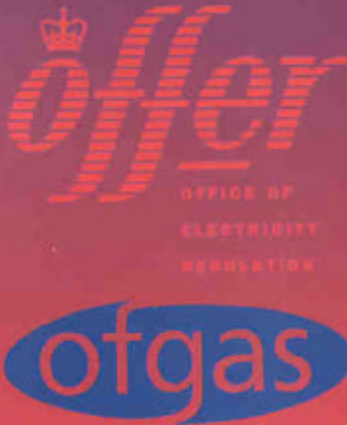


June 1999

**A Review of the Development of
Competition in the Designated
Electricity Market**



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1. Introduction

The monopoly held by each of the 14 Public Electricity Suppliers (PESs) to supply electricity to customers in the PES's authorised area has been withdrawn in stages. In 1990 customers with a maximum demand above 1 megawatt (MW) were able to choose their supplier. In accordance with the licence provisions put in place at privatisation this was extended in 1994 to all customers with a maximum demand over 100 kilowatts (kW). The monopoly over customers below 100kW has been removed in stages with competition being phased in between 14 September 1998 and 24 May 1999. This document sets out OFFER's initial views on the development of competition to date in the market to supply customers below 100kW and, in particular, designated customers ¹.

This document is an initial assessment of the development of competition focusing primarily on the market for Designated Customers. It looks at the development of competition to date and analyses how things might develop in the future. It also contains information requested by the Trade and Industry Select Committee about the impact of competition on particular groups in the below 100kW market.

Section 2 of this report gives the background of how competition was introduced, including changes to the regulatory framework and timetable. Section 3 looks at PES prices; in particular the changes to the incumbent PES's prices and those tariffs which are presently subject to price control. Section 4 describes changes in the market using information gained from a questionnaire issued to suppliers and other sources including the weekly returns from companies under the controlled market start-up (CMSU) monitoring arrangements put in place by OFFER. Section 5 concentrates on the further development of competition including initiatives by suppliers which may adversely affect it. Where relevant the report also gives the results of the recent survey undertaken for OFFER by MORI which will be published in June.

The roll-out of competition below 100kW has only just been completed. This document is therefore very much an initial assessment. It is too early to draw any firm conclusions about the market's operation, the way in which competition will

¹ Designated customers are defined as domestic customers and those industrial and commercial customers who use less than 12,000kWh per annum (excluding sites using half-hour metering or supplied on a multi-site contract).

develop and what, if any, further measures might be needed to secure effective competition and to protect customers. Some initial observations are however timely and appropriate. The position will be considered further in a second review to be published later in 1999.

It would be helpful to receive responses to the issues raised in this document by 20 July 1999. It is open to respondents to mark all or part of their responses as confidential. However, we would prefer, as far as possible, that responses were provided in a form that can be placed in OFFER's library. Responses should be addressed to:

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Any general queries about the contents of this paper can be raised with Paul Tonkinson at the above address in the first instance (telephone contact 0121 456 6405).

2. Background

2.1 *The introduction of competition*

The Electricity Act 1989 provided the framework for the introduction of competition. Since 1990 customers with a maximum demand over 1 megawatt (MW) have been able to take electricity from their local PES or from a competing second-tier supplier. Since April 1994 customers with a maximum demand over 100kW (say a large school or hospital) have had a similar choice.

The final step in the introduction of competition for all customers (some 26 million) was originally scheduled to begin in April 1998. OFFER concluded that the market in each PES area should open in phases over a six month period in order to ensure new systems worked well and to avoid disruption to customers. In the event because of problems related, in the main, to PESs' IT systems and their ability to communicate properly with each other initial market opening was delayed until 14 September 1998. On that date the initial phase of the market opened in 4 PESs (Eastern, Manweb, Scottish Power and Yorkshire). Two further PES areas opened their first phase in October (Seeboard and Midlands); four in November (Scottish-Hydro, Northern, South Western and Norweb); two in December (London and East Midlands) and two in January 1999 (Swalec and Southern).

There were three broad phases to opening the market in each PES area. The first contained 10 per cent of domestic and business customers defined by postcode plus all the customers in the PES area that: took supplies through a half hourly meter; and those with a maximum demand meter. About thirteen weeks later the second phase added approximately a further 30 per cent of domestic customers by postcode and included all remaining business customers in the PES area. The third and final phase some 13 weeks later included all remaining customers. The phases for the introduction were based on postcode areas. These were chosen because they were discrete, easily defined and provided the flexibility to enable a reasonable cross section of customers to be identified. The announcement of the first phase of postcodes for each PES area was made in July 1997. In some of the later phases additional steps were introduced to ensure complete postcodes which overlapped PES areas could open on a single date.

By the end of 1998 22 per cent of the premises below 100kW had access to competition. By 29 March 1999 that had increased to 75 per cent and all business customers across Great Britain had access to competition. The process was completed on 24 May 1999 when the final 18 per cent of customers entered the market.

Decisions about market opening were made by OFFER following consultation with the PESs, other suppliers and other interested parties. OFFER also considered reports from the settlement bodies (the Electricity Pool of England and Wales and Scottish Electricity Settlements Ltd) and the Central Integration and Design Authority (CIDA)² about the readiness of the parties. Once the market opened OFFER supplemented this with detailed monitoring information from PESs and suppliers.

Suppliers entered the market when they had completed testing. For the PESs this was normally the same date as the market opened in their locality. Up to 28 days before the market opening date suppliers can start to register customers with the PES in whose the premises to be supplied is situated (the registration opening date). The full roll out of competition is shown in the tables below. Table 1 comprises both the registration and supply start dates for each phase. Table 2 shows the numbers of customers affected. Table 3 shows the dates when new suppliers were first authorised to supply.

² CIDA was established by OFFER with support from the PESs and Settlement bodies to assist in the design of the arrangements for competition and the testing of PESs and suppliers. It was managed on behalf of OFFER by the Overall Programme Manager.

Table 1 - Timetable For The Opening Of The Competitive Market

PES AREA	REGISTRATION OPENING	MARKET OPENING
PHASE 1		
Eastern Electricity Manweb ScottishPower Yorkshire	17 August '98	14 September '98
Seeboard Midlands	30 September '98	28 October '98
Northern	7 October '98	4 November '98
Scottish Hydro	14 October '98	11 November '98
Norweb SWEB	2 November '98	30 November '98
London	18 November '98	16 December '98
East Midlands	3 December '98	31 December '98
SWALEC	14 December '98	11 January '99
Southern	31 December '98	28 January '99
PHASE 2		
Eastern Electricity Manweb ScottishPower Yorkshire	16 November '98	14 December '98
Seeboard Midlands Northern	24 December '98	21 January '99
Scottish Hydro	31 December '98	28 January '99
Norweb SWEB	25 January '99	22 February '99
London	15 February '99	15 March '99
East Midlands Southern SWALEC	1 March '99	29 March '99
PHASE 3		
Eastern Manweb ScottishPower Yorkshire	25 January '99	22 February '99
Seeboard	1 March '99	29 March '99
Midlands Northern Scottish Hydro	24 March '99	24 April '99
East Midlands London Norweb SWALEC SWEB Southern	26 April '99	24 May '99

Table 2. PES Market Opening - Number of Eligible Customers ('000s)

PES Area	Sept	Oct	Nov	Dec	Jan	Feb	March	April	May	Total
East Midlands				235		340	683	7	1,026	2,291
Eastern	316			1,306		1,470	8			3,101
London				204		18	1,065		677	1,965
Manweb	112			596		653		<1		1,362
Midlands		179			1,002	69	231	634	80	2,195
Northern			140	<1	618	<1		730	<1	1,488
Norweb			166			1,133			898	2,197
Scottish-Hydro			91	7	250	47		217		620
ScottishPower	164			795		832		4		1,795
Seeboard		203			930		844			1,976
Southern					274	<1	1,254	18	1,089	2,636
Swalec					103	2	459	<1	415	979
SWEB			133			559			621	1,312
Yorkshire	186			755		979				1,919
Monthly total	778	382	537	3,899	3,176	6,102	4,545	1,610	4,807	25,838
Cumulative total	778	1,160	1,697	5,596	8,773	14,875	19,421	21,031	25,838	
Overall % of GB market open	3	4	7	22	34	58	75	82	100	

Source: OFFER based on PES estimates.

Table 3. Supplier Market Entry Dates

Supplier	First Registration Date	First Supply Date
British Gas Trading	17/08/98	14/09/98
East Midlands	03/12/98	31/12/98
Eastern Electricity	17/08/98	14/09/98
Eastern Energy¹	17/08/98	14/09/98
Enron	25/01/99	22/02/99
Independent Energy	25/01/99	22/02/99
London	18/11/98	16/12/98
Manweb	17/08/98	14/09/98
Midlands	30/09/98	28/10/98
National Power²	01/02/99	01/03/99
Northern	07/10/98	04/11/98
Norweb	02/11/98	30/11/98
PowerGen	03/12/98	31/12/98
Scottish-Hydro³	14/10/98	11/11/98
Scottish Power	17/08/98	14/09/98
Seeboard	30/09/98	28/10/98
Southern	31/12/98	28/01/99
Swalec	14/12/98	11/01/99
SWEB	02/11/98	30/11/98
Yorkshire	17/08/98	14/09/98

- Notes: 1. Non-half hourly (designated) customers only.
 2. Half hourly (non-designated) customers only.
 3. Scottish Hydro allowed initially to compete in only ScottishPower's authorised area.

2.2 Statutory framework

2.2.1 Electricity Act 1989

The Director General of Electricity Supply (DGES) must exercise his functions under the Electricity Act 1989 in a manner which is best calculated to fulfil the duties described in section 3 of the Act. These duties include a duty to promote competition in the supply of electricity and a duty to protect the interests of customers. Appendix 1 sets out the DGES's duties in full.

2.2.2 Competition Legislation

The DGES has concurrent powers with the Director General of Fair Trading under the Fair Trading Act 1973 and the Competition Act 1980. In relation to these concurrent powers, OFFER works in conjunction with the Office of Fair Trading (OFT) under the terms of an agreement between the DGES and the OFT. In exercising his functions under the

competition legislation, the DGES must act in accordance with his general duties under the Electricity Act. The new Competition Act 1998, which will confer additional concurrent powers on the DGES takes effect in March 2000. There are two tests which may be applied under the Competition Act, but only one needs to be satisfied to take action. The first prohibits agreements which prevent, restrict or distort competition and the second prohibits the abuse of a dominant position. If a PES is found to have breached the prohibition then it may be subject to a fine up to 10 per cent of its turnover.

2.3 Relevant Licence Conditions

During 1997 extensive consultations took place on the revisions to the PES and second tier supplier licences. The resulting licence modifications, which took effect at the beginning of 1998, provided for greater protection for customers, and new obligations on suppliers (particularly in respect of the PES) in order to facilitate competition.

2.3.1 Scope of regulation

Conditions relating to contract terms and customer protection cover all domestic customers and small business customers whose annual consumption is 12,000kWh or less. These are known collectively as designated customers. Second tier suppliers are not able to supply designated customers unless they have given the Director General of Electricity Supply advance notice of at least two months.

Under the terms of the Act and of their operating licences, all electricity suppliers have a wide range of obligations which they have to meet in relation to the services they provide to designated customers. A number of these are specifically designed to protect the interests of disadvantaged and disabled customers. In setting up the licences for the new market, OFFER was concerned to ensure that customers would be adequately protected. Licence conditions of PESs and second tier suppliers covering the companies' social obligations, are therefore identical in all important aspects.

2.3.2 Customer Protection

The main safeguards which apply to supply to designated electricity consumers include:

- a) Duty to supply: PESs and any second tier suppliers which notify the DGES of their intention to supply designated customers must offer to supply any designated customer who has requested a supply. All suppliers which supply designated customers must publish their prices and make available their principal terms and conditions of supply. They can only seek a deposit or payment through a prepayment meter if the customer is uncreditworthy.
- b) Range of payment options: All electricity suppliers are required to have available a range of payment methods which customers may use. These include payment by cash at reasonable locations, cheque, an agreed monthly amount or quarterly in arrears, and by prepayment meter.
- c) Elderly, disabled and chronically sick customers: Electricity suppliers are required by licence to provide special services to domestic customers who are of pensionable age, disabled or chronically sick. Suppliers have to keep a register of customers who qualify. The special services include: bill re-direction; communications appropriate to blind or partially sighted customers and deaf or hearing impaired customers; advance notice of interruptions to electricity supply; special means of identifying company officials; repositioning meters (this service has to be free for disabled customers); advice on fuel use; and the provision (where practicable) of special controls and adapters for appliances and meters.
- d) Treatment of customers in debt: All suppliers have to treat customers in payment difficulties sympathetically. They must:
 - identify customers in difficulty;
 - provide information on how customers might reduce future bills by more efficient use of energy;
 - where appropriate, accept payment through direct deductions from social security benefits;

- accept payment by instalments - taking into account the customer's ability to pay;
 - offer a prepayment meter where safe and practicable, calibrated to recover the debt at a level which the customer is able to afford; and
 - follow the agreed procedures before they are able to disconnect for non-payment. Elderly and disabled customers have special protection against disconnection during winter months.
- e) Complaint handling: All electricity suppliers have to establish and publish details of their procedures for dealing with complaints from customers.
- f) Site access: Companies must provide customers with details of how they will provide information about visits, including identification of company staff, and the special services they have available for certain customers who may be disabled.

All suppliers are required to have arrangements in place to meet these requirements. They have to set them out formally in Codes of Practice which are approved by the DGES following consultation with the relevant Consumers' Committee. In addition, all suppliers are required to report to the DGES on their performance in meeting their social obligations. OFFER monitors companies' performance under the Codes and has put in place quarterly monitoring arrangements from April 1999.

2.3.3 Direct Marketing

Face to face contact on the doorstep or selling over the telephone is used by most suppliers wishing to enter the designated market. It has been particularly effective in persuading domestic customers to change supplier and is seen by many customers as a useful way of finding out about the competitive market. If done badly however, doorstep selling can cause distress. In the light of the problems which arose in the domestic gas market, OFFER consulted widely in March 1998 on the proposal to introduce a condition into suppliers' licences to control this activity in the designated market. As a result, in July 1998, suppliers' licences were modified to include new conditions on marketing of electricity to designated customers. This requires:

- selection and training of sales staff who are in direct contact with designated customers;
- an independent audit of sales activity: a customer signing a contract following a sales visit or telephone call should be contacted within 14 days by someone else from the company to ensure that the customer is content with the sales approach and is aware of having signed a contract;
- where a sale takes place two months or more before a customer is due to change supplier, a requirement that the company should maintain contact with the customer and inform them of progress;
- a ban on using agents who seek payment in advance for arranging a supply of electricity; and
- the supplier to establish schemes for paying compensation to customers where the supplier has failed to comply with its obligations under the condition.

2.3.4 Non-discrimination

Both PES and second-tier supply licences include non-discrimination provisions relating to the supply of electricity to final customers. These take effect where the licensee is in a dominant position in any market. The licence provision prohibits a dominant supplier from showing undue preference or exercising undue discrimination against any person or class of person. The condition is less stringent after competition is established. Where competition is established in a market the dominant supplier is able to price in a way that is reasonably necessary to meet established competition, but not in a way that is predatory. The condition requires that dominant suppliers give 28 days' notice to the Director General if they propose to introduce new terms of supply under either tariff or contract. The text of the condition is set out at Appendix 2.

In November 1997, the Director General determined that each PES was dominant in its own authorised area for:

- designated customers until otherwise notified; and
- other premises below 100kW until at least one second-tier supplier is able to supply all these customers.

He did not rule out determining that a PES or any other supplier might be dominant in other markets or that as competition developed a PES may no longer be dominant in a market in which it was initially determined to be dominant.

The licence conditions deals only with undue discrimination and undue preference in electricity supply terms including the charges set. It does not address all aspects of anti-competitive behaviour. Specifically, it complements and does not substitute for the normal operation of UK competition law in the electricity industry where, as noted above, the DGES has concurrent powers with the Director General of Fair Trading.

2.3.5 Confidentiality provisions

PESs are required to ensure that procedures are put in place to prevent the unauthorised disclosure of information between the supply and distribution businesses. PESs must produce statements of compliance and report annually against these to the Director General. OFFER has proposed changes to these provision in the context of its work on separation of businesses. Our proposals were published in the document “Separation of Businesses: Proposals and Consultation”, May 1999.

2.3.6 Commercial Arrangements

PESs are required to enter agreements for the provision of certain services necessary to ensure all suppliers are able to compete. This includes access to and use of PESs’ distribution systems, and agreements for the provision of meter operation, data collection, data aggregation and prepayment services. In addition, there are agreements in place to enable a supplier to use a PES’s distribution system and standard terms of connection between the PESs and designated customers which are approved by Director General. This enables the customer’s supplier to obtain a standard connection agreement from the customer on behalf of the local PES when entering into a supply contract.

Licences also provide for PESs to establish certain services for the benefit of both customers and the suppliers. This include: a metering point administration services for registering customers’ premises supply and technical details; and, together with other PESs, a data transfer service to allow for electronic transfer of information between industry participants.

To assist the change of supplier process, all suppliers are required to notify each customer of a unique number, known as the supply number, which identifies the customer's meter point. The supply number also provides information to enable suppliers to provide quotes for supply to customers. Supply numbers now appear on each bill or statement sent to the customer.

2.3.7 PESs and Second Tier Suppliers

The Electricity Act distinguishes between public electricity suppliers and second tier suppliers. A single company or group may, however, hold a variety of PES and second tier supply licences. In this review, PES is used to indicate the activity of a public electricity supplier within its own area. Second tier supplier is used to include all other suppliers including supply by companies operating PES licences supplying customers outside that PES's authorised area.

3. PES Tariffs in the Designated Market

This chapter sets out developments relating to the PESs' tariffs and its price controls.

3.1 Supply Price Control

The initial supply price controls in 1990 covered almost all PES supply business customers and provided for almost all costs (such as generation costs, and distribution and transmission charges) to be passed directly through to customers. When the franchise reduced to 100 kW in 1994, OFFER set new controls covering only customers below 100kW, ie. those who could not take advantage of the competitive market. From April 1998 OFFER reduced the scope of the control further to cover only designated customers.

The present price restraints apply to designated customers and came into force on 1 April 1998, and are due to cover the two financial years 1998/99 and 1999/00. The restraints identified for each PES a list of tariffs that designated customers are able to take. The restraints apply to final prices (excluding VAT) and so cover all elements of cost, generation, distribution, transmission, supply business costs and margin, and the fossil fuel levy. The restraints allow for variations in the fossil fuel levy to be passed through into prices.

The restraints are expressed in the form of a tariff basket they specify that for each PES a weighted average of these tariff prices should increase no faster than RPI-X where the value of X varied between PESs. The quantities to be used in weighting the tariff basket were pre-specified and are listed in the PES licences. Hence, the restraints compares old and new prices using identical pre-specified quantities.

In the second year of the control, 1999/00, the restraints specify that all prices the listed tariffs applying on 31 March 1999 must fall by at least 3 per cent in real terms.

The price restraints were set for the financial years 1998/99 and 1999/00. The arrangements provide default conditions for subsequent years should new arrangements not be agreed with the PESs. These defaults specify that maximum prices to be charged to designated customers should not rise faster than inflation, that is they should remain constant in real terms.

The restraints also required that for PPM customers, in respect of the surcharge, this should not increase; and, excluding the surcharge the average unit price must be reduced in line with the average unit price in the comparable domestic tariffs.

3.2 PES Price Movements

All PESs offer a range of tariffs for business and domestic users. The details vary between companies but in general two broad tariff groups can be identified.

The two main tariff groups are:

- Standard: the unrestricted tariff used by about three quarters of all domestic customers;
- day/night: the two rate tariff offering lower prices for periods over night - often known as the Economy 7 tariff. This is used by about one in five domestic customers.

Many PESs have also offered multi-rate tariffs to customers often associated with specialist heating schemes. Other tariffs are also available on a preserved basis. The take up of such tariffs is generally low and these tariffs are not considered further in this review.

Both of the main tariff groups is associated with three main payment methods:

- direct debit;
- quarterly cash/cheque;
- prepayment meter.

Other payment methods are normally available, but in general these are charged as a rate equivalent to the quarterly cash/cheque method.

A similar range of tariffs is available to non-domestic designated customers.

3.2.1 Percentage Changes to Nominal Annual Bills between 1997 and 1999

Table 4 shows the movement of the main tariff prices by PES since 1 April 1997. Some caution should be exercised in comparing price movements as during this period a number of PESs made special one off payments or otherwise reduced tariffs during the year. The figures given relate to annual bills for typical customers. These are defined as customers using 3,300kWh a year on the standard tariff and 6,600 kWh on day/night tariffs.

All bills are expressed in nominal terms and are exclusive of VAT and inclusive of Fossil Fuel Levy except those for Scottish Hydro Electric.

All tariffs have reduced significantly in real terms during the period. On average Domestic Standard bills have decreased in nominal terms by between 5 and 6 per cent across the country since 1997. The most significant decrease has been in the Scottish-Hydro PES area where bills have fallen by 12 per cent for Direct Debit and Quarterly Credit customers and 5 per cent for Prepayment Meter customers. Bills in the London area have also fallen by 11 per cent for all payment methods.

Domestic Economy 7 bills have fallen by an average of 3 to 4 per cent overall. They have fallen most significantly in the London area by 10 per cent for Direct Debit and Prepayment Meter customers and 9 per cent for Quarterly Credit customers. In the SWALEC area prices have also fallen significantly by 8 per cent for all payment methods.

PES prices are presently at or close to the tariff limits set under the price restraints.

**Table 4: First Tier Annual Bills in Nominal Terms (excl. VAT) as at 1 April 1997, 1998 and 1999.
Percentage Changes between 1 April 1997 and 1 April 1999**

	Domestic Standard											
	Quarterly Credit (£)				Direct Debit (£)				Prepayment Meter (£)			
PES	01/04/99	01/04/98	01/04/97	% Change between 1997 and 1999	01/04/99	01/04/98	01/04/97	% Change between 1997 and 1999	01/04/99	01/04/98	01/04/97	% Change between 1997 and 1999
East Midlands	242	239	259	-7	232	233	254	-9	263	251	273	-4
Eastern	239	244	254	-6	233	234	249	-7	251	265	276	-10
London	245	246	272	-11	235	236	261	-11	255	257	283	-11
MANWEB	265	267	276	-4	258	259	269	-4	280	285	294	-5
Midlands	241	241	257	-7	234	234	250	-7	250	250	267	-7
Northern	263	270	275	-5	255	262	267	-5	279	285	291	-4
NORWEB	244	246	249	-2	236	238	241	-2	261	261	247	5
Scottish Hydro	240	266	267	-12	232	257	258	-12	250	261	263	-5
Scottish Power	265	263	259	2	256	259	255	0	260	279	275	-6
SEEBOARD	243	234	258	-6	237	226	254	-7	256	250	276	-8
Southern	261	243	265	-1	252	238	261	-4	274	258	281	-3
SWALEC	276	284	302	-9	269	277	294	-9	302	309	330	-9
SWEB	261	261	274	-5	253	256	268	-6	272	272	285	-5
Yorkshire	243	243	244	-1	231	231	234	-2	266	266	268	-1
Average	252	253	265	-5	244	246	258	-6	266	268	279	-5

Table 4 (Cont)

	Domestic Economy 7											
	Quarterly Credit (£)				Direct Debit (£)				Prepayment Meter (£)			
PES	01/04/ 99	01/04/ 98	01/04/ 97	% Change between 1997 and 1999	01/04/99	01/04/ 98	01/04/ 97	% Change between 1997 and 1999	01/04/9 9	01/04/9 8	01/04/9 7	% Change between 1997 and 1999
East Midlands	334	336	345	-3	324	326	340	-5	355	357	366	-3
Eastern	338	338	350	-4	330	330	344	-4	348	348	362	-4
London	344	346	377	-10	333	335	362	-9	348	349	381	-10
MANWEB	363	364	376	-4	354	356	367	-4	376	378	393	-4
Midlands	349	349	367	-5	338	338	359	-6	366	366	384	-5
Northern	354	360	364	-3	343	349	353	-3	373	379	384	-3
NORWEB	343	344	347	-1	336	337	340	-1	360	362	365	-1
Scottish Hydro	375	379	377	-1	362	366	365	-1	369	372	371	-1
Scottish Power	378	381	378	0	368	370	374	-3	391	394	396	-1
SEEBOARD	328	328	341	-4	320	320	337	-5	334	302	359	-7
Southern	341	341	343	-1	332	333	336	-1	352	355	358	-2
SWALEC	378	386	408	-8	368	377	397	-8	402	411	434	-8
SWEB	369	369	376	-2	358	361	369	-3	378	378	385	-2
Yorkshire	336	336	338	-1	324	324	328	-1	359	359	362	-1
Average	352	354	364	-3	342	345	355	-4	365	365	379	-4

All figures include Fossil Fuel Levy with the exception of those of Scottish Hydro

4. Development of Competition

This chapter gives an outline of the changes in the designated market to 31 March 1999, and gives information on more recent developments. Several sources of data have been used for this chapter: research on customer awareness conducted by MORI for OFFER; responses from suppliers to a quantitative survey issued by OFFER in April 1999; and routine data collected by OFFER as part of the monitoring of supplier performance and the roll out of competition.

4.1 Customer Awareness

During February/March 1999 MORI carried out over 1,000 interviews with domestic electricity customers in those areas opened up to competition by the end of December 1998. Some of the main results of the survey are set out in this section. Where possible we have contrasted the research with electricity customers with that carried out by MORI for Ofgas. Details of the research are set out at Appendix 3.

The level of awareness of competition is generally high and equivalent to the early stages of the rollout of competition in the gas market. It is however a little lower than is presently the case in gas. Table 5 sets out the position.

Table 5: Awareness of Competition

Question: Were you aware that you can now buy electricity from suppliers other than your electricity company?				
		Date	(Base)	% Aware
Electricity		February 1999	(1,212)	89
Gas	Phase 1 :	October 1996	(1,187)	86
	Phase 2b:	December 1997	(1,015)	88
	National	July 1998	(2,511)	95

Base: All

Source: MORI

There is some evidence that many customers do not feel well informed about electricity competition - 54 per cent described themselves as very or fairly well informed, whilst a

majority of those on low income (57 per cent) and in class E (54 per cent) described themselves as not very or not at all informed.

Most customers said they had learnt about competition through a range of channels. Those aware of competition were asked to list different ways in which they may have found out about competition. Table 6 gives the results for the top mentions. Information from OFFER's own national campaign was mentioned by 3 per cent.

Table 6: Sources of information

	All aware of competition (1,102) % mentioning	Switchers (362) % mentioning
Radio/TV advertisements	45	35
Advertising/Promotional leaflets/ brochures	40	44
Door to Door salespeople	36	64
Newspapers/Magazines	33	23
Radio/TV programmes	22	14
Friends/neighbours/relatives	17	17
Posters	8	3
Exhibition stands	8	16

Source: MORI

It is noteworthy that the direct sales techniques of doorstep sales and exhibition stands were markedly more significant for switchers.

Customers' awareness of a range of suppliers was limited. Most customers could name only one or two suppliers (generally the local PES and British Gas). The awareness amongst switchers was somewhat higher. Table 7 gives the results.

Table 7: Familiarity with Electricity Suppliers

	Switchers (313) %	Non-switchers (849) %
1 supplier only	3	28
2 suppliers only	38	34
3 suppliers only	31	22
4+ suppliers	28	13

Source: MORI

The main reason given for switching supplier in electricity, as in gas, was cheaper prices. Dual fuel benefits were also significant. The main reasons given for staying with the existing supplier were “no reason to change”, “can’t be bothered”. However, other reasons were also seen as important including a fear that lower prices may not be maintained. Table 8 summarises the main reasons given.

Table 8a: Main Reasons for Switching

	%
Cheaper prices	83
Dual Fuel	47
Persuasive Salesman	18
Better Services	11

Base: All switchers (363)

Table 8b. Main Reasons for Not Switching

	%
No reason to change	76
Can’t be bothered	29
Lower prices may not be maintained	23
Don’t know enough about suppliers	23
Waiting to see what happens	15
Savings not enough	15
Not been approached	13

Main reasons given including both spontaneous and prompted responses. Reasons given quoted by less than 10 per cent excluded.

Base: All non-switchers (849)

Source: MORI

4.2 Compliance with Social Obligations

As outlined in section 2.3.2, electricity suppliers, under the terms of their operating licences, are required to have available a range of payment options and to produce certain Codes of Practice for domestic customers. These include Codes covering: the services companies make available to domestic customers who are of pensionable age, disabled or chronically sick; the payment of bills and procedures for dealing with customers in payment difficulties; and, for all customers, a Code giving advice on how to use electricity efficiently. The licences also require suppliers to draw relevant Codes to

the attention of those customers to whom they apply and to give or send copies free of charge to anyone who asks for them.

The relevant licence conditions are the same for PESs and second tier suppliers. Codes are agreed with the regulator and each supplier must comply with the provisions. OFFER monitors companies' performances under the Codes. New quarterly monitoring arrangements have been put in place from 1 April 1999, which include a requirement for suppliers to report to OFFER on the range and number of services they make available to customers.

OFFER/Ofgas's recently published Social Action Plan: Discussion Document' considers the companies' Codes and the services provided to disadvantaged customers in particular. The document raises a number of issues concerning companies' compliance with the Codes, which will be taken forward in discussion with customer groups and the industry.

The following sections summarise the results of OFFER's initial survey of suppliers compliance with the social obligation and the contents of suppliers' Codes.

4.2.1 Payment of Bills/Customers in Payment Difficulties

Method of payment is an important factor for many customers, including the elderly and those in payment difficulties. A range of payment methods is available from suppliers. Table 9 compares methods of payment for electricity between different suppliers.

Table 9: Payment Methods Available

	PESs	Second Tier Suppliers
Total Number of Suppliers	14	17
Monthly direct debit (equal instalments)	All	All
Monthly standing order (equal instalments)	13	8
Quarterly variable direct debit (based on actual consumption)	All	14
Payment on receipt of quarterly bill	All	All
Frequent payment instalments	All	13
Fuel direct (payments made by DSS) ¹	All	All
Prepayment meter	All	All

¹ Fuel direct is only available to customers in debt and in receipt of certain benefits.

For customers facing difficulties in paying, with low incomes, or in other disadvantaged groups, prepayment meters and regular cash or budget plans are particularly important. Table 9 suggests that most companies have available at least one ‘free’ method of cash payment in addition to prepayment meters, but that the picture is varied.

The relevant Code of Practice requires all licensed suppliers to treat sympathetically customers in payment difficulties. In particular, debt recovery rates must take into account the customers’ circumstances. Table 10 indicates that there are a range of debt payment arrangements available to customers of second tier suppliers and PESs as stated in the suppliers relevant Code of Practice.

Table 10: Debt Payment Arrangements Available for Customers

	PESs	Second Tier Suppliers
Total number of suppliers	14	17
Short-term deferment	2	2
Fixed instalments before next bill ¹	4	5
Monthly direct debit ²	5	5
Regular instalments over longer period ³	12	14
Prepayment Meter ⁴	All	All
Fuel Direct (payments made by DSS)	All	All
Individual ⁴	4	6

Source: Suppliers’ Codes of Practice on Payment of Bills and Guidance for Dealing with Customers in Difficulty

- Notes:
- ¹ Bill cleared during following quarter by making fixed instalments.
 - ² Monthly payments made to cover annual usage plus debt.
 - ³ Fixed payments towards annual consumption plus a proportion of debt on the date and of the amount agreed in advance. Schemes vary between weekly, fortnightly, or monthly and in cash, by cheque or standing order.
 - ⁴ Supplier’s Code states that individual repayment arrangements will be made with customers - these may include any of the foregoing payment methods.

OFFER’s review also indicated that none of the PESs charged interest on prepayment meter debts but that some second tier suppliers reserve the right to do so. It is our understanding however that most do not intend to apply these clauses to domestic customers except in exceptional circumstances. OFFER will be requiring companies to report the number of customers paying interest in this manner. Meter installation was generally free of charge if the customer responded promptly to debt follow up procedures, although just under one third of suppliers reserve the right to pass on the cost of installing a prepayment meter in

exceptional circumstances. In cases where, due to a lack of response from the customer the supplier had incurred additional costs in following up the debt, suppliers reserve the right to pass these costs on to the customer. About half of the companies either will, or reserve the right to, charge customers an administrative charge if their previous supplier assigns a debt to the new supplier.

All Codes refer to the advice available from agencies such as the Citizens Advice Bureaux or Money Advice Centres. A half of suppliers state explicitly that they will accept debt recovery repayment levels which take into account the repayment of other debts and a similar proportion state explicitly that they will halt debt recovery procedures (for between 10 to 21 days) to allow advice agencies time to help. All Codes, for example, refer to the advice available from agencies such as the Citizens Advice Bureaux or Money Advice Centres.

4.2.2 Services to Elderly, Disabled and Chronically Sick Customers

All suppliers must have codes of practice in place dealing with services to their customers. For the disabled and chronically sick the provisions of the Codes must include:

- keeping a register of customers who qualify under the Code;
- a bill redirection service;
- communications appropriate to blind or partially sighted customers and deaf or hearing impaired customers;
- repositioning meters (free for disabled customers) ;
- advice on fuel use;
- advance notice of interruptions to supply;
- special means of identifying company individuals; and
- provision of special controls or adapters for appliances or meters.

A review of suppliers codes showed that: all suppliers offered this minimum level of service, that many offered additional services and that the services are provided free of charge with the exception of the provision of special adapters for appliances.

4.2.3 Energy Efficiency Advice

All electricity companies are required to have Codes of Practice on the efficient use of electricity, the details of which are approved by the Director. They include information and advice on efficient use and details of how to obtain further information from the supplier or other sources.

Under the Codes put in place by suppliers, all companies provide an energy efficiency advice telephone service and make mention of the energy efficiency Code in the Codes of Practice for the elderly and disabled and to customers in payment difficulties. As well as providing direct advice about energy saving measures all Codes give details of independent organisations which provide further information and financial assistance (companies are required to report to OFFER the number of calls to their energy efficiency advice lines). In addition, most Codes of Practice directly link energy efficiency advice to debt situations. No supplier makes a charge for provision of services under the energy efficiency Code.

4.2.4 Summary

The licence conditions for all suppliers with respect to their social obligations are in all important regards identical. The Codes of Practice in which companies have to set out the arrangements to meet these obligations must be agreed by the Director. Companies' performance under the Codes are monitored by OFFER.

This initial assessment of the Codes has given a broad view of the services provided by suppliers under the Codes of Practice. Whilst these vary, there is evidence to suggest that the quality of services to elderly, disabled and chronically sick customers, to customers in payment difficulties, and to customers who require energy efficiency advice is being maintained in the competitive market. Companies' statements in Codes whilst important, do not give the full picture. Monitoring the services actually provided will be necessary to ensure compliance with the social obligations. Specific areas for consideration will include the level of debt repayments required; the number of customers on the careline register), the volumes and accuracy of energy efficiency advice, and the nature of complaints raised by customers and their representatives. OFFER will continue to pay close attention to compliance with the social obligations as the market develops further.

4.3 The New Suppliers

The number of suppliers has increased since the beginning of the roll-out of competition. In September 1997 there were 4 suppliers in the market. By the end of April 1999 there were 17 suppliers operating in the designated market. A further 2 suppliers have licences to supply and are presently under-going entry processes. Most of these suppliers operate on a Great Britain wide basis. A full list of suppliers is set out in Appendix 4. In addition to the licensed suppliers there have been a significant number of 'affinity deals' with other organisations including trade unions and supermarkets.

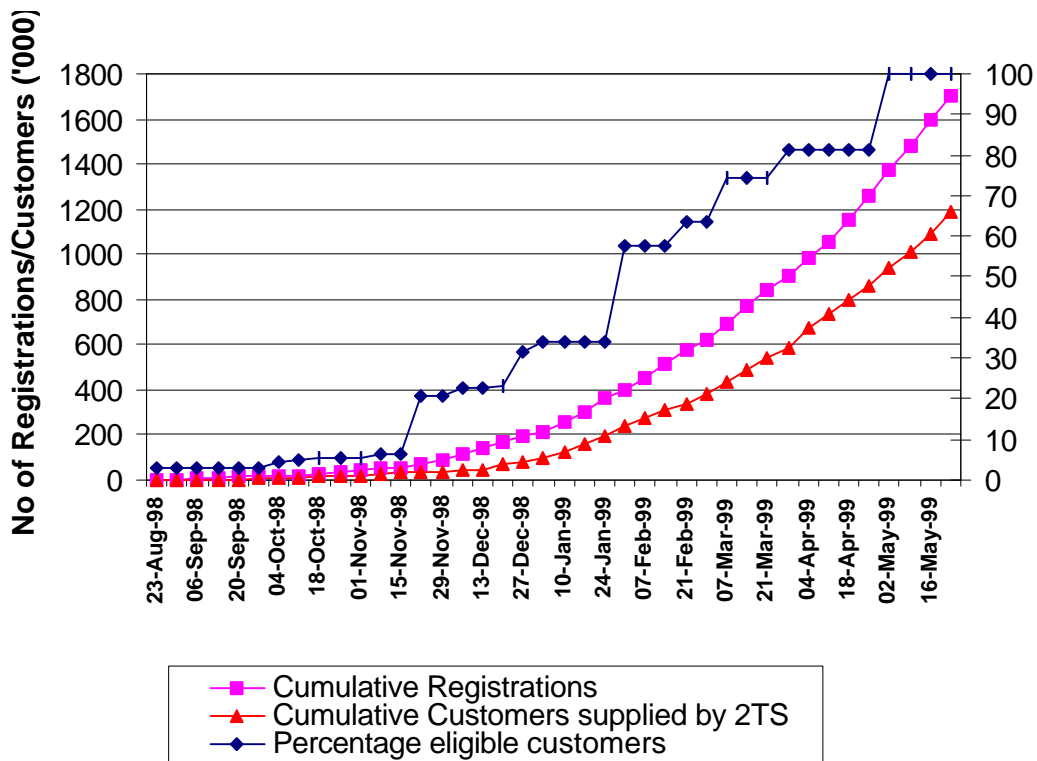
4.4 Changes in Market Shares

Most of the figures presented in this section of the review are based on customers who have changed supplier. This is based on supplier returns of activity at end of March 1999. A more up to date picture can be considered by reviewing registration data. Data on registration numbers at the end of May gives an indication of the likely movement of competition over the period to the end of June 1999 (this is because most registrations are made 28 days prior to change of supplier). Some caution should be exercised in the use of these figures however as objections and erroneous transfers may reduce the number of changes of supplier that take place. In addition the data available to OFFER on registrations does not routinely distinguish between designated customers and others under 100kW. The overall impact of these factors does not however detract from the general picture.

4.4.1 Overview of Switching Behaviour

The number of customers switching supplier has increased steadily since the market opened in September 1999, although switching volumes have been influenced by the roll-out phasing. Figure 1 shows the overall number of customers changing supplier in the 100kW market together with the number of registrations recorded and the percentage of customers eligible for competition.

Figure 1 Market Share Gain and Registrations in the 100kw Market by all Competitors to the Local PES.

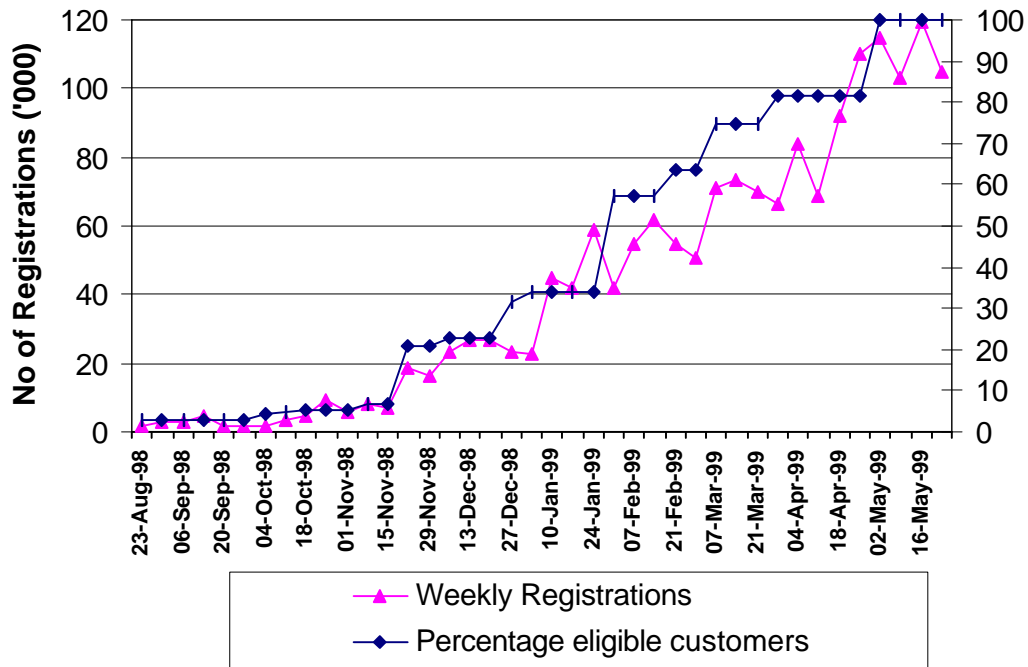


Source: PES Registration Data

By the end of May 1999, some 1.3 million customers were supplied by suppliers other than the local PES. This represents 4.7 per cent of the total number of customers below 100kW.

Figure 2 shows the percentage of customers eligible for competition together with the weekly registrations notified to OFFER by suppliers competing in the market. As can be seen the growth in the level of registration activity closely matches the extension of competition during the roll-out period. This suggests that the roll-out process has had a major impact on the initial development of competition. Data on individual PESs, especially those which completed the roll-out at the end of May, should therefore be treated with particular caution.

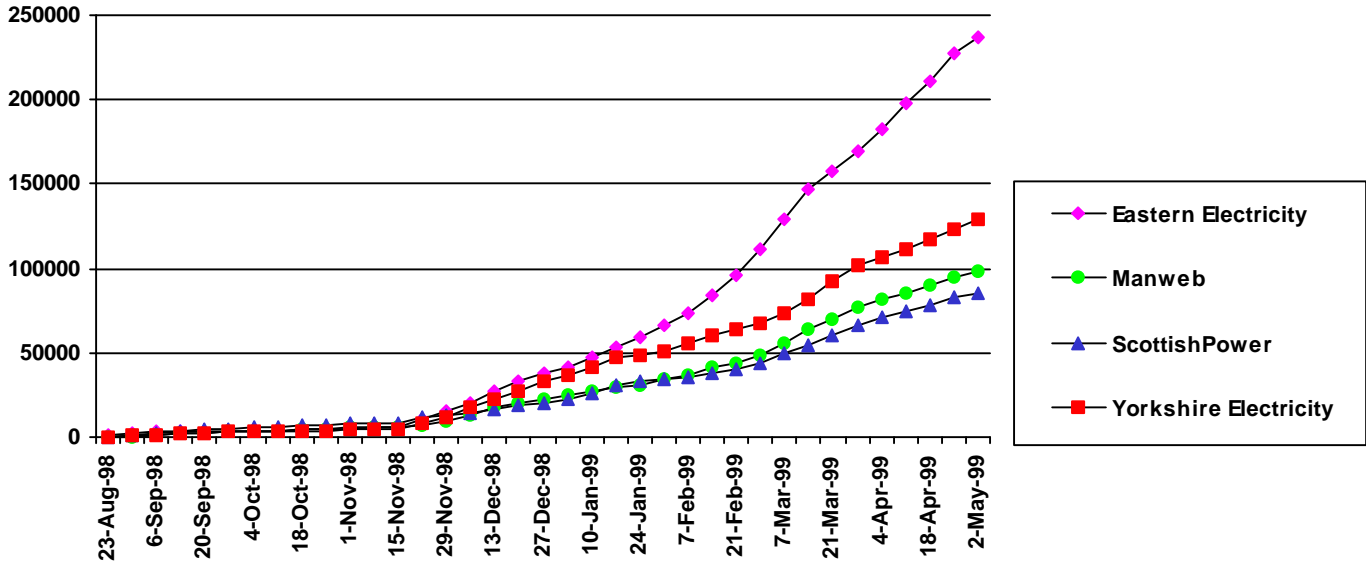
Figure 2: Level of Registrations Activity below 100kW



Source: PES Registration Data

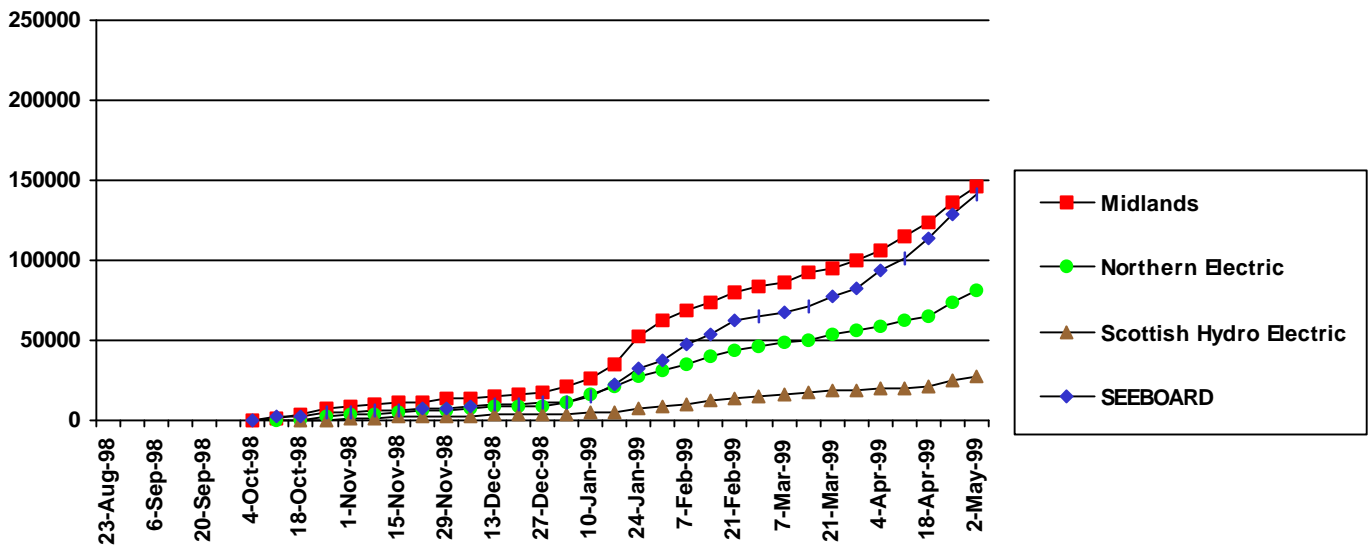
As might be expected the level of registration activity varies significantly between PES areas. Figures 3 a-c set out the level of regulation activity on a cumulative basis by PES area. Companies are grouped according to the timing of initial market opening.

Figure 3a Cumulative Registrations by PES area (Eastern, Manweb, ScottishPower, Yorkshire)



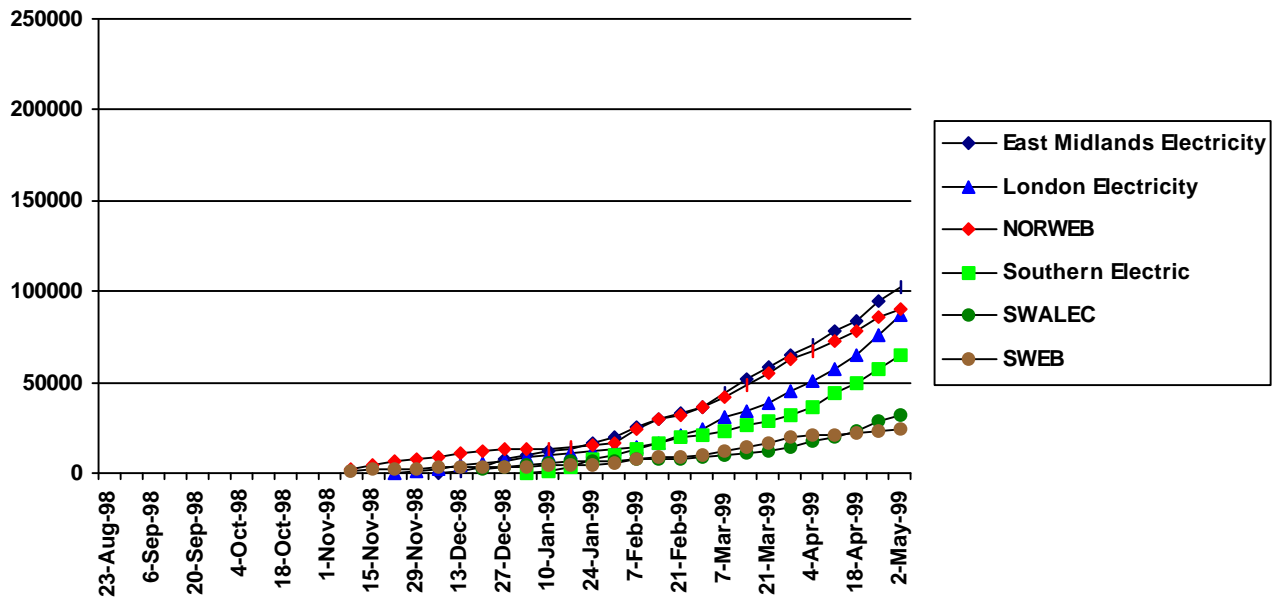
Source: PES Registration Data

Figure 3b Cumulative Registrations by PES area (Midlands, Northern, Scottish Hydro, Seaboard)



Source: PES Registration Data

**Figure 3c: Cumulative Registrations by PES area
(East Midlands, London, Norweb, Southern, SWALEC, SWEB)**



Source: PES Registration Data

As can be seen, initial levels of activity during the first phase of market opening in each PES area were low, with volumes increasing rapidly as subsequent phases opened. There is also some indication of a more rapid increase in registrations in the case of those areas opening later to competition. This may reflect the timing of suppliers' main advertising and sales efforts. However, most major suppliers report a backlog of signed contracts awaiting processing and registration.

Table 11 sets out regional data for the number of customers below 100kW who have changed supplier as of 31 March 1999, together with the percentage of each PES area which remained supplied by the local PES.

Table 11: Switchers by PES area and PES share of below 100kW market as of 31 March 1999

PES	Customers Supplied by Second Tier Suppliers 31 March 1999 ('000s)	Local PES Market Share %
East Midlands	34.7	98.5
Eastern	111.0	96.5
London	23.9	98.5
Manweb	48.8	96.5
Midlands	75.8	96.8
Northern	43.0	97.2
Norweb	29.1	98.7
Scottish-Hydro	14.3	98.2
ScottishPower	42.4	97.9
Seeboard	59.4	97.2
Southern	19.6	99.3
Swalec	8.2	99.2
SWEB	10.6	99.3
Yorkshire	59.0	97.3
Total/Average	579.9	97.9

This table shows that on average PESs had lost just over 2 per cent of the below 100kW market (excluding those parts not then open to competition by 31 March 1999) with the percentage loss ranging from nearly 1 per cent to 3½ per cent. These regional variations are in part influenced by the precise timing of the roll-out and so should be treated with caution at this stage.

Table 12 gives an estimation for the development of competition to the end of June based on registration data. This suggests that the average share of second tier suppliers will rise to nearly 8 per cent, with this ranging by region from 10 per cent in Eastern to just over 4 per cent in SWEB. Again, this data is influenced in part by the timing of roll-out decisions. However, some regional variations appear to be emerging. In particular, it would seem that the level of switching is markedly below average in the Southern and SWALEC areas (perhaps influenced by the delays in opening competition in these areas) and in the SWEB area and in Scotland.

Table 12: Expected PES Market Share of 100kW market by end June 1999

PES	Customers Registered to PES (%)
East Midlands	91.7
Eastern	90.1
London	90.6
Manweb	90.6
Midlands	90.8
Northern	91.0
Norweb	92.4
Scottish-Hydro	94.3
ScottishPower	94.5
Seeboard	90.5
Southern	94.6
Swalec	93.0
SWEB	95.7
Yorkshire	93.2
Average market share across PESs	92.2

4.5 Designated and Domestic Markets

The preceding analysis has focused on all customers below 100kW. A somewhat different picture emerges from the early data on the level of switching in the market sectors below 100kW. Table 13 summarises the percentage level of switching by PES as at end March 1999 for all 100kW customers, domestic customers, designated customers, business customers (that is all non domestic customers below 100kW, some of whom may be in the designated market) and non-designated customers. In each case, the percentage is based on the size of the relevant market open to competition on that date.

Table 13: Switchers by Markets below 100kW as at 31 March 1999

	Below 100kW	Domestic	Designated	Business	Non-Designated
East Midlands	1.5	1.3	1.4	2.5	1.7
Eastern	3.5	3.4	3.3	3.9	18.0
London	1.1	0.9	1.0	1.6	2.0
Manweb	3.5	3.4	3.3	4.0	29.6
Midlands	3.2	3.0	3.0	5.2	8.1
Northern	2.8	2.8	2.6	3.2	27.6
Norweb	1.3	1.2	1.2	2.3	2.7
Scottish-Hydro	1.8	1.6	1.7	3.9	4.2
ScottishPower	2.1	2.0	1.9	2.7	15.6
Seeboard	2.8	2.7	2.7	3.4	6.3
Southern	0.7	0.7	0.7	0.6	0.9
Swalec	0.8	0.8	0.8	0.9	0.9
SWEB	0.7	0.5	0.6	2.4	3.3
Yorkshire	2.7	2.7	2.6	1.5	1.4
Average	2.1	2.0	2.0	2.6	4.3

Note: Percentages of customers in category eligible for competition. The average figures have been calculated from the numbers of switchers.

In considering Table 13 it should be recalled that East Midlands, Southern and SWALEC completed the second stage of the roll-out at the end of March. Although all business customers in those areas were eligible for competition only a few had the opportunity to switch when the survey was taken. Indeed, in general the figures are influenced by the roll-out programme, with companies opening their markets later in the period generally retaining a larger proportion of customers across all categories.

Experience from the market above 100kW shows that larger customers tend to have a greater propensity to switch. This appears to be the case below 100kW. Eleven of the 14 PESs show the percentage of switchers in the business sector being higher than in the domestic sector. Another 11 out of the 14 PESs show the percentage of switchers in the non-designated sector as the greatest amongst the sectors set out in the Table. Some PESs have lost nearly 30 per cent of non-designated supplies (a rate of switching equivalent to the initial take up of competition in England and Wales in the above 100kW market).

4.6 Market Shares of Competitors

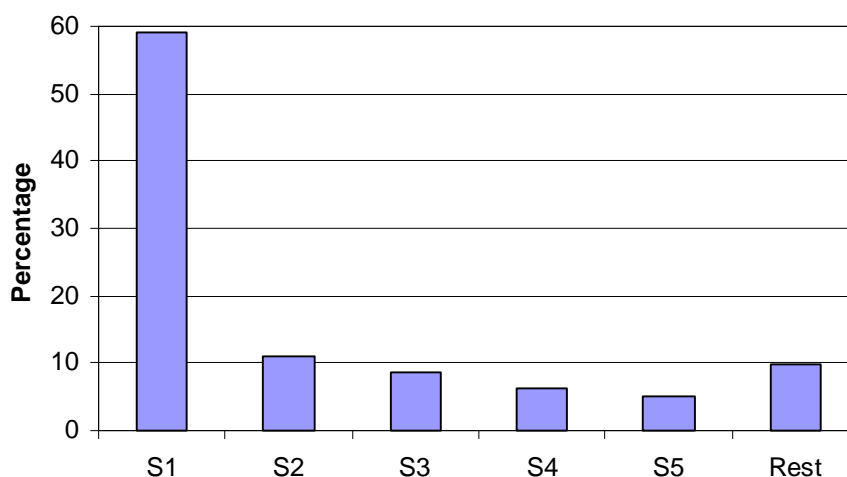
4.6.1 Overview

While it is too early to draw any firm conclusions about the pattern of activity in the below 100kW market from the information available to date, certain trends do appear to be emerging. It must also be the case that at this stage the variation between suppliers' differing performance in terms of customer acquisition may be down to the phase when they entered CMSU, strength of the host PES's brand name, any retention strategy it may have operated, competitors' prices and other factors likely to be relevant in the longer term to the development of the market.

4.6.2 Domestic Customers - National

In Figure 4 below, this shows the national market share by supplier for domestic switchers as of end of March 1999. Those suppliers whose market share is 5 per cent or more are shown separately. For the remainder, their individual market share figures have been aggregated. The table shows one supplier as taking over a half of domestic switches, with five suppliers having a share of switchers of 5 per cent or more.

Figure 4 National Share of Domestic Switchers by Suppliers

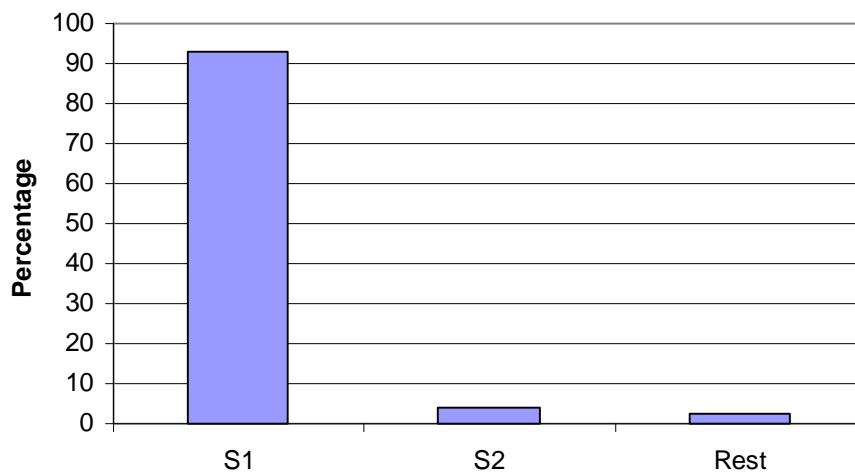


Source: Data provided by suppliers as of 31 March 1999.

4.6.3 Domestic Customers - Scotland

Figure 5 below uses the same criterion as above to analyse the picture in Scotland. The picture is somewhat different here where there are only two suppliers whose share of switchers is 5 per cent or more. This may be the result of a number of factors including: the necessary infrastructure for trading in Scotland is different to that for England and Wales creating an additional complexity for new suppliers; and the fact that there are two entrenched incumbents, perhaps creating the perception that the prospect for establishing competition in Scotland is more difficult than in England and Wales.

Figure 5 Share of Domestic Switchers in Scotland by Suppliers

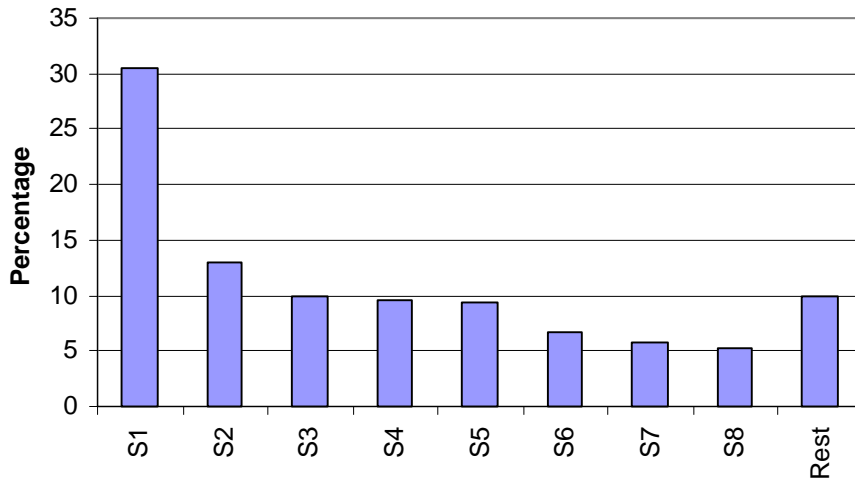


Source: Data provided by suppliers as at 31 March 1999

4.6.4 Non Domestic

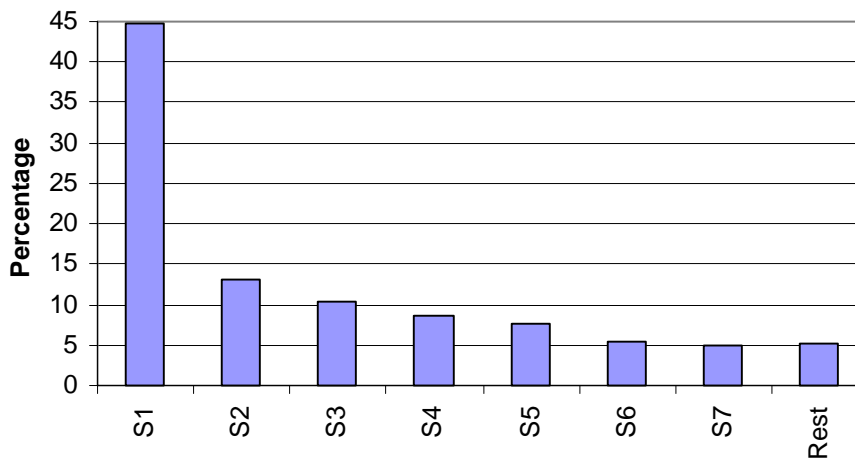
Figures 6 and 7 below show the number of suppliers which have gained 5 per cent or more of the non-domestic below 100kW market for Great Britain as a whole and separately for Scotland. In both scenarios, there are far more suppliers whose market share is above the stated threshold figure than is the case in the domestic sector. British Gas plays a less significant role in this sector, with PESs, generators and independents competing to supply non-domestic customers. Suppliers report that many business customers are entering into multi-site contracts, perhaps covering a large number of sites spread across Great Britain.

Figure 6 National Market Share of Non-Domestic Switchers by Suppliers



Source: Data provided by suppliers as at 31 March 1999.

Figure 7 Market Share of Non-Domestic switchers by Suppliers in Scotland



Source: Data provided by suppliers as at 31 March 1999

In these figures the identity of suppliers varies - in particular, it is not the case that the largest supplier in one category is necessarily the largest in others, or that the prefixes S1, S2, etc, relate to the same supplier when used in different figures.

4.6.5 Supplier Strategy

About a third of designated suppliers to England and Wales and Scotland appear to have adopted a national customer acquisition strategy, and have targeted each PES's authorised area as these have opened. This maybe because they are players with a nationally recognised brand, or in the case of PESs' second- tier supply businesses they have decided to follow such a strategy to offset losses in their own PES area. In some cases the supplier's strategy may reflect the ownership of a non-fuel subsidiary or affiliate, for example, a water company, where an alternative customer base has been established.

Of the remaining second-tier supply businesses, the majority are also PES licence holders and have focused their activity on winning customers in areas which are contiguous with or close to their own PES's authorised areas. This 'halo' approach capitalises on these adjacent customers' probable awareness of the supplier's known brand through regional television advertising and/or because of the connection of the company's name to an area wider than its franchise area. In the case of the remaining suppliers the level of activity is low often reflecting a strategy by those companies to concentrate on retaining customers within the existing PES franchise area.

In the domestic sector British Gas (BGT) held just under 60 per cent of the switchers nationally, with a national market share of domestic electricity supply of 1.2 per cent by end March. On the basis of registration data this can be expected to increase to about 3.7 per cent by the end of June. This compares SWALEC, the smallest PES in England and Wales, with a 3.5 per cent national market share and about 95 per cent of the domestic market in its own area.

4.6.6 Market Share and Payment Method

The types of payment method competition offers and the changes in numbers of customers on PESs' different tariffs, is relevant to the interpretation of competitive behaviour. It is for consideration whether particular tariff types represent separate sub-markets.

Table 14 gives details of the main payment methods offered by the PESs as at 31 March 1999.

Table 14: Domestic Customer Payment Type % by PES

% Quarter ending March	Monthly Direct Debit and Standing Order		Quarterly payment		PPM		Others ¹	
	1998	1999	1998	1999	1998	1999	1998	1999
East Midlands	34.9	37.0	48.8	47.0	13.1	12.8	3.3	3.2
Eastern	29.7	32.4	54.6	52.5	12.3	11.2	3.4	3.9
London	24.2	24.0	51.8	52.0	22.2	22.2	1.9	1.8
Manweb	28.2	28.3	46.1	46.3	22.3	22.3	3.4	3.2
Midlands	30.7	31.7	46.6	46.1	15.9	16.1	6.8	6.2
Northern	32.7	44.2	42.9	26.3	10.5	13.8	14.0	15.7
Norweb	36.2	36.7	44.7	44.9	13.4	13.0	5.6	5.3
Scottish-Hydro	25.4	27.0	46.4	44.7	22.1	24.5	6.1	3.8
ScottishPower	23.6	23.3	40.8	40.8	22.9	23.0	12.7	12.9
Seaboard	34.8	35.5	51.8	50.9	11.6	11.8	1.8	1.8
Southern	45.0	42.8	41.5	43.5	12.5	12.4	1.1	1.3
Swalec	30.2	31.2	45.7	35.9	17.8	18.2	6.3	14.8
SWEB	29.3	30.5	51.8	50.3	16.6	17.2	2.3	2.0
Yorkshire	30.9	31.3	43.5	43.0	13.2	13.3	12.4	12.4
Average	31.1	32.6	46.9	44.6	16.2	16.6	5.8	6.3

Notes: ¹ "Others" includes: Flexible payment plans, weekly/fortnightly payment, optional monthly bills and fuel direct, monthly cheque/cash. Columns may not add up to 100 per cent due to rounding.

Source: OFFER Customer Accounting Statistics

In total some 7.8 million electricity customers pay by direct debit, with about 3.7 million using a prepayment meter. These payment methods accounts for nearly a half of all domestic customers.

Table 15 summarises the position of second tier suppliers as of 31 March 1999. Highest and lowest show the supplier with the highest/lowest proportion of customers using the specified payment method.

Table 15: Domestic Customer Payment Type % by Switchers

%	Direct Debit	Quarterly	Prepayment	Other
Average	46.7	46.4	5.9	1.0
Highest	81.8	71.2	19.6	9.5
Lowest	14.0	18.2	0	0

These figures suggest that suppliers are attracting a greater proportion of customers to direct debit payments, with a lower proportion of customers paying by the more costly option of prepayment meter and other (often cash based) methods. Caution should be exercised in interpreting these figures. MORI in its research found that 28 per cent of switchers changed their payment method when they changed supplier - with just 5 per cent of switchers stating that they were pressured or required to change. Given that many domestic switchers will have undertaken some price comparisons, a level of switching to cheaper payment options might be expected. As is shown in Table 16 MORI research shows that customers are generally not well informed about cheaper payment options. For example, over a quarter of prepayment meter customers think, wrongly that it is the cheapest payment method, and only about a third of quarterly credit customers know that it is not the cheapest payment method.

Table 16: Awareness of Price Differential by Payment Method

Q: Is this the cheapest method of payment offered by your electricity supplier?				
%	Customers Existing Payment Method			
	Direct Debit	Quarterly	Prepayment	Other
Yes	58	20	26	27
No	2	35	37	27
Don't know	40	45	37	46

Base: All (1,212)

Source: MORI

In addition, prepayment meters and other payment schemes have previously been associated with debt recovery. At this early stage of the market, second tier suppliers will not have had much need to discuss with customers debt recovery through meters. By contrast, PESs installed nearly 48,000 meters to recover debt in the first 3 months of 1999, with an average debt being recovered at a rate of £3.23 over 62 weeks.

4.6.7 Market Shares by Tariff type

It is also relevant to consider the development of competition against different tariff types. Table 17 sets out the percentage of domestic customers supplied on a day/night tariff by PES.

Table 17: Day/Night Tariff Domestic Customers as percentage of all Domestic Customers by PES

East Midlands	50.4
Eastern	36.9
London	8.5
Manweb	9.5
Midlands	18.5
Northern	10.7
Norweb	17.4
Scottish-Hydro	41.9
ScottishPower	20.5
Seeboard	33.1
Southern	14.9
Swalec	8.3
SWEB	22.8
Yorkshire	13.9
Average	22.8

Source: PES Data

This can be contrasted with the initial position of second tier suppliers which is set out in Table 18. Again, highest/lowest gives the percentage for the supplier with the highest/lowest proportions of day/night tariff customers.

Table 18: Day/Night tariff domestic customers as a percentage of all domestic switchers

Average	14.0
Highest	38.7
Lowest	0

The lower level of switchers amongst day/night tariff customers may be associated with a variety of factors including an emphasis on dual fuel sales (suggesting less focus on customers with day/night tariffs who typically use electricity rather than gas for heating) and the roll-out programme.

4.6.8 Identity of Switchers

The data set out above gives a general picture of the identity of switchers in the domestic market. This is supplemented by the research undertaken by MORI at an earlier stage of the opening of the market. The data from the MORI study is summarised in Table 19.

Table 19: Identity of Switchers Data from MORI Study

Who has switched so far?			
% which have switched			
Total		5	
Age	16-34	4	
	34-64	7	
	65+	4	
Social Class	AB	9	
	C1	5	
	C2	3	
	DE	4	
Housing Tenure			
	Owner Occupier	7	
	Rented	3	
	Income below £5,000		2
	Bank Account	Yes	5
		No	2
	Payment Method		
		Direct Debit/Standing Order	10
		Cash/cheque	3
		Prepayment	1
		Other	3
		Telephone switcher	7
		Gas switcher	11
		Heating: Gas	7
		Electric	1
		Coal/Oil	1

Base: All (1,212)

Source: MORI

MORI looked at a range of different types of 'disadvantaged' customer using several definitions: low income customers with a household income of less than £5,000 pa; those in social classes D and E (particularly the latter); benefit recipients; the elderly (particularly those who receive a state pension only rather than an additional occupational pension); those without a bank or building society account; single parent families; PPM customers; and those who have had difficulty paying their bills at some time.

These groups formed between 7 per cent (single parent families) and 26 per cent (those who have had difficulty paying their bills at some time) of electricity customers in the areas

opened up to competition by the end of December 1998. As expected, there is a high degree of overlap between the different groups.

It is clear that, generally speaking, customers who fall into these disadvantaged groups tend to be less knowledgeable about electricity competition and are less likely to have switched supplier (or indeed to say they will switch in the next 12 months). This is particularly true of low income groups, those without a bank or building society account and those who pay by prepayment meter for their electricity - 2 per cent or fewer of these groups has switched to date, compared to 5 per cent overall - and fewer than half feels well informed about competition.

Hardly any of these customers say that they have not switched because they were told they could not or that they could not switch because they are in debt. In addition, it seems that, as with gas competition, the suppliers may have been targeting C2DE areas with doorstep salespeople, knowing that they respond better to such an approach - 46 per cent of DEs say they have been approached by a doorstep salesperson (48 per cent of Es) compared to 22 per cent of ABs. The only exception to this may be those in 'poor' condition housing, who have one of the lowest levels of switching and the lowest levels of contact with the new suppliers.

Though many 'disadvantaged' customers do not know that they are paying by a more expensive payment method, almost all are satisfied with the way they pay. They mainly choose these methods of payment for convenience and budgeting purposes. Some customers may describe these methods as cheaper because they are better able to control the amount they spend on electricity. Nevertheless, it appears there are at present significant barriers to this group of customers playing a full part in the competitive market arising from lack of information, issues associated with payment methods and debt. The revised social action plan will need to address these issues.

4.6.9 Pricing

OFFER collects and publishes data on supplier prices. Table 20 shows that on the unrestricted standard domestic tariff across all PES areas, the best savings available on an annual direct debit account average, about 11 per cent, for quarterly the average is also about 10 per cent and for prepayment 6 per cent.

**Table 20 Average Range of Annual Bills as at 31 March 1999
Standard Domestic Tariff**

	Payment Method (all based on average annual consumption of 3,300 kWh)		
	Direct Debit	Quarterly	Prepayment Meter
Average PES Bills (£)	256.32	264.69	279.46
Average bills for second tier suppliers (£)	246.76	255.96	296.39
Reduction on average PES bill (%)	4	3	-6
Average of lowest annual bills offered in each PES area (£)	217.77	222.11	235.25
Reduction on average PES bill (%)	11	10	6
Average range of competitors' bills in each PES area (£)	26.88	29.33	95.56
Average number of competitors offering lower prices than PES	14	13	4

The position for each PES is set out at Appendix 5. Table 21 summarises the position for each PES.

**Table 21: Best Savings on PES Annual Bill as at 31 March 1999
Standard Domestic Tariff**

	Direct Debit		Quarterly		Prepayment	
	PES bill (£)	Best Saving %	PES bill (£)	Best saving %	PES bill (£)	Best saving %
East Midlands	243.55	8	254.05	9	276.31	4
Eastern	245.01	11	250.95	10	263.50	8
London	246.55	8	257.05	8	268.20	2
Manweb	270.50	10	278.14	10	293.81	6
Midlands	245.34	10	252.92	9	262.88	6
Northern	268.19	11	276.49	11	292.72	11
Norweb	248.05	9	256.36	9	273.65	3
Scottish-Hydro	271.59	16	277.87	13	277.52	8
ScottishPower	267.37	10	276.25	10	290.11	5
Seeboard	243.08	9	251.48	12	262.97	11
Southern	248.35	10	254.96	9	268.63	2
Swalec	282.72	9	290.14	9	316.69	13
SWEB	266.07	7	274.30	6	285.90	5
Yorkshire	242.16	10	254.76	10	279.46	3

Table 21 shows that on the basis of typical annual bills all standard domestic tariff customers in all areas can obtain savings by switching. The level of savings varies by region and by payment method.

Some concern has been expressed that savings may not be available for low users or day/night tariff customers. Table 22 summarises the position for low users. Suppliers estimate that about 11 per cent of domestic customers on the standard tariff use 1,500 kWh a year or less. Typically second tier suppliers charge slightly higher standing charges than PESs. Nevertheless, as the table shows, even at consumption levels of less than half of the average, customers are able to make savings by switching.

Table 22: Best Savings available by PES for low users (1,500 kWh a year) - as at 31 March 1999

	Direct Debit		Quarterly		Prepayment	
	PES bill (£)	Best Saving %	PES bill (£)	Best saving %	PES bill (£)	Best saving %
East Midlands	125	3	136	5	158	5
Eastern	126	10	130	9	141	4
London	132	9	143	10	158	3
Manweb	148	8	154	6	171	8
Midlands	128	8	132	5	142	6
Northern	151	17	156	14	171	13
Norweb	132	5	137	5	158	1
Scottish-Hydro	150	17	154	12	152	7
ScottishPower	142	7	149	5	163	3
Seeboard	120	16	128	21	127	9
Southern	135	11	137	7	155	4
Swalec	157	13	161	9	190	17
SWEB	140	5	144	3	159	4
Yorkshire	126	8	139	9	163	6

Table 23 gives the position for day/night tariff customers with an average consumption of 6,600kWh per annum.

Table 23: Best Savings available by PES area for Domestic Economy 7 customers as at 31 March 1999

	Direct Debit		Quarterly		Prepayment	
	PES bill (£)	Best Saving %	PES bill (£)	Best saving %	PES bill (£)	Best saving %
East Midlands	342.30	4	352.80	4	375.06	5
Eastern	346.84	7	354.61	8	365.46	5
London	351.98	3	362.86	3	366.85	1
Manweb	373.40	4	382.58	5	396.71	5
Midlands	355.35	5	366.35	5	384.03	5
Northern	360.34	6	371.48	6	391.52	2
Norweb	354.01	4	361.34	5	379.61	1
Scottish-Hydro	384.18	9	397.85	9	390.86	7
ScottishPower	388.83	6	399.84	6	413.70	3
Seeboard	336.23	3	344.63	4	350.98	12
Southern	350.11	5	357.74	5	372.35	2
Swalec	395.41	7	405.51	7	431.36	7
SWEB	375.54	3	387.16	3	396.82	6
Yorkshire	339.94	5	352.54	5	377.32	4

4.6.10 Differentials between Payment Methods

Table 24 shows the differential between charges on the standard domestic tariff by payment method. First, for the PESs (Table 24a) and second tier (Table 24b) for the differentials charged by second tier suppliers calculated as an average of differentials charged in each PES area.

**24a: Differentials between Charges for Standard Tariff Payment Methods as
at 31 March 1999 -PESs**

PES	Prepayment Meter minus Quarterly Credit (%)	Prepayment Meter minus Direct Debt (%)	Quarterly Credit minus Direct Debit (%)
East Midlands	8.8	13.5	4.3
Eastern	5.0	7.6	2.4
London	4.3	8.8	4.3
Manweb	5.6	8.6	2.8
Midlands	3.9	7.2	3.1
Northern	5.9	9.2	3.1
Norweb	6.7	10.3	3.4
Scottish-Hydro	-0.1	2.2	2.3
ScottishPower	5.0	8.5	3.3
Seeboard	4.6	8.2	3.5
Southern	5.4	8.2	2.7
Swalec	9.2	12.0	2.6
SWEB	4.2	7.5	3.1
Yorkshire	9.7	15.4	5.2
Overall Average	5.6	9.1	3.3

Table 24b: Differentials between charges for Standard Tariff Payment Methods as at 31 March 1999 - Second Tier Suppliers

Second Tier Supplier	Prepayment Meter minus Quarterly Credit (%)	Prepayment Meter minus Direct Debt (%)	Quarterly Credit minus Direct Debit (%)
British Gas Trading	7.4	12.1	4.3
East Midlands	9.1	13.8	4.3
Eastern	31.6	37.4	4.4
Enron Direct	8.2	13.2	4.6
Independent Energy	31.9	37.1	3.9
London Electric	31.7	37.2	4.2
Midlands	17.9	21.5	3.1
Northern	7.3	11.9	4.2
Norweb	14.6	17.1	2.2
Scottish-Hydro	24.3	28.4	3.4
ScottishPower	9.3	13.8	4.2
Seeboard	11.8	15.6	3.4
Southern Electric	9.0	11.3	2.1
Swalec	8.9	11.5	2.5
SWEB	18.2	21.9	3.1
Yorkshire	11.8	18.4	5.9
Overall Average	16.0	20.3	3.8

The differentials between quarterly credit and direct debit are similar in the case of PESs and second tier suppliers. However, in general the differentials between prepayment meter and other payment methods is greater in the case of second tier suppliers than in the case for PESs under present price control arrangements. OFFER is presently considering the level of charges levied by PESs for prepayment meter customers. Although competitors' cost structures will not correspond to those of the local PES, the data does provide an indication that suppliers may not be competing on price to these customers to the same extent as to other customers.

4.6.11 Position of Competitors Relative to PES tariffs

In order to understand the development of domestic competition it is important to assess the relative position of PESs' tariffs against those of competitors.

Table 25 shows second tier supplier tariffs as an index of those of the host PES for each payment method. The table demonstrates that on average prices by each second tier supplier are lower than those of the host PES for both direct debit and quarterly credit tariffs.

Against an index of 100 for all host PES tariffs, the national index for second tier suppliers varies from 90.8 to 99.9 for direct debit and 89.7 to 98.5 for quarterly credit tariffs. The median figures are similar at 96.8 and 96.3 respectively. Typically therefore, the savings on offer to domestic direct debit and quarterly credit customers range upwards to about 10 per cent. Savings for prepayment meter customers are lower with the index for second tier suppliers ranging from 96.6 to 123.9.

Table 25: Comparison of Direct Debit, Quarterly Credit and Prepayment Meter Tariffs of all Suppliers in the Domestic Market as at 31 March 1999

Second Tier Suppliers - Averages across all PES areas

Second Tier Suppliers	INDEX, Host PESs Direct	INDEX, Host PESs Quarterly	INDEX, Host PESs Prepayment
	Debit Tariffs = 100	Credit Tariffs = 100	Meter Tariffs = 100
British Gas Trading	95.7	94.2	96.8
East Midlands	95.9	94.3	99.6
Eastern	98.7	97.1	122.4
Enron Direct	99.0	97.7	100.9
Independent Energy	90.8	89.7	112.7
London	99.8	98.3	123.9
Midlands	98.9	98.4	109.6
Northern	97.8	96.4	98.9
Norweb	95.2	95.6	102.7
Scottish-Hydro	96.0	96.1	112.4
ScottishPower	97.6	96.1	100.3
SEEBOARD	96.0	95.3	100.9
Southern	94.0	95.2	96.6
Swalec	97.6	98.5	100.3
SWEB	95.0	95.2	105.6
Yorkshire Electricity	99.9	96.6	105.5
Average Index for Second Tier Suppliers	96.7	95.9	105.7
Median Index for Second Tier Suppliers	96.8	96.3	102.4

Notes: ¹ PES and Second Tier Supplier tariffs averaged across country

4.6.12 Business Customers

OFFER also monitors prices for small business customers. The picture for non-domestic customers is more diverse. Many small customers are part of larger groups and are supplied on individual contract terms.

Of small business customers about 81 per cent of customers pay by credit, with 18 per cent on direct debit terms. Only around 1 per cent pay by prepayment meter (less than 20,000 customers). Initial indications of prices suggest that savings can be made by business customers. The data set out in Table 26 is based on supplier data provided as of 31 December 1998 and given the average expected revenue per unit for small business customers (excluding VAT). OFFER is presently collating more up to date data on business prices. On the basis of the data gives below, however, it seems likely that savings for single site business credit customers are broadly similar to those available for domestic customers with greater savings for direct debit customers.

Table 26: Prices to Designated Business Customers 31 December 1998

	Direct Debit	Credit
PES average revenue per unit sold (pence)	6.96	7.13
Range of PES revenue (pence)	6.54-7.48	6.64-7.76
Second Tier Supply average revenues per unit (pence)	6.37	7.24
Range of second tier supplier revenue (pence)	4.91-7.52	6.32-7.86
Best Savings %	29	13

Notes: Average unit prices exclude VAT and may vary as a result of different assumptions on customer consumption.

Source: Supplier estimates

4.7 Summary of Market Development

This initial review of the development of competition below 100kW has been set against the closing stages of the roll-out of competition. The roll-out timetable has had a significant impact on the way competition has developed to date. Broadly speaking those PES areas where markets opened earlier have seen greater activity. However, the pace of switching has been more rapid in later PES areas. The indications are that by the end of June the timetable of roll-out will be a far less significant issue in analysing the development of competition.

Over 100,000 customers a week are presently changing supplier nationally. At the end of March second tier suppliers supplied 580,000 customers (or 2.1 per cent of those customers then eligible for competition). By the end of June these figures are likely to increase to over 1.7 million customers and nearly 8 per cent of all below 100kW customers. Early indications suggest that a greater proportion of business customers (particularly larger business customers outside the designated market) are switching supplier than is the case for domestic customers.

In the domestic sector there are some indications that switching is more prevalent amongst higher income groups and those with direct debit or quarterly payment methods. This may reflect a number of factors including barriers to customers with prepayment meters taking a full part in the market and price differentials. Domestic direct debit and quarterly customers can typically save up to 10 per cent by switching (although this figure does vary by region). Almost all suppliers offer worthwhile savings in comparison to the local PES. For prepayment meter customers, however, the scope for savings is lower (up to 6 per cent) and only a minority of suppliers offer prices below those of the local PES. PES prices have remained at or close to the maximum levels required under price controls.

At present a range of suppliers are competing in the market, although mergers have reduced the overall number of competitors somewhat. Most are existing PES licence holders. The most active competitor in the domestic sector is British Gas which holds in excess of half of the switchers to date, four other suppliers have in excess of 5 per cent of switchers each. In the non-domestic sector the picture is more diverse with 8 suppliers each having a 5 per cent or more share of switchers.

Domestic customers are aware of competition and in the MORI survey carried out in February and March this year, 54 per cent of electricity customers felt very or fairly well informed. This was only slightly less than for gas customers when surveyed by MORI in July/August 1998 when Phase 3 of the market had opened there. Cheaper prices is the overriding reason for switching electricity supplier. Conversely, the main reasons why people have so far not switched are due to inertia and a lack of real incentive to change. Amongst these non-switchers just over 11 per cent indicated that they are likely to switch suppliers in the next 12 months. This again was very much in line with the results for the gas market when MORI conducted its survey there last July

Based on the published Codes of Practice, suppliers appear to be complying with the social obligations in licences, although experience of actual service to domestic customers with special needs is so far limited. Suppliers also appear to be offering a range of payment options to customers.

5. Future Development of Competition

This section looks at the prospects for the development of competition in the designated market for the future. We identify a number of issues which may have an impact on the future development of competition, including some aspects of behaviour by PESs that may give cause for concern. Discussed below are issues relating to:

- special terms;
- exit letters;
- debts and objection processes;
- meter reading and validation;
- PES distribution/supply;
- advertising;
- inappropriate marketing;
- dual fuel offers.

Overall, as each PES has been opened to competition, the pattern of customer loss has been similar, although the extent of the number of customers deciding to change supplier has varied between PESs. This may be due to a number of factors, and it is too early to conclude with any certainty the relative importance or otherwise of each. The factors include: the level of awareness of price reductions available; the intensity of competitors' marketing campaigns in rivals' areas; and the to extent to which PESs are attempting to retaining their customers. There may also be other factors which are having some impact on the development of electricity competition. These are discussed below.

5.1 Special Terms

A number of PESs have introduced a variety of schemes offering a range of benefits and incentives to customers. These have included discounts off electricity charges, discounts off holidays, the chance to win holidays and reimbursement of the cost of extended warranties for electrical goods. Some of the schemes have been modified or withdrawn at OFFER's insistence. OFFER must consider the effect of such offers on the development of competition in the supply of electricity and whether they comply with conditions in suppliers'

licences including those dealing with non-discrimination. Examples of some of the schemes include:

Holiday vouchers: offers of points redeemable as discounts against holidays booked with a travel agent with which the PES has an affinity agreement. Customers of the PES are awarded points towards the cost of a holiday with further points worth awarded with each of the next four quarterly bills providing the customer continues to take a supply of electricity from their incumbent supplier. The PES proposed originally that if a customer changed supplier the points accumulated would be forfeited.

The PES agreed to amend the scheme so that accumulated points may be retained by a customer who has switched to an alternative electricity supplier. It has also agreed not to include a cancellation form together with a contract in any mailing literature used to promote such schemes. OFFER considers it inappropriate, at this early stage of competition, for the PES to undertake such action whilst it remains a dominant supplier within its designated market.

OFFER's principal concern about this scheme is that its intention appears to be to tie-in existing customers to the dominant incumbent supplier during a period when customers may not be fully aware of the alternative offers available.

Gas Marketing Alliance: an affinity arrangement with a domestic gas supplier. Under the proposed arrangement customers who take electricity and also enter a contract to take supply of gas from the affinity partner will receive a bonus payment towards their electricity bills. The payment will be in the form of four quarterly credits to the customer's electricity account. Whilst the other terms and conditions on which the customer is supplied with electricity remain the same as for other customers, the intention of the scheme appears to be to retain existing customers.

Shareholder Scheme: a discount scheme for shareholders of its parent company. The deal offers shareholders a one off payment to those who enter into a contract with the PES for a supply of electricity and gas. Shareholders who do not have a gas supply but take an electricity supply receive a smaller one off payment redeemable against bills.

In order to qualify for the scheme a customer must hold shares in the PES's parent company, thereby the PES argues that any customer in Great Britain taking a gas and electricity supply from the supplier can benefit. There is no minimum shareholding

requirement. Customers who receive the payment are not required to remain a customer for a minimum period and may switch supplier at any time. These payments can only be redeemed against the customer's electricity and/or gas bills and seem likely to significantly affect a customer's evaluation of the contract terms of their supply. Although there is no minimum shareholding requirement, the class of customers eligible for the scheme is relatively closed.

5.1.1 *The Regulatory Framework*

The Director General is required to monitor and enforce the licence conditions to which suppliers are subject, including Conditions 4 and 4A of the PES licence. Condition 4 prohibits any separate business from giving or receiving any cross-subsidy to or from any other business of the Licensee or an affiliate or related undertaking of the Licensee. Condition 4A deals with the prohibition of discrimination in the supply of electricity. In particular the licence condition constrains the way in which a dominant supplier in an area may set its prices or terms for the supply of electricity to customers. See Appendix 2 for the full licence conditions.

Complaints from some suppliers about some of the schemes being offered say that schemes which offer inducements to existing PES customers to remain with the PES are effectively retention schemes. Complaints allege that such schemes are anti-competitive and in some cases breach the licence condition on discrimination.

5.1.2 *Discussion*

The introduction of innovative schemes designed to attract customers can be a positive indication of the development of the market. Suppliers need to compete to provide benefits to customers to attract and retain their business. However, where schemes are offered by dominant suppliers, particularly at the very early stages of the development of competition, other considerations apply. Such schemes may be tantamount to discriminatory offers focused on giving benefits to customers with a greater propensity to switch and/or who are particularly profitable to retain. Particularly when the price savings made available by competitors is relatively low, such schemes may have the effect of retaining specific customer groups and hampering the development of competition.

As more schemes are being offered by PESs, OFFER considers that it would be sensible to set out some general guidance on whether such schemes are likely to unduly retard the development of competition. The following issues require consideration:

- whether a dominant supplier may be showing undue preference or undue discrimination by restricting the benefits of a scheme to certain customers. Such schemes may be considered unduly discriminatory or preferential unless all categories of customers are given the opportunity to join and benefit from the scheme and the promotion and marketing of a scheme must not be directed only at particular classes or groups of customers;
- whether some schemes offered by dominant suppliers are anti-competitive as they seek to tie-in customers. An important consideration is whether the customer is free to change supplier without losing any benefits accrued up to the date of transfer. Schemes that offer a benefit or saving only if a customer continues to take a supply of electricity from the PES for a period of time, sometimes a year or more, or otherwise additionally incentivise the customer to remain with the PES may be considered by OFFER to be anti-competitive. Loss of any benefits or savings, should a customer change supplier, may effectively amount to a termination fee as defined in suppliers' licences.³
- whether any scheme involves any cross-subsidy to or from any other business of the PES or an affiliate or related undertaking. Unless the full cost of a scheme is paid for by the PES supply business it may breach the licence condition prohibiting cross subsidy between the supply business and any other business of the licensee.

Views are invited on these issues.

5.2 Change of Supplier Exit Practices

Most suppliers on notification that they are about lose a customer write to them. These letters, generally referred to as exit letters, serve a useful purpose in providing a further reminder to customers that they are about to change supplier. They can, when properly used, avoid the erroneous transfer of some customers. However, there are variations between suppliers in the content and timing of such letters.

³ A termination fee is defined in PES and second-tier supply licences as "...any sum of money or any penalty (whether financial or otherwise) which may be demanded of a customer solely in consequence of the termination of a contract to supply electricity to premises."

Some suppliers, in particular some PESs, have used the letters to encourage customers to change their minds about switching. In some cases the letters suggest that the old supplier can prevent the transfer going ahead if the customer does change their mind. In other cases, exit letters are being sent with a contract, tariff application form, or a contract cancellation form included.

Such use of exist letters is considered inappropriate. If customers believe they have been erroneously transferred, that is they have inadvertently changed supplier, the normal course of action is for them to contact their existing or old supplier which may be able to seek a cooperative objection with the 'new' supplier. It is acceptable for exit letters to indicate to customers that upon contacting the 'old' supplier they can return there after going through normal process of changing supplier.

5.3 Debt and Objection Process

Electricity suppliers' licences enable them to assign unpaid final bill debts. Suppliers can also block the transfer of customers with debt. This "objection" process imposes costs on new suppliers and may deter suppliers from offering supply to customers though likely to be in debt.

The level of objections vary considerably by PES from just over 1 per cent to nearly 12½ per cent. This may reflect differing policies by suppliers. OFFER will be reviewing the position with individual suppliers and in the Competitive Market Review Group (established by OFFER with suppliers to keep under review the development of the market in electricity).

Many disadvantaged customers in debt could benefit from lower prices if they were able to switch suppliers. Currently, a number of second tier electricity suppliers will charge an administration fee as well as recovering the debt if they take on an assigned debt. Usually, the contract states the fee will cover "reasonable administration costs". Questions about identifying and removing barriers to assigning debts are being taken forward in the context of OFFER's ongoing monitoring/review of the designated supply market. Changes here may also help over come supplier concerns about marketing to disadvantaged customer groups. Issues about this are being taken forward under the Social Action Plan.

5.4 Meter Reading and Validation

OFFER has kept under review the level of meter readings achieved by suppliers on change of supplier. The level of reading achieved is largely dependent on supplier policies in respect of collecting customer 'own-reads' and providing actual reads. The extent to which suppliers are relying on estimated readings is a matter of concern to OFFER and customer groups. At present on average about 45 per cent of meter readings on change of supplier are estimated. However, the variation amongst suppliers ranges from 1 per cent and to over 90 per cent on estimated bills.

There are a number of possible reasons including: the supplier's policy; the validation process adopted by suppliers for checking customers' own readings, and the performance of the data collector, which is used by suppliers to obtain active readings on behalf of supplier.

OFFER is discussing these issues with suppliers with a view to ensuring that these procedures are working effectively.

5.5 PES Distribution and Supply Integration

The initial stages of market opening have raised some further issues associated with the integration of PES distribution and supply functions. PESs operate the registration systems which record for supply and settlement purposes, the identity of suppliers at each premises (strictly for each metering point) and gives other data about the meter and configuration of the supply. Some suppliers have expressed concerns that information provided to the registration system is passed to the PES supply business and used for marketing purposes. OFFER has not seen any specific evidence on these matters but the selective and unauthorised passing of information would represent a serious breach of the PESs licence and contractual obligations on data confidentiality.

More generally the integration of distribution and supply functions is seen by independent suppliers as providing a significant advantage to the host PES through the integration of services - particularly in relation to meter reading and meter operations. OFFER has recently proposed wide-ranging changes to the present obligations on PESs designed to ensure the independence of the distribution businesses from supply interests. OFFER's proposals are set out in its May 1999 publication "Separation of Businesses: Proposals and Consultation".

5.6 Advertising and Price Comparisons

Over recent months, OFFER has received complaints from various sources about some suppliers' advertisements placed in local or national media. These in the main have involved claims about the advertisers prices compared to those of their rivals. In some cases, the prices or tariffs with which the advertiser's offers are being compared, relate to a more expensive payment method. When compared with a similar payment method, the savings offered may not have been so great.

Some aspects of advertising are handled by other bodies such as the Independent Television Commission, the Radio Authority and the Advertising Standards Authority (ASA). However, issues relating directly to the effects of advertising on the development of competition or abuse of a PES's dominant position, in relation to electricity, fall within OFFER's remit.

The ASA operates a self-regulatory system of advertising control, funded by the advertising industry. It promotes and enforces standards in all non-broadcast advertisements in the UK, with the aim of ensuring that the British Codes of Advertising and Sales Promotion are followed. The codes are devised by the Committee of Advertising Practice (CAP), whose members include advertising, sales promotion and media businesses. The ASA can ask an advertiser to amend or withdraw an advert. If the advertiser does not comply, the ASA can ultimately refer a misleading advertisement to the Office of Fair Trading.

In a fully competitive market, advertising of the type above could be seen simply as evidence of vigorous competition. However, in a market where there are dominant suppliers with a locally established reputation, then the effect of such adverts may have a pre-emptive or retentive effect. Although the ASA may uphold complaints against suppliers' advertising, its remit does not extend to considering the cumulative effective of a number of actions, particularly those where the strategy is one of local customer retention or national customer acquisition. This is an area where OFFER may need to take action to protect customers and competitors.

Customer groups have suggested that more work should be done to ensure the accurate and fair comparison of prices by suppliers. OFFER agrees. OFFER/Ofgas will be considering with suppliers and customers the best means of establishing clear price comparisons to be used by suppliers and others in comparing prices. The standardisation of interest rate charges and of car fuel consumption comparisons provide examples of the type of approach that might be considered.

5.7 Marketing

OFFER collects information on complaints related to marketing of electricity. These related primarily to electricity sales which involve face to face contact with customers, for example, on the doorstep, or selling over the telephone. Direct marketing of this type is seen by suppliers as the most effective way of informing customers about competition. However, doorstep selling is the method which can most alarm customers if done badly.

In the case of electricity, the number of complaints referred to OFFER has over the past seven months since September, the start of competition, has shown a steady increase. While the increase in the level of complaints does give cause for concern, it should be placed in the context of the number of customers who have been visited at home or called by telephone, which is in the magnitude of several millions. Also the increase in complaint levels must be related to the opening of the market, and the increasing numbers of customers eligible for competition. Notwithstanding this, any complaints about mis-selling give cause for concern. There have been a very small but worrying number of instances where salespeople have systematically misled customers into signing contracts. In these circumstances, OFFER has met with the suppliers concerned to ensure remedial action has taken place, but also to ensure that their systems and procedures adopted are robust and comply with the relevant licence provisions.

5.8 Dual Fuel

One of the most significant developments in the competitive market has been the emergence of dual fuel - a joint offering of both gas and electricity - from suppliers either directly or through specific alliances between gas and electricity suppliers. This is thought to have customer appeal as a more convenient way of buying fuel. Additionally, the cost savings which can be realisable because of, for example, combined administration, billing systems and, potentially meter reading, would allow lower prices to be charged to customers.

In November 1997, following representations made to them, OFFER and Ofgas published a consultation paper on dual fuel offers.⁴ This deals in particular with the position of PESs competing in the gas market before their own markets were open to competition.

⁴ 'Dual Fuel Offers in the Gas and Electricity Markets - Consultation Document', December 1997.

Principally, the consultation paper sought to address concerns raised in representations relating to:

- the domestic gas market being opened to competition before the domestic electricity market; and
- the PES monopoly in electricity meter reading services to smaller customers being maintained until 2000.

A decision document⁵ was issued in January 1998. In that document OFFER and Ofgas asked PESs (within their authorised areas) and BGT for two undertakings:

- that companies would not enter into dual fuel contracts in their own area until their supply monopoly had ended; and
- that PESs would not undertake joint reading of gas and electricity meters unless they offered the service on a non-discriminatory basis to all suppliers, until such time as the PESs' electricity meter reading monopoly is removed.

OFFER and Ofgas issued a policy statement essentially incorporating the two undertakings which had been asked for previously by both organisations.

At present, British Gas is by far the largest competitor in the domestic electricity market. It holds in excess of 50 per cent of switchers. Some PESs have expressed concern that competition from British Gas may be unfair because of its national customer base. Some have expressed concern that it may be cross-subsidising its prices in the electricity market as a means of retaining customers in the gas market. Ofgas has been reviewing BGT's dual fuel prices. Similar concerns about anti-competitive behaviour have been expressed about PESs in relation to their pricing and policies in the gas market.

The position of the PESs in the gas market is also significant. Table 27 summarises the market shares of competitors in the domestic gas market.

⁵ 'Dual Fuel Offers in the Gas and Electricity Markets - An OFFER and Ofgas Joint Decision Document, January 1998.

Table 27: Domestic Gas Customers as of May 1999

	% Switchers	No of domestic customers (000s)	% of customers
BGT	-	15,700	76
PES Affiliates	82	4,228	20
Others	18	853	4
Total	100	20,781	100

OFFER/Ofgas will be reviewing the position further to consider whether any supplier is abusing its dominant position in one market and distorting the development of competition through actions in another linked market.

5.9 Summary of Issues

The introduction of competition has just been completed. Over the past eight months significant changes have been experienced by both customers and suppliers alike. Nonetheless, both appear to have adapted to these changes. The prospects, therefore, for competition appear to be good. They could be further enhanced by suppliers making customers more aware of the offers available in a manner that does not confuse customers.

Against this, however, are a number of concerns which may militate against competition developing as quickly as OFFER would wish. In particular, the widespread introduction by PESs of special schemes may distort the development of the market. Dual fuel offers also need to be considered given their increasing significance in the market. Practical issues associated with meter reading and registration processes need to be addressed. The separation of PES distribution and supply activities and the reform of legislation have a particularly important impact.

Views are invited on:

- whether any further changes to PES or second tier licences are required to deal with the potential impediments to competition identified in this chapter;
- whether other issues are impeding the development of competition that require action by the regulator.

APPENDIX 1: General Duties of Secretary of State and Director

- (1) The Secretary of State and the Director shall each have a duty to exercise the functions assigned or transferred to him by this Part in the manner which he considers is best calculated:
 - a) to secure that all reasonable demands for electricity are satisfied;
 - b) to secure that licence holders are able to finance the carrying on of the activities which they are authorised by their licences to carry on; and
 - c) subject to subsection (2) below, to promote competition in the generation and supply of electricity.

- (2) The Secretary of State and the Director shall each have a duty to exercise the functions assigned or transferred to him by this Part in the manner in which he considers is best calculated to secure:
 - a) that the prices charged to tariff customers by public electricity suppliers for electricity supplied in pursuance of section 16(1) below to premises in any area of Scotland specified in an order made by the Secretary of State are in accordance with tariffs which do not distinguish (whether directly or indirectly) between different parts of that area; and
 - b) that public electricity suppliers are not thereby disadvantaged in competing with persons authorised by a licence or exemption to supply electricity to such premises.

- (3) Subject to subsections (1) and (2) above, the Secretary of State and the Director shall each have a duty to exercise the functions assigned or transferred to him by this Part in the manner which he considers is best calculated:
 - a) to protect the interests of consumers of electricity supplied by persons authorised by licences to supply electricity in respect of:
 - i) the prices charged and the other terms of supply;
 - ii) the continuity of supply; and
 - iii) the quality of the electricity supply services provided.
 - b) to promote efficiency and economy on the part of persons authorised by licences to supply or transmit electricity and the efficient use of electricity supplied to consumers;
 - c) to promote research into, and the development and use of, new techniques by or on behalf of persons authorised by a licence to generate, transmit or supply electricity;
 - d) to protect the public from dangers arising from the generation, transmission or supply of electricity; and
 - e) to secure the establishment and maintenance of machinery for promoting the health and safety of persons employed in the generation, transmission or supply of electricity.

and a duty to take into account, in exercising those functions, the effect on the physical environment of activities connected with the generation, transmission or supply of electricity.

- (4) In performing his duty under subsection (3) (a) (i) above, the Secretary of State or the Director shall take into account, in particular, the protection of the interests of consumers of electricity in rural areas.
- (5) In performing his duty under subsection (3) (a) (iii) above, the Secretary of State or the Director shall take into account, in particular, the protection of the interests of those who are disabled or of pensionable age.
- (6) In this section references to the functions assigned to the Secretary of State by this Part do not include references to functions under section 36 or 37 below and references to the functions so assigned to the Director do not include references to functions relating to the determination of disputes.
- (7) In this Part, unless the context otherwise requires:

“exemption”

means an exemption under section 5 below;

licence”

means a licence under section 7 below and “licence holder” shall be construed accordingly.

APPENDIX 2: Supplier Licence Condition. Prohibition of discrimination in supply

- (1) This Condition applies where the Licensee is in a dominant position in a market for the supply of electricity to customers at premises.
- (2) Where this Condition applies the Licensee shall not supply or offer to supply electricity to customers in any market in which it is dominant on terms which are predatory.
- (3) Where this Condition applies, but subject to paragraph 4, the Licensee (taken together with its affiliates and related undertakings) shall not, in supplying or offering terms for the supply of electricity to customers in any market in which it is dominant:
 - a) show undue preference to any person (or class of persons) within such market;
 - b) exercise undue discrimination between any persons (or classes of person) within such market; or
 - c) set terms which are unduly onerous.
- (4) Nothing in paragraph 3 shall prohibit the Licensee, within any area or class of customers (the "relevant area or class") in respect of which there is established competition in the supply of electricity, from supplying or offering to supply electricity on terms which are reasonably necessary to meet that competition, save that the Licensee (taken together with its affiliates and related undertakings) shall not, in supplying or offering terms for the supply of electricity:
 - a) show undue preference to any person (or class of persons) or exercise undue discrimination between any persons (or classes of person) within the relevant area or class of customers; or
 - b) set terms in respect of any person (or class of persons) in a market in which the Licensee is dominant, save such persons who are within the relevant area or class of customers, which are unduly onerous.
- (5) For the purposes of this Condition, terms are unduly onerous if the revenue from the supply of electricity to customers on those terms:
 - a) significantly exceeds the costs of that supply; and
 - b) exceeds such costs to a significantly greater degree than the revenue from supply to all other customers of the Licensee (and of its affiliates and related undertakings) within the same market exceeds the costs of supply to those customers.
- (6) For the purposes of this Condition, a market may be defined by reference to a geographical area, or to a class of customer or both, save that no market defined by reference to Designated Customers shall comprise fewer than 50,000 such customers.
- (7) In determining, for the purposes of this Condition, whether any persons constitute a class of person, due regard shall be had to the circumstances of supply to such persons including (without limitation) volumes, load factors, conditions of interruptibility, location of premises being supplied and date and duration of the supply contract.

- (8) For the purposes of this Condition, the Director shall determine any question as to:
- a) whether any area or class of customers constitutes a market for the supply of electricity;
 - b) whether the Licensee is dominant in any market for the supply of electricity;
 - c) whether there is established competition in respect of the supply of electricity in any area or to any class of customers; and
 - d) whether any terms are predatory, having due regard to whether such terms:
 - i) incorporate charges which do not reasonably cover the avoidable costs incurred in consequence of supplying the customers in question; and
 - ii) are intended or are likely to restrict, distort or prevent competition in the supply of electricity.
- (9) The Director may determine that the Licensee is dominant in a specified market:
- a) at any time prior to this Condition coming into force; or
 - b) having first consulted with the Licensee and such other persons as he considers appropriate (and having taken into account any representations made to him), at any time after this Condition has come into force,
- and where the Director does make such a determination he shall immediately notify the Licensee.
- (10) Where the Director has notified the Licensee of his determination in accordance with paragraph 9 that it is dominant in a specified market, the provisions of paragraphs 11 to 16 shall apply in respect of that market.
- (11) Where this paragraph applies the Licensee shall, prior to supplying or offering to supply electricity under a tariff or Designated Supply Contract on any new terms, give to the Director at least 28 days' notice in writing of its intention to supply on such terms.
- (12) For the purposes of this Condition, a tariff or Designated Supply Contract is on "new terms" if:
- a) it is a form of tariff or Designated Supply Contract under which the Licensee has not previously supplied or offered to supply electricity;
 - b) it is a tariff or Designated Supply Contract in respect of which the Licensee is varying the terms as to price; or
 - c) it is a tariff or Designated Supply Contract in respect of which the Licensee is varying any other terms in such a manner as to significantly affect the evaluation of that tariff or contract.
- (13) Where the Licensee has given notice to the Director of its intention to supply on new terms it shall not supply or offer to supply electricity on such terms until either the period of notice given to the Director has expired and:

- a) the Director has not given or sent to the Licensee a counter-notice (the “counter-notice”) in accordance with paragraph 14; or
 - b) prior to the expiry of such period, the Director has informed the Licensee that he will not issue a counter-notice in respect of such terms.
- (14) The Director may issue a counter-notice where, having considered the new terms and having had regard to the likely effects of issuing such counter-notice (including, but not limited to, the likely effect upon the business of the Licensee), he determines that further consideration is required to assess whether such terms are in breach of the provisions of this Condition.
- (15) Where the Director issues a counter-notice in respect of any new terms the Licensee shall not supply or offer to supply electricity on such terms until either:
- a) a period of 3 months from the date of the counter-notice has expired; or
 - b) prior to the expiry of such period, the Director indicates to the Licensee that he has no present intention of taking enforcement action under Section 25 of the Act in respect of such terms.
- (16) Where the Director issues a counter-notice he may:
- a) give or send a copy of that counter-notice to any Interested Person;
 - b) invite representations from Interested Persons as to the matters to which the counter-notice relates; and
 - c) require the Licensee, within a reasonable period determined by the Director, to provide him with such further information relating to the new terms as he may specify (save that he may not by virtue of this paragraph require the Licensee to furnish him with information for the purpose of exercising his functions under Section 48 of the Act),

and the Director shall take into account any representations made to him by the Licensee in respect of such terms.

- (17) The Director may, at any time after notifying the Licensee of his determination in accordance with paragraph 9 that it is dominant in a specified market, determine that the Licensee is no longer dominant in that market, and where he does make such a determination:
- a) the Director shall immediately notify the Licensee; and
 - b) the provisions of paragraphs 11 to 16 shall cease to apply in respect of the specified market.
- (18) For the purposes of this Condition, any reference to the Licensee being dominant in a market for the supply of electricity shall be treated as a reference to the Licensee, taken together with its affiliates and related undertakings, being so dominant.
- (19) In this Condition:

“Interested Persons”

means all Electricity Suppliers which supply electricity within the market or area or to the class of customers in question, the Relevant Consumers’ Committee and such other persons or bodies as in the opinion of the Director have a legitimate interest in the terms on which the Licensee supplies electricity.

“terms”

means all the terms on which a supply of electricity is offered or provided which significantly affect the evaluation of that supply, and shall include all terms as to price.

APPENDIX 3 Market Research Methodology

'Electricity Competition Review', a Research Study Conducted for OFFER by MORI (forthcoming publication)

A total of 1,212 interviews was conducted with domestic electricity customers in those areas opened up to competition by the end of December 1998. Interviews were conducted with the person wholly or jointly responsible for paying the household's electricity bill and who would make the decision to change supplier, either on their own or in consultation with another household member. The proportion of 'switchers' and customers in the E social class were boosted to allow for their separate analysis.

To ensure that the results are representative of customers in the areas selected, the data were weighted to the known profile of households by age, social class and working status of head of household, as well as by the Mosaic life code of those Enumeration Districts (EDs) in the areas opened up to competition, and the percentage of switchers understood to be in these areas at the time of fieldwork - that is, 5 per cent. Data entry and analysis were carried out by Independent Data Analysis.

All interviews were conducted face-to-face, in-home, between 6 February and 15 March 1999. Fieldwork was carried out by MORI/Field & Tab. Interviewers were provided with a list of addresses within each sampling point (ED). They were instructed to leave at least three doors between each call. Half the interviews conducted by each interviewer were carried out in the evenings or at the weekend.

'Gas Competition Review', MORI, November 1998

'Customer Characteristics by Payment Method', Research Study Conducted for Ofgas by MORI, December 1998

National Quantitative Research, July/August 1998: 2,511 in-house, face-to-face interviews with household gas bill payers, including 803 interviews with switchers and 691 interviews with Scottish households, both of whose numbers were boosted to allow for separate analysis. Similarly, the proportion of "lower income" Enumeration Districts in the sample were boosted so as to provide a more robust sample of lower income groups for separate analysis. Data were grouped by postcode into gas competition areas using postcode lists supplied by Ofgas. Final data were weighted to reflect the known profile of gas customers in England and Wales, and Scotland, by work status, age, social group and switchers vs non-switchers. Fieldwork was carried out by MORI/Field & Tab between 11 July and 16 August 1998

APPENDIX 4: Suppliers licensed to supply into the Designated Market

<u>Name of Licensee</u>	<u>Areas licensed to Supply</u>
British Gas Trading	England & Wales, Scotland
Eastern Energy	England & Wales, Scotland
East Midlands	England & Wales, Scotland
Enron Direct Limited	England & Wales, Scotland
Imperial Power plc *	England & Wales
Independent Energy UK Ltd.	England & Wales, Scotland
London Electricity	England & Wales, Scotland
Manweb	England & Wales, Scotland
MEB	England & Wales, Scotland
Northern Electric	England & Wales, Scotland
Norweb	England & Wales, Scotland
Scottish & Southern Energy plc	England & Wales, Scotland
ScottishPower	England & Wales, Scotland
Seeboard	England & Wales, Scotland
Southern Electric	England & Wales, Scotland
SWALEC	England & Wales, Scotland
SWEB	England & Wales
WRE Limited *	England & Wales
Yorkshire Electricity	England & Wales, Scotland

*At present going through market testing process. While therefore licensed, as yet unable to provide a supply of electricity to designated customers .

Note: The list includes only those suppliers which have issued a Designated Supply Notice as required by PES and Second Tier licences. It therefore excludes both National Power and PowerGen.

APPENDIX 5: Range of Annual Bills by PES Area as at 31 March 1999

		PES Area														
Payment Method		East Midlands Electricity £	Eastern £	London £	MANWEB £	Midlands £	Northern £	NORWEB £	Scottish Hydro £	Scottish Power £	SEEBOARD £	Southern £	SWALEC £	SWEB £	Yorkshire £	Average
Direct Debit	In Area Bills	244	245	247	270	245	268	248	272	267	243	248	283	266	242	256
Quarterly Credit		254	251	257	278	253	276	256	278	276	251	255	290	274	255	265
Prepayment Meter		276	263	268	294	263	293	274	278	290	263	269	317	286	280	279
	Second Tier Bills															
Direct Debit	Average of Typical Annual Bill	238	229	244	258	237	249	242	252	259	233	241	277	261	234	247
	Max of Typical Annual Bill	251	244	251	269	253	257	250	270	272	241	248	287	271	244	287
	Min of Typical Annual Bill	224	218	226	244	220	240	226	229	240	222	224	257	246	218	218
	Best saving available	20	27	21	27	25	29	22	43	28	21	25	26	20	24	25
	% Saving	8%	12%	8%	10%	11%	11%	9%	17%	11%	9%	10%	9%	8%	10%	10.89%
	Range of Competitors Annual Bills	28	26	25	26	33	17	24	42	32	19	25	30	24	26	27
	Number of Suppliers offering savings	13	15	10	16	15	16	14	12	12	16	15	13	14	13	14

Quarterly Credit	Average of Typical Annual Bill	247	238	253	267	246	258	252	262	268	242	250	287	271	244	256
	Max of Typical Annual Bill	266	259	263	280	265	267	258	281	287	248	256	298	279	255	298
	Min of Typical Annual Bill	231	226	237	251	230	246	234	240	249	222	231	265	258	229	222
	Best saving available	23	25	20	27	23	31	23	37	27	29	24	25	17	25	25
	% Saving	9%	11%	8%	10%	9%	12%	9%	14%	10%	12%	9%	9%	6%	10%	9.93%
	Range of Competitors Annual Bills	35	33	25	29	35	22	24	41	37	26	25	33	21	25	29
	Number of Suppliers offering savings	13	14	11	14	13	15	11	10	11	16	11	12	13	16	13
Prepayment Meter	Average of Typical Annual Bill	300	275	284	309	283	301	292	300	311	281	290	329	302	294	296
	Max of Typical Annual Bill	358	337	344	380	349	344	370	416	344	344	344	363	370	344	416
	Min of Typical Annual Bill	265	243	262	276	246	262	265	255	276	235	263	276	272	270	235
	Best saving available	12	20	6	18	17	31	9	22	14	28	5	40	14	9	17
	% Saving	4%	7%	2%	6%	6%	10%	3%	7%	4%	10%	2%	12%	5%	3%	5.89%
	Range of Competitors Annual Bills	93	93	82	104	104	82	105	160	68	109	81	87	98	73	96
	Number of Suppliers offering savings	3	5	2	3	5	4	2	4	4	3	2	3	7	6	4