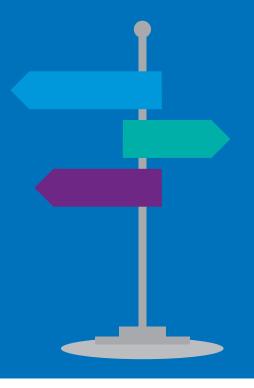


Where next for retail price regulation?

June 2017



Greg Clark, Secretary of State for Business, Energy and Industrial Strategy, wrote to Ofgem on 21 June, asking them to advise him on, "what actions you intend to take in three respects:

- Safeguarding customers on the poorest value tariffs
- Ensuring that micro businesses are fairly treated
- Considering the future of standard variable tariffs"

This follows a decision by the Government in the Queen's Speech not to legislate immediately on a price cap for all customers on Standard Variable Tariffs (SVTs), as previously proposed by Greg Clark⁽¹⁾, although his letter implies that this option is still one of those under consideration. In his letter to Ofgem, Greg Clark referred back to the earlier analysis carried out by the Competition and Markets Authority (CMA) on consumer detriment arising from current tariff structures. The CMA's final report⁽²⁾ in 2016 stated that "average detriment is assessed at £1.4 billion a year over the period as a whole, with an upward trend, reaching almost £2 billion in 2015".

The note provides a high-level assessment of some of the options Ofgem could look at in addressing the areas of concern the Government has highlighted. We have also assessed the original proposal of a price cap for all SVT customers in our report <u>'What would a price cap mean for the energy market?'</u>

Whatever form of action is now taken by Ofgem and the Government, it is likely to have significant effects on the operation of the retail energy market, including on:

- Pricing and tariff structures
- Customer acquisition and retention strategy
- Customer services and investment

 $^{^{\!\! 1\!\! 2}}$ Greg Clark's letter to Ofgem, Department for Business, Energy & Industrial Strategy, June 2017 $^{\!\! 2\!\! 2}$ Energy market investigation final report, Page 612, Paragraph 10.50, CMA, June 2016

Potential retail market interventions

An absolute price cap per KWh for all SVT customers as advocated by Martin Cave(3). Our detailed report is available here.

- Reaches all disengaged consumers; follows market fundamentals consequent to initial level setting.
- Could reduce capital available for innovation; risk of reduced switching if cap is set close to fixed price levels and prices 'bunch' around the cap.

Extending the existing Pre-Payment Meter (PPM) absolute price cap to Warm Home Discount (WHD) recipients. Citizens Advice(4) argue this would bring 2.6m customers into the

- Targets those who most need cheaper energy but who may struggle most to access better deals without Government help, draws on existing methodology for PPM cap calculation.
- More limited in scope than most alternatives and does not help those who are younger and vulnerable. Not all suppliers offer WHD

A percentage of customers are 'auctioned off' as a one-off event to the supplier offering the best terms for the customers.

- A 'big bang' event that is likely to attract attention and meet some political objectives. For those customers transferred it may result in a much better
- X One-off only so does not solve the issue of SVT pricing or consumer engagement in the medium or long term. Customers may not want to be 'auctioned off'.

Smart Metering and other smart technologies such as Electric Vehicles and Demand Side Response to better manage and reduce energy demand to reduce bills.

- Targets a different mechanism and aligns with environmental goals and wider market trends on reduced energy demand, as well as Smart policy.
- X May take longer and have a small impact on bills. It will also affect those who are most engaged and able/willing to adjust their behaviour.

A cap on the size of the variation between a company's SVT and fixed price tariffs, as advocated by John Penrose MP⁽⁵⁾.

- Directly avoids a large 'jump' in prices as a contract ends; impacts all customers; affects suppliers with a smaller existing gap less.
- X Can pull fixed price contract prices up as well as SVT down; Government retains less control over how companies change behaviour in response to the intervention.

Customers would roll on to the cheapest one year Fixed Price offer from their existing supplier if they do not engage at the end of a contract. This is similar to the approach used in insurance markets.

- Ends unlimited contracts, and if well designed, would keep loyal customers on competitive rates.
- Customers may not want fixed contracts; could distort the fixed price contracts a company is willing to offer.

New customers could not be moved on to SVTs on conclusion of a fixed price deal. **Existing customers** are unaffected.

- Stops the SVT problem exacerbating further, making the market steadily more competitive over time and meets some political objectives such as reducing market share of the Big 6.
- X Does not impact the large stock of customers already on SVT where media and political attention is focused. These customers may leave SVT very slowly. Potential implementation challenges

'smarter' energy system **More information** on switching

Promote the benefits of a

AII SVT

Relative

Price Cap

Extended

PPM Cap

Auction SVT

customers

customers on SVT

No new

Abolish SVT

X

Price Cap

Increased information to be provided to customers on the ease and benefits of switching supplier.

- Utilises existing channels for customer engagement; less interventionist approach that is consumer-led.
- X Previous campaigns for engagement have not always been highly successful: may not reach those who are least engaged and most vulnerable.

- Energy market investigation final report, Page 1415, CMA, June 2016
 How government can still help the poorest energy customers, Citizens Advice blog, June 2017
- a John Penrose: Energy bills. We need a relative price cap to boost choice, cut prices and stick it to the Big Six, Conservative-home, March 2017

Our team of energy specialists at KPMG is very well placed to help companies think through these implications of such changes. If you would like to find out more, please contact us using the contact details below.



Simon Virley CB FEI Partner and Head of Power and Utilities KPMG in the UK M: +44 (0) 20 7311 5037 E: simon.virley@kpmg.co.uk



Mark Darby Manager KPMG in the UK M: +44 (0) 20 7311 2398 E: mark.darby@kpmg.co.uk



Amy Marshall Director KPMG in the UK M: +44 (0) 20 7311 3202 E: amy.marshall@kpmg.co.uk



Wafa Jafri Associate Director KPMG in the UK M: +44 (0) 20 7311 8891 E: wafa.jafri@kpmg.co.uk

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