

The Undue Discrimination Prohibition

Response to Ofgem consultation from

Morten Hviid and Catherine Waddams

ESRC Centre for Competition Policy, University of East Anglia¹

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Ofgem seeks views on its proposals to extend the Undue Discrimination Prohibition standard licence condition from July 2012 to July 2014. If Ofgem is seeking a competitive solution for the residential energy market, it should allow the non discrimination clauses to lapse. However Ofgem's proposals for limiting tariffs in the Retail Market Review constitute extensive intervention in the market through the determination of the standing charge of standard tariffs, indicating a regulatory rather than a competitive solution to the problems perceived in the market. If these are to be pursued, it may be sensible to retain the non discrimination clauses rather than try to increase competitiveness by removing them, while other regulatory restrictions are being imposed on the market.

For reasons outlined in our response to the original proposals², and elaborated in our research paper³, we believe that the non discrimination clauses have hampered competition. They have reduced both the intensity of competition in standard tariffs between suppliers, and the incentives for consumers to switch, by reducing their potential gains. Research on consumer behaviour from both Ofgem⁴ and the Centre for Competition Policy⁵ demonstrates that expected gains from changing supplier are the main motivation for consumer search and switching activity, and the reduction in price differentials has narrowed these possible gains within standard tariffs. Ofgem reports reduced switching rates since the introduction of the clauses, which confirms this relationship and the effect of reducing tariff differentials: good deals are only available through one of the special time limited offers which Ofgem now blames for consumer confusion, and which were stimulated by the clauses themselves. As we concluded in our response of 13th May 2009 "There is a real danger that the regulator

¹ e: m.hviid@uea.ac.uk; c.waddams@uea.ac.uk; w: www.competitionpolicy.ac.uk

² <http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/UEA%20Response%20to%20Energy%20Supply%20Probe%20-%20Initial%20Findings%20Report.pdf>;
<http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Response%20from%20Catherine%20Waddams.pdf>;
<http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Response%20from%20Catherine%20Waddams%202.pdf>

³ http://competitionpolicy.ac.uk/documents/107435/107587/CCP_Working_Paper_10_18.pdf, an updated version is forthcoming in the Economic Journal; please ask the authors if you would like a copy of the latest version)

⁴ The Energy Supply Probe Initial Findings

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=4&refer=Markets/RetMkts/ensuppro>

⁵ See our response to the retail market review proposals http://competitionpolicy.ac.uk/c/document_library/get_file?uuid=85b50767-a8a4-473f-a9a2-a06d6c3126ea&groupId=107435 and Effective empowerment: Empirical estimates of consumer switching behaviour, by Catherine Waddams and Catherine Webster, Centre for Competition Policy discussion paper, forthcoming, 2012

will succeed in achieving the worst of both worlds, with the undue discrimination ruling softening competition, while the exception for temporary discounts leads consumers, particularly those for whom the regulator has a statutory responsibility, to make poor decisions.” Unfortunately this seems to be exactly what has happened, with a plethora of special offers generated by the non discrimination clauses and their exceptions, illustrated by Ofgem’s monitoring of the Supply Probe remedies⁶.

Ofgem is correct that margins between in-area and out-of-area prices have narrowed, but as noted in our paper the increasing margins which Ofgem’s own monitoring shows indicate that the source of such narrowing is likely to be from raising out-of-area prices rather than reducing those charged to consumers in-area. The margins for energy supply have increased substantially since the introduction of the non discrimination clauses, with some of the increase anticipating their introduction as this policy emerged as a likely remedy during the Energy Supply Probe in 2008⁷.

We argue that some of the problems which the retail market review proposals are seeking to address have been exacerbated by the non discrimination clauses in the ways anticipated at their introduction and outlined above. If Ofgem wishes to return to pursuing competitive solutions, which are likely to deliver better results for consumers as a whole but do not deliver guaranteed outcomes to particular groups within the market, then it should allow the non discrimination clauses to lapse. If, as seems more likely from its Retail Market Review proposals, Ofgem now intends to increase intervention in the market, then it may make sense to extend the non discrimination clauses as it proposes, and review the whole working of the market/regulation before their 2014 expiry. In either case a consistent decision to pursue either competitive or regulatory processes would help to avoid the danger that consumers as a whole will be denied the best outcome, while the protection of particular groups deemed to be vulnerable is ineffective.

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⁶ See for example figure 2.5 in http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Update%20on%20Probe%20Monitoring_FINAL.pdf

⁷ (see <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Pages/indicators.aspx> for Ofgem’s latest figures, April 2012)