy market?

- Energy unusual in its intrinsic homogeneity
  - Similar products (eg agricultural) generally auctions not markets

- If constant marginal cost, need only small fixed cost to make competition too aggressive for two firms to survive
  - effective competition (p=MC) results in single firm *Hviid and Waddams Price, European Competition Journal, April 2014*
- Can regulate the monopoly – regulatory failure problems

- Or allow softer competition

A fairer market?

While CMA justified prepay intervention by greater detriment, low income users clearly also influential

Prepay a poor surrogate for vulnerabiity or disadvantage

While average income of prepay users lower, errors of exclusion and inclusion

Is it fair if those who switch (and help the market function) get a better deal? If they don't, why would they bother?

Worry about non switchers only if barriers (intrinsic or extrinsic)? Best solutions may be competition for parts of market eg opt out auctions

Is fairness defined by opportunity (access), response or outcome?

Though fewer 'vulnerable' consumers had switched, a majority had done so

Vulnerable group	Incumbent	Switched
Over 65	46	54
Low income	47	53
Disabled	44	56
Rural	60*	40
Low educational attainment	52*	48
At least one	**47***	**53***
All consumers	***42***	***58***

*Significantly different from non vulnerable at 1%; from analysis of CCP 2005 survey