



**DUAL FUEL OFFERS IN THE GAS AND ELECTRICITY  
MARKETS**

**AN OFFER AND OFGAS JOINT DECISION DOCUMENT**

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## DUAL FUEL OFFERS IN ELECTRICITY AND GAS MARKETS

### 1 INTRODUCTION

In November 1997, following representations made to them, OFFER and OFGAS published a consultation paper on Dual Fuel Offers in the Gas and Electricity Markets (the offering of joint electricity and gas supply contracts). This dealt in particular with the position of public electricity suppliers (PESs) competing in the gas market before their own markets were open to competition.

The consultation paper identified three main concerns raised by the representations:

- the domestic gas market is being opened to competition before the domestic electricity market;
- the PES monopoly in electricity meter reading services to smaller customers is being maintained until 2000; and
- allegation that some PESs may be supplying gas at a loss.

In all, 54 responses were received to the consultation. A list of respondents is attached as an Appendix. These responses are summarised below, followed by a discussion of the points made and the conclusions of OFFER and OFGAS. Those responses not marked as confidential are available from both OFFER and OFGAS.

The issues may be divided somewhat differently into two main categories. First, there are the issues common to both OFFER and OFGAS. These are the issues associated with “dual fuel” and “dual metering” offers, insofar as the duties to promote competition in electricity and gas, respectively, may be brought to bear. Second, there are the issues which are for OFGAS alone. These include the issues associated with the ability of PESs and their affiliates to supply gas when their own electricity markets are not open to competition, and allegations about predatory pricing of gas, which both pertain to the duty to promote competition in gas. OFFER has already taken steps to limit the ability of PESs to supply electricity in other areas before their own areas are open. There is also the issue of the ability of PESs to read gas meters when their own electricity meter reading is not open to competition. This pertains to the duty on OFGAS, but not on OFFER, to promote competition in gas meter reading.

## **2 ISSUES COMMON TO OFGAS AND OFFER**

### **2.1 The domestic gas market is being opened to competition before the domestic electricity market.**

#### **Views expressed**

Generally, PESs argued that it would not be possible for the timetables for gas and electricity markets to be aligned at this late stage. The effect of the difference in market opening times would not have any significant impact either on the market or on the development of competition in the long term. There was no constraint on the ability of PESs or any other suppliers to offer to supply or market dual fuel because the markets opened at different times. Furthermore, any delay in the introduction of competition would be undesirable and detrimental to customers. It was important that in both markets there were robust systems in place to facilitate competition.

One PES accepted that it was unreasonable and anti-competitive for suppliers who were in a dominant position to be offering additional discounts contingent on customers taking a dual fuel supply before their own markets opened. Once both markets were open, customers would have a choice of suppliers and whether or not to take a joint supply or separate supplies of gas and electricity. Before then, however, inertia and advice from consumer bodies would militate against customers deciding to change suppliers until there was a genuine choice and offers could be compared.

Other suppliers including gas suppliers expressed concern about the difference in timing. Some said that it would damage the development of effective competition, distorting both the gas and electricity markets. The monopoly of PESs in their own areas meant they might be able to gain from the earlier opening of the gas market while competitors could not compete in electricity. The possibility of delay in the introduction of electricity competition beyond April 1998 meant that action was needed to remedy the effects. Financial penalties should be imposed on those PESs which delayed the introduction of electricity competition; this was a more realistic sanction than seeking to synchronise the timetables. Some suppliers suggested that dual fuel or gas offers should be prohibited in PES areas which were not open to competition or that PESs should be prevented from selling gas outside their own areas until the first phase of competition had been introduced.

Consumer organisations including consumers' committees argued that a degree of certainty was needed for both customers and suppliers as to when competition would start. The use of a penalty system to discourage delays in the opening of the electricity market should be considered. Many argued for prohibition on the sale of dual fuel in an area not open to competition. A more proactive stance on proscribing misleading advertising material was mentioned.

Many suppliers expressed concern that dual fuel offers might pre-empt the market, particularly if customers were tied into a combined contract. Most PESs disagreed, arguing that the customer was not disadvantaged since such dual fuel offers typically allowed a customer to terminate either the gas or electricity elements of the contract on 28 days' notice. Hence, they argued that there would be no significant barrier to the customer switching to a more attractive offer in due course when both markets are open to competition. Against this, some suppliers argued that in practice it was likely that customers who switched once would be unlikely to switch again as further savings might not be large enough to provide sufficient incentive to do so.

Some respondents suggested that PESs should be restricted from competing in the gas market on any basis until they had opened up their own electricity markets.

### **Discussion**

Dual fuel products are likely to be attractive to customers insofar as they can offer further discounts on prices for the supply of energy, and can also provide a more convenient service through fewer, joint meter reading visits, combined bills and single payment schemes. In response to the consultation paper, suppliers reported that significant cost savings could be obtained in marketing, administration and, when possible, metering and meter reading associated with dual fuel offers. Once the electricity and gas markets are both open to competition, dual fuel products are likely to be a major feature of the market place.

The timing of liberalisation of the gas and electricity markets have always been distinct, and to attempt to synchronise the programmes would not be practical.

Until competition in domestic electricity supply has been introduced, dual fuel savings can be delivered only by a PES or its affiliates. Other gas and electricity suppliers will be unable to supply domestic customers with electricity before that time, and they will be unable to obtain the associated savings from combining operations.

Having considered carefully the views of respondents to the consulting exercise OFFER and OFGAS have concluded that there are justified concerns about the position of PESs offering dual fuel products in their own franchise areas before they are exposed to competition. OFFER needs to be particularly concerned that this might limit the development of competition in the electricity market. OFGAS needs to be concerned that an opportunity available to a gas supplier affiliated to a PES that is not available to other gas suppliers could restrict or distort gas competition in that PES's franchise area.

In the view of OFFER and OFGAS, the making of such offers by PESs would pre-empt the establishment of a dual fuel market and be likely to restrict or distort competition in the gas and electricity markets.

Accordingly, OFFER and OFGAS propose that, within its authorised area, a PES should not enter into or in any way procure contracts for the supply of gas and electricity to domestic customers at any premises:

- with the express or implicit requirement that the offer is contingent upon maintaining an electricity supply contract (or tariff) with the customer; or
- where an additional discount is offered contingent upon the provision of both fuels, whether with immediate effect or with effect upon some later date and whether separately or by way of a lower price for either fuel;

until such time as the PES concerned has opened to competition the district in which the domestic customers' premises are situated.,

The position of the incumbent gas supplier also needs to be considered. Although present plans show the gas market opening in advance of the electricity market, any delay in gas competition would have the potential to place British Gas Trading (BGT) in an advantageous position, relative to other electricity and gas suppliers, and thereby restrict or distort competition in both markets. OFFER and OFGAS therefore propose that BGT should not be able to enter into or in any way procure contracts for the supply of gas and electricity to domestic customers at any premises:

- with the express or implicit requirement that the offer is contingent upon maintaining a gas supply contract with the customer; or
- where an additional discount is offered contingent upon the provision of both fuels, whether with immediate effect or with effect upon some later date and whether separately or by way of a lower price for either fuel;

until such time as BGT has opened the tranche which the domestic customers are situated to domestic gas competition.

Issues associated with the supply of gas by PESs and their affiliates, which are not linked to dual fuel offers, are dealt with in section 3 below.

## **2.2 The PES monopoly in electricity meter reading services to smaller customers is being maintained until 2000.**

The effect of the dichotomy in approach between both industries was the main point highlighted by the majority of non-PES respondents. There was a range of views: that the continuation of the PES meter reading monopoly was anti-competitive per se; that it could damage the effective introduction of competition in electricity by stifling innovation in joint meter reading systems;

and that it would give incumbent PESs an advantage which would mean that customers were denied the benefits of competition. Concern was expressed that non-PES suppliers could face higher electricity meter reading charges than PESs.

In contrast, PES respondents pointed out that the introduction of competition in electricity meter reading was being deferred in order to facilitate a satisfactory start to competition in electricity supply. Some respondents, although acknowledging that PESs would have an advantage in their own areas until 2000, deemed it not to be significant. Others noted that the PESs were required by their licences to provide meter reading services in the most economical manner practicable having regard to the alternatives available. A PES could therefore appoint an agent to carry out the meter reading service if it were cheaper to do so; there was no reason why this could not be an independent meter reading agency.

The solutions proffered by non-PES suppliers included removing the meter reading monopoly before 2000. Some respondents suggested linking this to the opening of the electricity market or bringing the date of ending the monopoly forward to 1999. Another suggestion was to prohibit PESs from undertaking gas meter readings until after March 2000. Others suggested that OFFER require PESs to negotiate and publish their charges for meter reading, such terms being the same for their supply businesses as for any other supplier, and that the charges be determinable by the Director General.

Against these suggestions, PESs argued that the purpose of retaining the meter reading monopoly was to allow the smooth introduction of competition and to reduce the level of confusion given the significant number of changes already taking place. Attempts to revise plans in any significant way would be disadvantageous. The cost of the necessary IT changes to accommodate multiple data collectors would be expensive and would perhaps impact on entry into the competitive market. Some PES respondents highlighted the effect of the condition in their licences requiring meter reading services be made available on a non-discriminatory basis and argued that, in the light of this, the differing timescales for the introduction of competition should not lead to any distortion. The point was also made that regional electricity companies acting as second-tier suppliers would be in the same position as other second-tier suppliers.

It was also argued that effective competition in meter reading had not developed readily in the gas market.

## **Discussion**

Under present arrangements, only the local PES is able to read electricity meters on behalf of all suppliers until 31 March 2000 when electricity metering is liberalised. This means that only the local PES can offer joint reading of electricity and gas meters and pass on the resultant economies to suppliers. Independent meter reading agencies are precluded from offering equivalent services and savings.

The continuation of the PES meter reading monopoly is only temporary, and is intended to smooth the introduction of competition in electricity supply, given the experience in 1994 when some problems arose with the joint introduction of competition in electricity supply and meter reading. OFFER considers that this objective remains important and now is not the time to introduce a change in plans such as removing the PES monopoly prematurely.

PESs are subject to non-discrimination conditions in offering their meter reading services to other suppliers. However, these do not extend to the provision of meter reading services for gas meters. In consequence, other suppliers are not able to access the benefits of joint reading of electricity and gas meters until the year 2000. This would have analogous adverse effects on the development of competition in electricity supply as the limited ability to make dual fuel offers. Accordingly OFFER and OFGAS propose that the PESs should not be able to read both electricity and gas meters unless the PES offers the service on a non-discriminatory basis to all suppliers, until such time as the PES's electricity meter reading monopoly is removed.

### **2.3 Allegation that some PESs may be supplying gas at a loss.**

Non-PES respondents condemned this practice if it was found to have occurred. One respondent said that this was often the case while another said that there was a widespread view that from time to time PESs have sold gas at a loss. Some said such behaviour would be difficult to identify; in particular to distinguish predation from normal introductory offers designed to secure a presence in the market. It was suggested that any short term gain from predation would result in more aggressive regulation in the long-term.

Some non-PES respondents argued that the position of monopoly in one market could be used to secure a competitive advantage in another by bearing the costs of market entry. PESs' monopoly over their distribution systems meant that they had the capability of using the profit there to offer lower gas prices to their existing customers. The separation of distribution and supply was mentioned in this context.

PES responses made reference to a number of factors. One pointed to the fact that as both gas and electricity licences provide for non-dominant suppliers to

predatory price, it seemed odd to suggest that this was against the customer interest. Another denied that gas was being supplied at a loss; its own prices were significantly above marginal costs. Some PESs indicated that they either did not offer dual fuel arrangements or that any gas business in which they had an interest was separate and therefore operated independently. Any gas contracts offered would be stand alone.

A number of PESs made reference to the dominance of Centrica in the gas market: they said that it would continue to retain nationally the majority of domestic gas customers which by implication were also electricity customers; that its national presence meant that it could pursue a marketing campaign that could not be matched by any individual PES; and that it had the capability to use its gas business to subsidise the selling of electricity at loss.

Responses to OFGAS' information requests have been received from some PESs and Centrica, but are still awaited from five other PESs. This issue will be taken forward.

### 3 ADDITIONAL OFGAS ISSUES

#### 3.1 **Competition in meter reading.**

Whilst the restrictions outlined above with respect to joint meter reading services will address the concern about PESs' discriminating between themselves and other suppliers, it does not address the concern that independent meter reading agencies are precluded from offering joint meter reading services and savings as they are not able to read electricity meters until the PES's monopoly is removed in March 2000. This could distort competition in the gas meter reading market. Such distortion would be reduced were the PESs to subject their meter reading service to competitive tender, which would be open to such independent agencies.

OFGAS has the responsibility to ensure effective competition in gas meter reading and therefore is seeking undertakings that PESs offering both gas and electricity meter reading services will procure these services via open competitive tendering.

#### 3.2 **Gas Suppliers affiliated to PESs.**

Gas suppliers who are affiliated to holders of first tier electricity supply licences are likely to have a number of competitive advantages, in respect of gas customers in the respective monopoly electricity areas, until the market for the supply of electricity is open to competition. These include:



- marketing advantages deriving from local knowledge and existing customer databases;
- marketing advantages from established brand loyalty; and
- lower unit administrative costs resulting from higher gas market penetration than other suppliers as a result of marketing advantages; and

There is a risk that these advantages may restrict or distort competition in the longer term.

OFGAS has reached the view, therefore, that in addition to the Dual Fuel restrictions, gas suppliers who are affiliated to holders of first tier electricity licences should not offer gas to domestic customers in their own monopoly electricity supply area except in parts of those areas open to competition in electricity supply. These suppliers would be able to supply customers who had entered into gas contracts before this restriction comes into effect.

#### 4 **NEXT STEPS**

OFFER and OFGAS are writing to each PES and Centrica to ask each company for an undertaking that it will act in accordance with these proposals. In the light of the responses received, OFFER and OFGAS will consider whether new licence conditions are required or whether any other action is appropriate. If the companies do not provide the necessary undertakings, OFFER and OFGAS will need to consider other steps, including a reference to the Monopolies and Mergers Commission.

OFFER and Ofgas will be monitoring the development of competition in domestic gas and electricity supply and the development of competition in metering, concentrating on the supply areas of those PESs which do not give undertakings.

**January 1998**

## Annex: Responses to the Duel Fuel Consultation

RESPONDENT	DATE OF RESPONSE
Accuread	19/12/97
Age Concern	19/12/97
Amoco	18/12/97
Beacon	23/12/97
BEAMA Metering Association	27/1 1/97
British Gas Trading	24/1 1/97
BP*	16/12/97
British Fuels Gas	17/12/97
Calortex	19/1 2197
Centre for Study of Regulated Industries	19/12/97
Consumers' Association	18/12/97
East Midlands Electricity*	19/11/97
Eastern*	19/12/97
ECCCG	18/12/97
ECCM&NW	8/1 2/97
ECCNER	18/12/97
ECCNW	19/12/97
ECCSER	16/12/97
ECCSWR	18/1 2197
ECCYR	16/12/97
Energy Savings Trust	29/1 2/97
Enron	15/1 2/97
Gas Consumers Council	19/1/98
Gas Strategies	12/97
London Electricity	22/1 2/97
London Total Energy	24/1 2/97
Lowri Beck	19/1 2/97
Midlands Electricity plc	16/12/97
Mobil Gas Marketing (UK)*	16/1 2/97
MRECC	18/12/97
National Consumer Council	19/12/97
National Energy Action	12/97
North Wales Gas Limited	25/1 1/97
Northern Electric	22/1 2/97
NORWEB*	17/1 2/97
Nuclear Electric	19/12/97
Office of Fair Trading*	22/1 2/97
PowerGen	17/12/97
S J Mancey*	14/12/97
Saga Group plc	18/1 2/97

Scottish Hydro-Electric*	18/12/97
ScottishPower*	19/12/97
SEEBOARD	19/12/97
Southern Counties Fuels	24/11/97
Southern Electric Gas	24/12/97
SWALEC	18/12/97
SWEB*	19/12/97
The Energy Information Centre	19/12/97
The Regulatory Policy Inst.	19/12/97
Transco	19/12/97
Trolhurst	16/12/97
University of Sussex SPRU	12/12/97
YE Gas	19/12/97
York Gas	22/12/97

\* These responses were marked confidential.