

Martin Cave: UK Regulatory Developments

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“UK developments in regulation”

Martin Cave

Agenda

- 1 Systems operators and their role**
- 2 Retail price caps bite back
- 3 BREXIT and regulation

What do (Independent) Systems Operators do?

- They emerged from the shadows with liberalisation, but pre-date it. They co-ordinate the different facets of activity with a value chain, typically in three time dimensions:

short-term: balancing an energy market, picking up the pieces after disruption , settling transactions (transaction cost reasoning)

medium-term: allocating capacity among competitors (anti-trust function)

long-term: co-ordinating investment within and across layers (indicative planning role).

- The significance of these roles varies from sector to sector: very prominent in energy; present in EU rail (under the title ‘infrastructure manager’); still novel in the (monopolistic) water sector
- They can be free-standing, or vertically integrated with an asset-rich transmission operator (a TSO) or a (separated) rail network operator, or fully integrated across the whole value chain

SOs and conflicts of interest

- No conflict - hence no visibility - in a fully integrated monopoly
- With an integrated incumbent facing downstream competition, clear risk of discrimination: for example, should an SO embedded in an integrated incumbent rail operator be allowed to choose its competitors' slot in the rail timetable? – *Probably not.*
- Integration with monopoly assets carries potential problems; suppose an electricity TSO is calculating network investment needs; might it exaggerate them to promote more capex if the allowed rate of return is generous?

Current UK SO issues

- Energy: SO integrated with transmission operator (National Grid). Ofgem proposes to 'legally separate' the SO, to avoid conflicts
- Rail: network company is the SO, but increasingly co-operates regionally with monopoly franchisee; this creates a possible conflict with plans to enhance on-rail competition
- Water: almost no upstream (but modest downstream) competition; increased emphasis on ensuring resilience in face of floods; SO role left with former monopolists
- How are SOs? regulated They are normally regulated as a component of the larger organisation to which they belong, or via a revenue cap or similar if independent.

ISOs and regulators: does this lead to duplication?

- It has been argued by Helm* that (with declining marginal costs) the key utility issue is the determination of capacity, the construction of which and access to which can be auctioned off competitively (by the SO), which retains and guarantees the RAB
- The SO can also supervise subsidies required by the Universal Service Obligations, which are an overhead on the system
- The above competitive processes remove the need for price cap renewal – and for powerful discrete regulatory bodies.

**D Helm, Regulatory reform and the system operator model, January 2017, available at*

<http://www.dieterhelm.co.uk/regulation/regulation/regulatory-reform-and-the-system-operator-model/>

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2. Retail price caps in the UK

- Supposedly disappearing:
 - 2002 energy
 - 2005 telecoms
 - 2011 most postal products
 - 2007 (in Scotland) and 2017 9in England) water for business customers: gradual move to (looser) end user caps

The standard alternatives to retail price controls are to promote entry and to encourage search and switch

Recent developments

- Finance sector:

- short term high cost debt (payday loans) price-capped following legislation in 2015
- financial regulator may extend the cap and widen it to other similar borrowings, including unplanned overdrafts

- Energy sector:

- UK competition authority (CMA) imposed a retail price safeguard cap for 15% of households on pre-pay tariffs in April 2017; the cap may be extended to an as yet unknown degree

- Telecoms

- Ofcom proposes to impose a retail price cap on voice only subscriptions (not widely supplied, and bought mainly by older customers)

Why?

Several reasons

- Pay-day loans: vulnerable customers under stress
- Telecoms: little supplier interest in the market; obstacles to customer search
- Energy: as well as technical issues for pre-pay customers, despite the presence of many suppliers, widespread customer disengagement leaves 70% of customers on poor value tariffs imposed by unilaterally powerful operators

Can demand-side measures solve these problems?

- A recent UK study* has reviewed the effectiveness of demand-side measures used by regulators and competition authorities in the UK, under three headings:
 - disclosure remedies
 - shopping around remedies
 - switching remedies
- It concluded that “ it is important to be speculative. Getting such remedies right is difficult. We can sometimes predict how consumers will act on the basis of past experience, but often we cannot.”
- It also noted that firms may seek to neutralise the measures

*Amelia Fletcher, *The Role of Demand-Side Effects in Driving Effective Competition*, a Review for Which? November 2016

A second debated issue: does a price cap kill competition for ever?

- Clearly it can, but this depends on:
 - its duration
 - the certainty of exit
 - the degree of headroom in the cap
- Retail caps have been withdrawn in the past, in Australia and the UK, in energy and telecoms
- A balance has to be struck between this risk and the scale and likely duration of consumer detriment from over-charging

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3. BREXIT

- Leaving the Single Market causes EU law not transposed into UK law to fall away: compare the thought experiment of Queensland leaving the Australian Federation
- The UK government proposes a ‘Great Repeal Bill’ to install desired elements of EU law into UK law (but without recourse to EU institutions), but many legal instruments imposing rights or duties are not amenable to this treatment – including many hard and soft regulatory rules

A brief review of the impact of BREXIT *on regulation*

- Sectors affected in ascending order of significance
 - Water (save for environmental aspects)
 - Telecoms (similar regulatory frameworks)
 - Energy (but interconnector issues)
 - [Financial sector]
 - Air transport (may be endangered as UK leaves EU Open Skies regime)
- + Competition law (UK separate review of 'large' mergers, etc)

State Aids

- EU SA rules preclude export and other subsidies, which are significant in energy and telecoms
- May ease path of possible future UK governments

Overall conclusion: probably not the greatest of UK's problems with Brexit