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Three questions on CMA energy market investigation

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CMA Findings

- Domestic market characterized by weak customer response
- CMA has various estimates of extent of customer detriment
- Majority Report recommends prompting customers plus temporary price cap on PPM tariffs (16% of market)
- Minority Report (Prof Cave)
  - Cites CMA calculation of £2 bn detriment in 2015
  - Says "harm is very severe",proposed remedies "untried & untested"
  - Recommends 2 year price cap on all SVT tariffs (70% of market)
- If detriment really is £2bn a year, does Cave have a point?
- But how reliable are CMA calculations of detriment?
- I pose 3 Questions

The CMA's well-functioning market

- "10.2 Our approach to assessing the scale of detriment has involved considering to what extent the outcomes that we have observed in the domestic retail energy markets are worse than we would expect to see in a well-functioning market …
- … **'a well-functioning market' … is not an idealised perfectly competitive market"**

- "10.27 We have based our assessment on the principle that … a competitive benchmark price … (b) should be reflective of the costs of an **energy supplier which has reached an efficient scale** … and which is **in a steady state** … and (c) it should generate revenue that is consistent with **a normal return**"

- Q1: Isn't this benchmark really an idealised perfectly competitive market?

CMA calculation of customer detriment

- Indirect approach:Detriment = inefficient costs + excess profit
- Inefficient costs average £290m or £420m pa
  - depending on whether efficient costs netted off
- Inefficient cost is defined as difference between actual & lower quartile costs of Big6 suppliers
- Don't all real markets have differences in costs?
- Only idealised perfectly competitive market not inefficient?
- Q2: Has Competition Commission, CMA or any other competition authority ever used this definition of customer detriment?

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Excess profits

- CMA uses as competitive benchmark EBIT margin 1.25%
- On this basis, it estimates excess profits at average £303m pa
- Suppliers argue that EBIT margin 1.25% is too low
- Difference of view between CMA and suppliers difficult to judge
- But CMA also finds that the actual EBIT margin in the I&C (large customer) market, if adjusted for differences in risk, would be 2.4%
- Ofgem & CMA agree I&C market is competitive, so no excess profit?
- I calculate 2.4% EBIT margin in domestic market would be worth about $300m
- So it would precisely remove the calculated domestic “excess profit”
- Q3: Is this double standards, & is the CMA domestic benchmark unreasonably severe?

What does all this mean?

- If
  - CMA benchmark is really unrealistic idealized perfectly competitive market
  - inefficient costs are not a legitimate component of customer detriment, and
  - average excess profits are actually approximately zero
- Then is there really a competition problem in domestic retail market?
- May be a social problem: are we comfortable with some customers (including some vulnerable customers) paying more than others?
- But if market adjusts to maintain zero excess profit overall, policies to assist some customers could well make other customers worse off
- CMA calculations encourage Ofgem, companies, customer groups & Govt to develop policies to address non-existent competition problem
- Could make all customers worse off – like Ofgem's post-2008 policies