



Submission to the Commission for Energy Regulation

Price Discrimination & Customer Protection in the De-regulated Electricity Market

Submission S/11/004

March 2011



The Competition Authority
An tÚdarás Iomáiochta

Consultation Question

Do you think that a further obligation of non-discrimination is warranted in the deregulated market? If so, do you think that this obligation should be applied to Electric Ireland, or to all suppliers in the market? Is this policy conducive to market stability and to the development of competition? Outline reasons for agreement or disagreement.

Introduction

- 1.1 A further obligation of non-discrimination on Electric Ireland, or indeed any other electricity supplier, is unwarranted at this time. There is no evidence that a non-discrimination clause is necessary to protect consumers. **Indeed there is an established body of evidence which suggests that Non Discrimination Clauses (NDCs) reduce competition to such an extent that they lead to higher prices for all consumers - including those considered most vulnerable.**¹
- 1.2 This submission makes three main key points relating to the proposals contained in the consultation paper:
- NDCs are likely to be counterproductive in retail electricity supply where competition has only recently taken hold;
 - The imposition of a NDC in a recently deregulated market raises regulatory uncertainty as it is no longer clear whether the market operates under the rules of price regulation or competition law; and
 - The proposals to reduce search costs and removing any remaining barriers to switching are a superior and sufficient approach to protecting consumers' interests than a regulatory intervention that is likely to raise prices for all consumers.

The Rationale for a Non Discrimination Clause

- 1.3 The rationale offered by some stakeholders for the introduction of a NDC is based on the concept of fairness. The final sentence of the introductory paragraph of this consultation states;

"The issue is that some customers, or groups of customers, may get left behind in terms of enjoying the benefits of competition, and inadvertently subsidise the discounts enjoyed by others."

- 1.4 Under the scenario outlined above, these consumers are often described as "harmed". These customers are not "harmed"; they just do not benefit as much from competition as other, more active consumers. A supplier or suppliers may; discriminate between customers and make customers that are less responsive to price and less able to switch, pay a higher price than others.

¹ Hviid M. and Waddams Price, (2008), Non-discrimination clauses in the retail energy sector, CCP Working Paper 10-18. For further reading see <http://www.uea.ac.uk/ccp>.

The Effects of Price Discrimination

- 1.5 Price discrimination can either reduce or increase overall consumer welfare and as such, any evaluation of the likely effects of price discrimination must be undertaken on a case-by-case basis.
- 1.6 If an electricity supplier can differentiate between active and inert consumers, then the latter might not benefit as much from better deals as the former. However there are many explanations for consumer inertia which caution against a generalisation that a high level of stickiness signals a need for further consumer protection. Some groups such as high income customers may be indifferent about their electricity bills. Other customers, anticipating a price war, stay with their current supplier in expectation of steeper discounts in the future. These groups have made a conscious decision to stay with their supplier. What is more important from a consumer protection perspective is to distinguish between those customers who have chosen to stay with their supplier from those who are potentially vulnerable because they find it difficult to switch supplier.
- 1.7 Competitive markets require that at least some consumers make an effort to search for better value and to avoid bad deals. This searching activity by active consumers helps less active consumers become aware of the value on offer and so has a positive effect on overall consumer welfare. The more that consumers know about deals in the market, the greater is the competitive pressure on firms to offer good deals.

The Unintended Consequences of Non Discrimination Clauses

- 1.8 A Non Discrimination Clause (NDC) distorts the competitive process by reducing active consumers' incentives to seek lower prices and suppliers' incentives to provide them. In any market some consumers are more active than others. The active cohort performs a valuable function as it gathers market information which is then disseminated to less active consumers. A NDC causes the number of consumers choosing to become informed to fall, as there is less reward to the individual customer for searching for lower prices. If consumers do not, or cannot search for better deals, electricity suppliers have no incentive to match their competitors' offers and so prices across the market will tend to be higher than they could be.
- 1.9 The entry of Airtricity and BG Energy and their accompanying advertising and promotional campaigns have raised consumer price awareness in what was previously a monopolised market. According to CER's own figures, approximately 40% of all Irish electricity customers have switched supplier over the past two years, one of the highest switching rates ever seen in Europe.²
- 1.10 The high level of activity demonstrates a clear preference among a sizeable group of Irish electricity consumers for choice and their ability to exercise that choice through a user-friendly switching system. The

² CER Press Release - 4 March 2011

imposition of a NDC would remove much of the incentive to exercise that choice and curtail the need among suppliers to offer better value for money.

- 1.11 Since electricity supply is a high-volume low-margin business, the potential for an Irish based retail supplier to offer differentiated pricing is already quite limited. Introducing an NDC in a small market like Ireland, where wholesale market liquidity is already acknowledged as a constraint on competition, will further reduce the scope for retail suppliers to offer innovative pricing.³

Implications of NDCs for Regulation and Competition Law

- 1.12 As a previously regulated market completes the transition to full liberalisation, competition law takes the place of direct regulation as the principal means of protecting consumer welfare. There is no presumption under competition law that discriminatory pricing is abusive.
- 1.13 All firms attempt to exercise some degree of market power and increasing market share is a legitimate business strategy. It is for this reason that Section 5 of the Competition Act 2002 prohibits only the abuse of a dominant position. It is important to recognise that it does not prohibit dominance - only its abuse.
- 1.14 The CER has decided to allow Electric Ireland to set its own prices presumably because it has decided that the company is no longer dominant. There is the possibility that once deregulated, Electric Ireland may offer selective discounts to win back consumers who have switched to other suppliers. If such a pricing campaign was successful, Electric Ireland would then find itself rising back over the market share threshold set by the CER for deregulation, and accordingly risk having its commercial freedom to act restricted.
- 1.15 In its 2009 consultation document, *Proposals on a Roadmap for Deregulation*, the CER stated that re-regulation was a possibility;
- "Firstly, it is possible that if competition suffers and/or prices rise unreasonably then some form of regulation could be re-imposed by the Commission. This could include a transitional response such as a price cap."*⁴
- 1.16 Imposing a further regulatory instrument such as an NDC in such circumstances amounts to re-regulation and punishes a company for being commercially successful.
- 1.17 If the CER was to impose a NDC on Electric Ireland, this could be seen by the market as a regulatory decision that Electric Ireland is either (a), a dominant undertaking, or (b) that Electric Ireland's pricing is somehow anti-competitive but does not breach competition law.

³ See the recent Consultation paper; SEM Market Power & Liquidity

⁴ Commission for Energy Regulation, Review of the Regulatory Framework for the Retail Electricity, Market Proposals on a Roadmap for Deregulation, December 2009.

- 1.18 This re-regulation is contradictory to the goal of achieving a competitive market and sends the wrong signal to market participants and to firms that may be considering entering the market. A response of this kind might suggest a lack of regulatory confidence in the operation of competition in the market. The regulatory uncertainty such an action would create is something that the CER should avoid.

Removing barriers to Switching Behaviour

- 1.19 Some consumer groups may appear to initially benefit from a NDC, but it is likely that many consumers within the group do not need the additional protection extended to them under the NDC. Some customers may have made the conscious decision to remain with their supplier because they place a high value on non-price elements such as the strength of the brand or the expectation of deeper discounts in the future.
- 1.20 It may also be the case that some electricity customers incorrectly perceive that the quality of service will suffer if they switch to a competitor as they mistakenly think that ESB, as the network owner, can discriminate against those who switch away from the Electric Ireland brand. Thus the decision to stay with a higher priced supplier may not be entirely irrational but may instead be based on an explicit preference or alternatively a behavioural bias.
- 1.21 If consumer inertia stems from behavioural bias as suggested by some research in the field of behavioural economics, then this should be addressed by presenting information in a more accessible and user friendly way. With increased choice comes increased complexity, so before consumers can make the best choices, it stands to reason that they need to gain knowledge of a market that previously required little involvement.
- 1.22 Price comparison websites that are regularly updated and supported by a neutral arbiter such as the CER would reduce search costs and protect consumers from misleading information. Consumers should also be in a position to obtain a notice period before price changes are implemented to have time to reconsider their choice.
- 1.23 Research into behavioural bias is at an early stage but it offers the opportunity to obtain a greater understanding of consumer decision making in order to distinguish truly vulnerable consumers from those who have low incentives to switch. This distinction is important is an essential first step in designing policies which address the needs of each group.
- 1.24 In cases where some consumer groups benefit from a ban on discrimination, the set of consumers likely to benefit would be relatively small, and at worst all consumers would lose out by paying higher prices overall. The key point is that the source of the competitive constraint is crucial in determining the effect of imposing a NDC.
- 1.25 For example, the consultation paper identifies recipients of the Free Electricity Allowance as having a lower switching rate than the market average and outlines the reasons for the relative inertia of this group. The approximately 340,000 recipients on this scheme receive 2,400 units of electricity free of charge each year, which is sufficient in many

cases to cover all their electricity needs. In many cases this allowance is underutilised or can be used to offset the cost of electricity where the recipient is living within an extended family household e.g. a grandparent living with their children. In this domestic setting, the allowance can substantially lower the cost of a family's electricity bill to such an extent that the householder may not feel the need to shop around for further discounts. The low rate of switching among scheme recipients may also be attributable to the current arrangement in which Electric Ireland customers who are on the scheme have their allowance debited directly from their bill while customers of Airtricity and BG Energy receive equivalent cash payments to set against their bill. Switching would be encouraged in this group if all scheme recipients were paid by the same payment method.

- 1.26 It may well be the case that there are groups of consumers that are not availing of the lower electricity prices currently on offer. But a clear distinction should be drawn between those who prefer not to switch from their current supplier from those who are constrained in some way from switching and are therefore at risk of exploitation.
- 1.27 If some currently inert consumers are susceptible to behavioural biases as suggested by research in the field of behavioural economics, then these biases can be addressed by, for example, presenting price comparison information in a form that is clear and easily accessible. In the parlance of behavioural economics, these consumers may only require a "nudge" to alter their behaviour.
- 1.28 On the other hand, vulnerable consumers may need more targeted intervention. There are a range of targeted and cost-effective measures which can be put in place which protect the most vulnerable in society, none of which are likely to raise prices.

Conclusion

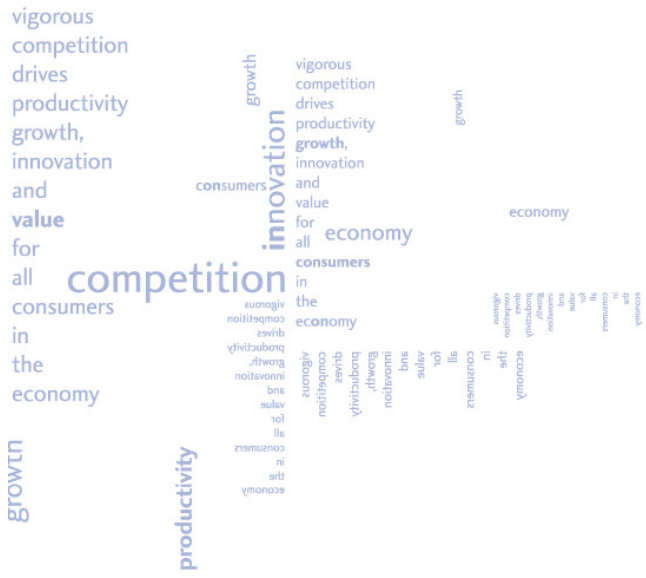
- 1.29 Price discrimination by electricity companies is not of itself bad for consumers. Switching by active consumers can drive down prices and encourage inactive consumers to shop around.
- 1.30 Introducing a NDC to the retail electricity market when competition is only taking off may ensure that all consumers pay very similar prices – but it is likely that all consumers pay higher prices than they would under a truly competitive market. Keeping prices unnecessarily high is bad for consumers, including vulnerable consumers.
- 1.31 Imposing a NDC would also send out a confusing message to market participants and possible entrants as it would be contradictory to the decision to remove price regulation.
- 1.32 The CER's resources would be better spent on implementing the initiatives listed in the consultation paper that would remove the remaining barriers to switching and improve consumers' ability to make better informed decisions.
- 1.33 The CER should ensure that all consumers get clear information about when their contracts are ending and what renewal options are open to them. It has been shown in other sectors, most notably in insurance,

that renewal notices act as a trigger for otherwise passive consumers to start searching for better deals.⁵

- 1.34 The CER should consider proposals similar to those outlined in Ofgem's *Retail Market Review* which are aimed at facilitating domestic consumers to compare prices and choose a better deal.⁶ If consumers have access to clear and transparent information on all the deals available on the market, they are more likely to save money by switching supplier or moving to a new deal.

⁵ This was one of the recommendations in the Competition Authority's 2005 study: *Competition Issues in the (Non-Life) Insurance Market*, available to download at <http://www.tca.ie/EN/Promoting-Competition/Market-Studies/Insurance.aspx>.

⁶ Ofgem: *The Retail Market Review - Findings and initial proposals*, March 2011. Available to download from <http://www.ofgem.gov.uk/>.



The Competition Authority, Parnell House, 14, Parnell Square, Dublin 1, Ireland
 Tel: +353 (0)1 8045400 LoCall 1890 220224 e-mail: info@tca.ie

www.tca.ie