



Review of British Gas Trading's Price Regulation: Licence Modification and Invitation to a Workshop on the Assessment of the Development of Competition in the Domestic Gas and Electricity Markets

Enclosed is Ofgem's *Review of British Gas Trading's (BGT) Price Regulation: Licence Modification*. This document implements the licence modification to BGT's Gas Suppliers' Licence, which puts into effect BGT's supply price control from 1 April 2000. The document discusses:

- the responses to the Final Proposals¹;
- the prices that BGT are charging its domestic customers from 1 April 2000; and
- the work that Ofgem will undertake over the next nine months to determine whether the remaining price controls on BGT's prices can be removed from 1 April 2001.

As explained in this document, over the next year, Ofgem will review the price regulation that should apply to BGT's domestic gas prices from 1 April 2001. To commence this review we are holding a workshop on Tuesday 20 June 2000, at Ofgem's Stockley House office, to discuss the factors we should consider when assessing the development of competition in the gas and electricity supply markets.

This review of competition will inform Ofgem's decision about the regulation of BGT's domestic gas prices from 1 April 2001, and in particular, whether Ofgem removes all price control regulation from BGT's domestic gas prices from 1 April 2001. Ofgem will be assessing the development of competition in both the domestic gas and electricity markets as part of this review. This recognises the increasing interactions between the two markets, e.g. 'dual fuel' supply offers, which Ofgem found in its 1999 review of the domestic gas supply market.²

At the workshop, Ofgem will:

- explain the timetable for its review of BGT's supply price control and its assessment of the development of competition in the gas and electricity supply markets. In particular, we will explain when in the review attendees will have a

¹ "Review of British Gas Trading's Price Regulation, Final Proposals", Ofgem, February 2000.

² "A Review of the Development of Competition in the Domestic Gas Market", Ofgem, December 1999.

formal opportunity to provide comments (Ofgem's price control work programme is shown on page 53 of the enclosed document);

- explain the main aspects of BGT's current gas supply price control (BGT's current prices and an analysis of customers bills are discussed in Chapter 3 of the enclosed document);
- explain the approach Ofgem adopted for its 1999 review of competition in the domestic gas supply market and the main conclusions of this review (see attachment 1 to this letter); and
- seek views on the factors Ofgem intends to consider when assessing the development of competition in the domestic gas and electricity supply markets during this review.

Ofgem will include a summary of the views expressed at the workshop and in response to the enclosed document, in its July 1999 survey, which will seek information from shippers, suppliers and customer representatives for its domestic gas and electricity supply competitive market reviews.

All gas and electricity suppliers, gas shippers, customer representatives (including the GCC and the electricity consumers committees), other utility regulators, the Office of Fair Trading and the Department of Trade and Industry have been invited to the workshop. Ofgem would like as many representatives of those organisations as possible to attend the workshop. If you, or another representative of your organisation would like to attend the workshop, please contact Kiera Bower (020 7932 6362 or email: kiera.bower@ofgem.gov.uk) by 16 June 2000 to confirm your attendance. If you have any questions about the issues to be covered in the workshop please contact either Bethan Carver (020 7932 6382 or email: bethan.carver@ofgem.gov.uk) or Giles Stevens (020 7932 1681 or email: giles.stevens@ofgem.gov.uk) who will be pleased to help.

Yours sincerely

Nick Fincham
Director, Competition

Attachment 1: 1999 Review of the Competitive Domestic Gas Supply Market

Ofgem's Approach to Assessing the Development of Gas Supply Competition in its 1999 Competitive Market Review

The action needed to secure effective competition in gas supply and to protect customers' interests in respect of BGT's prices and service in the domestic gas supply market depends on the extent to which competition can be relied on to protect customers' interests in terms of price and the quality and variety of service on offer.

Although customers have been able to choose a gas supplier other than BGT since the market opened in phases between April 1996 and May 1998, the removal of BGT's statutory monopoly does not in itself necessarily provide sufficient protection for customers. Ofgem believes that customers' interests will generally be best protected by effective competition, which is characterised by much more than just the absence of a statutory monopoly.

There are a number of important conditions for effective competition, including that:

- all customers in the market can attract and are aware of a range of competitive offers, whatever their status, location and levels of consumption;
- the abuse of market power is prevented; and
- the operation of competition is actually promoting innovation in the market and improved economic efficiency.

These conditions are inter-related, and underlying them is the fundamental requirement that a competitor should seek to offer better value to a customer than its rivals. Abuse of market power may be one of the factors that prevent this happening. Hence, it is important that such abuse is prevented. If there is effective competition, over time, competition can be expected to lead to innovation – since successful innovation will be properly rewarded – and to improved economic efficiency.

Where competition is well developed the enforcement of the non-discrimination provisions in the gas suppliers' licence (which in practice, only apply to dominant suppliers) and general competition law should provide sufficient safeguards for customers in the gas supply market, thereby removing the need for specific regulation under the Gas Act 1986 of BGT's prices and level of service.

As the development of competition is a dynamic process, characterised by constantly changing structures, behaviour and performance, the development of competition cannot be clearly measured against a simple set of indicators (e.g. market shares). It is important to consider the functioning of the domestic gas supply market in its entirety. The functioning of the market depends upon the combined effects of the actions of the incumbent, competitors and customers, as well as upon the structural conditions in which they all operate.

It is understandable that an incumbent will seek to defend its market position by responding to competition in a number of ways. Even when the incumbent is dominant, some responses will be in line with the general cut and thrust of everyday business (under competition law, dominant firms are not prohibited from competing). However, some responses may amount to the abuse of market power, since they may have the effect of pre-empting or forestalling the development of competition. To the extent that the incumbent maintains substantial market power, regulatory controls may be required to limit the range of moves open to the incumbent when responding to the development of competition, although whether such controls should extend beyond those associated with standard competition law will depend upon on the extent and the nature of the market power concerned, as well as the prevailing market conditions.

Competitors will seek to attack an incumbent's market position in a range of ways, which may reveal important evidence about the development of competition. For example, in the industrial and commercial gas supply market, the extent to which customers, in aggregate, are attracted to a new supplier appears to reduce as consumption and billing levels get smaller³, indicating that competitors appear more able to target price cuts and service levels to meet the individual needs of customers with larger bills. However, whether this is due to factors that impede the development of competition for smaller accounts, or to prices being closer to competitive levels of costs for smaller customers, is a matter for determination in the relevant circumstances.

In the domestic gas supply market, a range of customer acquisition techniques have been tried, including the offering of lower prices and the offering of complementary products through a variety of selling methods including general advertising, mail shots and doorstep selling. Taken together, these are the means by which customers are stimulated to consider competing offers in the context of their present bills. However, there may be a group of customers who are not receiving or are unreceptive to such marketing techniques or who are receptive to the retention techniques used by the incumbent, who will remain as customers of the incumbent supplier. If the incumbent is able to identify and segment such customers, they may be vulnerable to adverse incumbent behaviour, such as creeping relative price rises, inconspicuous in themselves, but cumulatively important. As competitors continue to refine their marketing tactics it may be expected that more of the customers currently protected by price controls will respond to competitive offers.

Bearing in mind the dynamic nature of competition, Ofgem considered the following indicators of the development of competition:

- customers' awareness of the opportunity to choose an alternative supplier and the range of competing offers;

- suppliers' behaviour, including entry and exit;

³ "1997 Competitive Market Review, Part 1: Above 2,500 therms a year", Ofgas, May 1998.

- suppliers' performance, in particular suppliers' market shares;
- customers' behaviour, including switching suppliers and tariffs/ payment methods;
- the range of price and related offers available from new entrants, including 'dual fuel';
- potential barriers to the development of competition, including BGT's behaviour and the general operation of the market; and
- the ability of entrants to enter the gas supply market, by considering their potential 'head room'.

To inform better Ofgem as to whether, and for which groups of customers, price regulation on BGT may remain relevant, the review paid particular attention to whether competition was developing at different speeds for different groups of customers. There is a wide range of possible groupings of customers that could be considered. However, the actions of suppliers and customers provides some indication of how customers could most appropriately be grouped for this purpose.

The way Ofgem asked for information in its survey, gave an indication as to the possible ways in which customers could be categorised, based on suppliers' and customers' activities. These categories also took account of how the scope of price control regulation could in practice be reduced⁴. Ofgem classified customers using the following characteristics:

- tariffs and payment methods;
- volumes consumed;
- where they live, further analysing this into PES areas or the areas of domestic gas competition rollout phases and tranches;
- whether they are supplied gas and electricity by the same supplier (“dual fuel”); and
- whether they have a debt with their supplier which would allow the supplier to block their transfer to another supplier using the provisions of Standard Condition 7(4) of the gas suppliers’ licence.

The quality of information available to look at all these splits varied.

The Conclusions of Ofgem’s 1999 Domestic Gas Competitive Market Review

Customer Awareness

Ofgem was encouraged by the high level of awareness amongst customers of their ability to choose an alternative gas supplier. The number of gas customers stating that they intend to switch supplier over the next year was similar to the numbers who stated they would switch in the 1998 MORI survey and suggests a continuation of current switching trends of about 32,000 per week.

Ofgem remained concerned that the social compliance statements provided by gas suppliers provide little indication of the quality of the services provided by suppliers and is considering

⁴ Price control regulation can only be removed from or retained for a group or groups of customers that can be readily identified and distinguished from other customers.

how the reporting requirements could be changed to provide better information about the standards of service customers are receiving.

Entry and Exit

There were 26 suppliers including BGT in the domestic gas supply market. Of these suppliers, 13 were also licensed domestic electricity suppliers and able to make 'dual fuel' offers.

Market Share

BGT supplied about 73% of the customers in the domestic gas market in Great Britain. There was evidence to suggest that BGT had lost more customers consuming higher volumes than those consuming lower volumes.

By payment method, BGT supplied 70% of direct debit customers, 80% of other credit customers, and 94% of prepayment customers.

Ofgem estimated that about 3 million of the 5 million customers who have switched from BGT to another gas supplier are supplied on 'dual fuel' deals. A further 1.6 million customers who have switched from their local PES to another electricity supplier were also supplied on 'dual fuel' deals.

Based on returns from the 1999 Domestic Gas Market Survey, Ofgem estimated that around 70% of PrePayment and 35% of Standard customers were unable to switch supplier because they had a level of debt that allowed their supplier (usually BGT) to block their transfer to another supplier under Standard Condition 7(4) of the gas suppliers' licence.

Customer Switching

Switching levels during the year averaged about 32,000 per week. From December 1998, once the initial impact of the roll-out of competition had subsided, the switching rate had remained broadly constant. There was also evidence that some customers had switched more than once.

Some customers appeared to be switching payment methods, although overall the percentage of customers paying by direct debit had not been significantly affected, while the number of customers paying by prepayment meters continued to increase as the number paying by standard credit reduced.

Overall, the level of customer activity, either by switching gas supplier or payment method suggested that competition was allowing some customers to make choices about suppliers and payment method in the competitive market.

Price and Related Offers

A lot of gas customers were able to obtain a range of competitive offers. However, the picture varied depending on the customers payment method:

- Direct Debit customers were able to make a significant saving when transferring from BGT to any of its 25 competitors (up to 10%);

- Quarterly credit customers (including PromptPay customers) could benefit from a range of competitive price offers, with discounts of up to 20% available. However, customers paying by a frequent payment method⁵ had a limited range of competitive offers to choose from, with some suppliers not offering a frequent payment method; and

⁵ This includes customers who pay their bill in weekly, fortnightly or monthly instalments, but do not use a direct debit.

- prepayment customers encountered a limited range of competitive offers. It was possible, at certain volume levels, for domestic prepayment customers who switch from BGT (and wish to retain their prepayment meter) to obtain a discount. However, at average prepayment consumption levels (i.e. 480 therms) BGT's prepayment offer was the most competitive in terms of price. In addition, some of the complementary products offered by suppliers were not available to prepayment customers.

Assessment of Available 'Head Room'

Ofgem considered the position of a potential entrant deciding whether or not to enter the domestic gas supply market. Ofgem's analysis considered the position of a supplier entering the market to provide gas and electricity, and gas only, assuming the price cap proposals for BGT took effect from 1 April 2000, which they broadly did.

The analysis suggested that the price cap proposals left substantial head room for entrants supplying both gas and electricity. On the basis of the assumptions, new entrants could offer discounts for prompt pay, standard and prepayment of between 10 and 20%. There was less head room available to suppliers entering the gas supply market only. However, based on the assumptions, it was possible for such new entrants to offer discounts to prompt pay, standard and prepayment customers in the order of 2 to 10%.

Barriers to Entry

Ofgem continued to monitor BGT's behaviour in the domestic gas supply market to ensure that it did not pre-empt the development of effective competition in an anti-competitive manner. Ofgem will consider any evidence of BGT abusing its dominant position and decide whether to take action under the Gas Act 1986 or the Competition Act 1998, if appropriate.

Ofgem was concerned that suppliers' right to object to transfers on the grounds of debt under Standard Condition 7(4) of the gas suppliers' licence and suppliers' perceptions about future

levels of Transco's prepayment meter charges were significant barriers to the development of competition for prepayment customers.

Bearing in mind the evidence from the review of increasing interactions between the gas and electricity markets and the evidence that suppliers need to be able to offer 'dual fuel' to compete effectively in the domestic gas supply market, Ofgem was particularly concerned by the number and size of the barriers to entry in the electricity supply market.

Overall Conclusions

Overall, Ofgem believed that competition in the gas supply market was developing well. 96% of customers were aware of their ability to choose an alternative gas supplier, 25% of customers had switched gas supplier, the level of customer switching was continuing at about 32,000 per week, the number of rival suppliers to BGT was well in excess of that required for competition, most customers were able to obtain competitive offers, with discounts of up to 20% compared to BGT's tariffs available.

Increasingly the gas and electricity supply markets were being characterised by 'dual fuel' offers, with almost half of electricity and gas switchers supplied on 'dual fuel' contracts. Ofgem remained concerned about the barriers to entry in the electricity supply market, many of which it planned to address over the next eighteen months.

June 2000

Review of British Gas Trading's Price Regulation

Licence Modification

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Executive Summary

In February 2000, Ofgem published its Final Proposals for its review of the prices that British Gas Trading (BGT) could charge to domestic gas customers from 1 April 2000. This document sets out responses to these proposals and Ofgem's conclusions. These conclusions are embodied in the attached modification to BGT's Special Licence Condition (Appendix 1). This modification has been agreed with BGT.

Scope

Ofgem has concluded that BGT's Direct Debit customers (about 5 million customers) should be removed from the scope of revised price controls as competition is sufficiently developed for these customers. Ofgem has concluded that revised tariff caps should apply to BGT's customers paying on PromptPay, Standard and PrePayment tariffs (about 9 million customers) as competition is not yet sufficiently developed to protect these customers' interests.

Duration

Ofgem intends that revised tariff caps last for one year only. Subject to satisfactory progress in removing barriers to entry, it remains Ofgem's firm intention to remove the price controls in respect of BGT's PromptPay, Standard and PrePayment customers from 1 April 2001.

Level

Ofgem has concluded that the remaining tariff caps should be set at a level that implies a cut in BGT's revenue from price control customers in 2000/01 of about 4.5% or about £12 per customer. In setting the level of the tariff caps Ofgem has sought to ensure that they do not act to discourage competitors and potential competitors.

BGT's removal of standing charges

BGT has replaced its existing tariff structure of a standing charge and a unit charge with a structure that has no standing charge and a two tier unit charge.

Ofgem has concluded that BGT's revised tariff structure does not breach the provisions of BGT's Gas Suppliers' Licence, in particular Standard Condition 13, which prohibits a dominant supplier from setting terms that are unduly discriminatory, unduly preferential, onerous or predatory.

BGT's revised prices

On 22 March 2000, BGT announced its revised prices for domestic gas customers to apply from 1 April 2000. PromptPay customers at average consumption have seen reductions in their annual bill in 2000/01 of 3.1% or about £8. Standard and PrePayment customers, at average consumption, have seen reductions in their annual bills in 2000/01 of 3.6% or about £10. Customers at lower volumes¹ will benefit from the largest reductions in their annual bills. The overall reduction in revenue from price controlled customers is 4.5% or £12 per customer. These revised prices are consistent with Ofgem's conclusions for the level of the revised tariff caps to apply to BGT's PromptPay, Standard and PrePayment tariffs.

BGT has also announced revised prices for its non-price controlled tariffs, Direct Debit and Advance Pay. Direct Debit and Advance Pay domestic gas customers, at average consumption, can expect to see reductions in their annual bills of 1% or about £3.

¹ Less than 4,572 kWh a year.

1. Introduction

Purpose of this document

1.1 The purpose of this document is to set out Ofgem's conclusions to its review of the prices that BGT can charge its domestic gas customers from 1 April 2000. It takes into account responses to Ofgem's Final Proposals for BGT's price control review published in February 2000.² Ofgem's conclusions are embodied in the modification to Special Conditions 3 and 4 of BGT's Suppliers Licence (attached as Appendix 1). This has been agreed with BGT. This document also summarises the work that Ofgem will undertake over the next twelve months to determine whether the remaining price controls on BGT's prices can be removed from 1 April 2001.

Background

1.2 Ofgem's Final Proposals included:

- ◆ removing BGT's Direct Debit customers from the scope of price controls;
- ◆ setting revised price controls for BGT's PromptPay, Standard and PrePayment customers for a further one year, with a firm intention to remove these price controls after 1 April 2001;
- ◆ reducing BGT's allowed revenue from its remaining price controlled customers by 4.5%; and
- ◆ allowing BGT to replace its current tariff structure of a standing charge and commodity charge with a tariff structure that has a two-tier commodity charge and no standing charge.

1.3 Ofgem received ten responses to its Final Proposals, including one from BGT,

² "Review of British Gas Trading's Price Regulation: Final Proposals", Ofgem, February 2000.

five from other suppliers, three from customer groups and one from an energy efficiency organisation. Non-confidential responses are placed in Ofgem's library.

Structure of this document

- 1.4 Chapter 2 summarises the responses to Ofgem's Final Proposals and sets out Ofgem's conclusions. Chapter 3 sets out BGT's revised prices for its domestic customers. Chapter 4 explains the work Ofgem intends to undertake over the next year to assess whether the remaining price controls can be removed from 1 April 2001.

Contact details

- 1.5 Ofgem seeks comments on its work programme to review BGT's price control over the coming year. If you would like to express a view it would be helpful to receive comments by 30 June 2000. Responses should be addressed to:

Nick Fincham
Director, Competition
Office of Gas and Electricity Markets
Stockley House
130 Wilton Road
London SW1V 1LQ

- 1.6 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 Ofgem's library.
- 1.7 If you would like to discuss any of the issues raised in this document, please contact Colin Garland on 020-7932-1671 (or e-mail: colin.garland@ofgem.gov.uk) or Bethan Carver on 020-7932-6382 (or e-mail: bethan.carver@ofgem.gov.uk) who will be pleased to help.

2. Respondents' Views to the Final Proposals and Ofgem's Conclusions

Introduction

2.1 This chapter summarises responses to the Final Proposals document and sets out Ofgem's conclusions for the regulation of BGT's prices to domestic gas supply customers from 1 April 2000. This chapter is structured in line with the main elements of Ofgem's Final Proposals. These were:

- ◆ assessment of the development of competition;
- ◆ scope of revised controls;
- ◆ duration of revised controls;
- ◆ level of revised controls; and
- ◆ BGT's proposal to remove standing charges.

2.2 This chapter also discusses a number of other issues that were raised by respondents to the Final Proposals.

Assessment of the development of competition

Ofgem's Final Proposals

2.3 Ofgem's Final Proposals for the scope, duration and level of revised tariff caps for BGT were largely informed by an assessment of the development of competition. Ofgem's Final Proposals considered responses to Ofgem's Review of the Development of Competition in December 1999³ and responses to Ofgem's Initial Proposals for BGT's price regulation.⁴

³ "A Review of the Development of Competition in the Domestic Gas Market", Ofgem, December 1999.

⁴ "Review of British Gas Trading's Price Regulation: Initial Proposals", Ofgem, November 1999.

2.4 Overall, Ofgem believed that competition in the domestic gas supply market was developing well. A range of evidence supported this view including:

- ◆ 96% of customers being aware of their ability to choose an alternative supplier;
- ◆ over 25% of customers having switched gas supplier, with the level of customer switching running at about 32,000 per week;
- ◆ the existence of a significant number of rival suppliers to BGT and continuing innovations in terms of price, service and related offers by these competitors; and
- ◆ most customers' ability to obtain competitive offers, with discounts of up to 20% available to some customers.

2.5 Ofgem found that competition was developing more rapidly for Direct Debit customers than any other payment method. Direct Debit customers were able to obtain a range of competitive offers from BGT's rivals, with discounts of over 10% available. BGT's market share for Direct Debit customers was about 70%, showing that a significant proportion of Direct Debit customers had taken advantage of competitive offers. Direct Debit customers were also able to take advantage of a range of complementary products offered by gas suppliers.

2.6 BGT's market share loss for customers paying by PromptPay, Standard and PrePayment was less than for Direct Debit. The majority of PrePayment customers and some Standard customers were prevented from switching to another supplier because they had outstanding debt and therefore BGT could object to their transfer under Condition 7(4) of the Gas Suppliers' Licence.

2.7 Ofgem said that BGT, as the incumbent gas supplier, might seek to circumscribe competitors' success before competition was effective. Such moves could be pre-emptive or could be aimed at ongoing competition. Ofgem had to consider whether any such moves would be contrary to the relevant provisions of the Gas Act 1986, the Gas Suppliers' Licence, or general competition law. In deciding

whether and how to use its powers, Ofgem had to distinguish moves that might be expected in the normal cut and thrust of business from those that stemmed from market power and that constituted an abuse of market power. Ofgem explained that such judgements could only be made by considering the specific circumstances of BGT's behaviour.

2.8 In its Final Proposals, Ofgem explained its position in relation to several aspects of BGT's behaviour that had been raised as areas of concern. These included:

- ◆ BGT's upstream market power. Ofgem said that BGT's dominant position would not in itself be a reason for regulatory action, but that Ofgem was concerned to ensure that BGT did not abuse its dominant position or market power. Ofgem said that it would take action if evidence came to light that BGT had abused any upstream dominance that it had, but noted that no firm evidence had been put forward by respondents to the Initial Proposals;
- ◆ BGT's advertising. Ofgem recognised the strong established brand awareness that BGT has using the "British Gas" name, but said that it did not consider this in itself as constituting evidence that BGT was abusing its dominant position. On the level of BGT's advertising expenditure, Ofgem said that in setting BGT's revised tariff caps for 2000/01, it took a view of an appropriate allowance for marketing and advertising to price controlled customers. However, this was not intended as a cap on expenditure for these individual activities. Within the overall constraints of the price control, BGT was able to spend its allowed revenue in whatever way it considered appropriate, whilst still meeting its licence obligations and Standards of Service. On the content of BGT's advertising, Ofgem said that, from March 2001, it would consider taking action under the Competition Act 1998 if BGT continued to breach the Advertising Standards Authority (ASA) and Independent Television

Commission (ITC) codes of practice.⁵ Ofgem noted BGT had not been found in breach of the ASA's code of practice since June 1998, but had been found in breach of the ITC's code of practice in January 2001 for its "Monster 2002" campaign;

- ◆ BGT's complementary products and services. On a specific issue, Ofgem requested and BGT agreed that customers could cash in the remaining value of their gas stamps upon transfer to an alternative supplier, in line with the principles Ofgem adopted for BGT's Goldfish credit card. On the more general issue of BGT's complementary products and services, Ofgem said that it was concerned to ensure that the cumulative effect of the discounts and offers available through BGT did not adversely effect the development of competition. Ofgem said it was particularly keen to ensure that BGT's discounts did not lead to an effective price for gas that could be considered predatory; and
- ◆ BGT's 'dual fuel' offer. Ofgem said that it would review its position on BGT's 'dual fuel' offer following BGT's announcement of its revised electricity prices and 'dual fuel' discount to ensure that it did not breach the provisions of its Licence or general competition law.

2.9 A key finding of Ofgem's assessment of the development of competition was that the gas and electricity supply markets were increasingly being characterised by 'dual fuel' offers. Almost half of electricity and gas customers switching did so to take advantage of combined gas and electricity offers. Against this background, Ofgem was concerned that barriers to entry in electricity (such as access to wholesale electricity supplies) could affect the development of competition in the gas supply market.

⁵ This position was first adopted in Ofgem's follow up document to the 1998 review of the development of competition. See: "Review of British Gas Trading's behaviour in the domestic gas market, a follow-up document", Ofgem, June 1998.

Respondent's views

- 2.10 One respondent has recently provided a detailed submission of what it considered as evidence that BGT had abused its upstream market power by manipulating wholesale gas prices.

Ofgem's conclusions

- 2.11 Ofgem's view on the development of competition remains as set out in the Final Proposals. Ofgem is currently assessing the information put forward by one respondent in relation to the suggestion that BGT has abused its upstream market power. Ofgem will report its findings in due course.
- 2.12 Ofgem's process and timetable for its next review of the development of competition is set out in Chapter 4.

Scope of revised controls

Ofgem's Final Proposals

- 2.13 On the basis of its assessment of competition, Ofgem believed that competition was sufficiently developed to protect the interests of Direct Debit customers. Therefore, Ofgem proposed to remove these customers from the scope of the revised price controls. Ofgem said that it did not believe that competition was sufficiently developed to protect the interests of PromptPay, Standard or PrePayment customers. Therefore, Ofgem proposed that revised tariff caps should continue to apply to the prices that BGT charged these customers.
- 2.14 Ofgem noted views put forward by three respondents to its Initial Proposals, who argued that PromptPay customers should be removed from the scope of the revised tariff caps. However, Ofgem said it was difficult to derive evidence to conclude that competition was sufficiently developed for BGT's PromptPay customers. For example some suppliers did not offer comparable tariffs. Although Ofgem recognised that some customers within the PromptPay tariff had similar characteristics to Direct Debit, such as standing order customers, it was not clear that other PromptPay customers were sufficiently distinctive from customers on BGT's Standard tariff. For instance, a significant proportion of BGT's PromptPay customers paid by quarterly cash and cheque. For these

customers the distinction between PromptPay and Standard is somewhat arbitrary: those paying 10 days after their bill benefit, but those paying 11 days after their bill do not. Some customers frequently drifted between the two tariffs. On balance, Ofgem considered that PromptPay customers should remain within the scope of BGT's revised tariff caps for 2000/01.

Respondents' views

- 2.15 One PES said that competition was sufficiently developed to protect all customers' interests and therefore price controls should be removed for all domestic gas customers.

Ofgem's conclusion

- 2.16 No new evidence to inform the scope of the revised controls was put forward by respondents that was not considered for Ofgem's Final Proposals. Ofgem has concluded that revised price caps should apply to BGT's customers paying by PromptPay, Standard and PrePayment tariffs.

Duration

Ofgem's Final Proposals

- 2.17 Ofgem stated that subject to satisfactory progress in removing the remaining barriers to entry, it was its firm intention to remove BGT's price control completely from 1 April 2001. Ofgem set out developments since the Initial Proposals on two major initiatives it was undertaking: the introduction of the New Electricity Trading Arrangements (NETA); and the alteration to the right of suppliers to object to the transfer of customers in debt.

Respondents' views

- 2.18 One supplier and one customer group said that Ofgem's intent to remove price controls after one year was premature. The supplier said that Ofgem should only consider competition to be established when BGT's market share fell below 50%. This supplier said that the date that Ofgem had given for removing the remaining price controls seems to have been reached in an arbitrary manner. The customer group said it remained concerned that Ofgem would not have sufficient evidence after one year to be in a position to conclude that the

remaining price controls should be removed, particularly for PrePayment customers.

Ofgem's conclusions

- 2.19 Ofgem remains of the view that if competition can be relied upon to protect customers' interests after 1 April 2001 then the remaining price controls on BGT are no longer required. Additional safeguards to protect customers' interests, including those provided by UK competition law and the provisions of the Gas Suppliers' Licence, will remain beyond 1 April 2001.
- 2.20 As Ofgem explained in its Final Proposals, in the event that BGT did abuse its dominant position after price controls were removed, Ofgem would consider using its new powers under the Competition Act 1998. The Act allows Ofgem to impose financial penalties of up to 10% of BGT's UK turnover. The potential size of these financial penalties would, for a business with a relatively small margin on turnover, act as a powerful deterrent to BGT abusing its dominant position.
- 2.21 In assessing the development of competition, Ofgem intends to gather and interpret as much relevant evidence as possible. Though market shares are a useful indicator of competition, Ofgem does not believe that they should be considered in isolation from other evidence. To rely solely on market shares, may risk giving an incomplete or misleading picture of the development of competition, and to base policy on market share targets risks over-riding consumer preferences with regulatory judgements.
- 2.22 Ofgem intends to undertake a detailed review and consultation over the next year in order to decide whether all BGT's remaining price controls can be removed from 1 April 2001. The consultation process that Ofgem intends to put in place and some specific issues that Ofgem will consider in deciding whether to remove the remaining price controls are discussed in more detail in Chapter 4.

Level of revised controls

Ofgem's Final Proposals

- 2.23 Ofgem's Final Proposals resulted in an implied reduction in BGT's revenue from

its price controlled customers of about 4.5% in nominal terms, equivalent to around £12 per price controlled customer. Based on analysis of new entrants costs, Ofgem found this left substantial headroom for competitors offering 'dual fuel' supplies. Competitors could potentially offer discounts ranging from 8% to 20% for PromptPay, Standard and PrePayment customers. Ofgem found less headroom available for gas only new entrants, but these suppliers could potentially still offer discounts for PromptPay and Standard customers of between 7% and 15%. Ofgem found that available headroom was tightest for gas only PrePayment customers. Acquisition costs for PrePayment customers were high, partly due to the risk of BGT exercising its right to object to the transfer of customers in debt.

Respondents' views

- 2.24 One supplier expressed concern about insufficient headroom for 'single fuel' suppliers. This supplier stated that many customers were better off having single fuel supplies for gas and electricity. Another supplier said that Ofgem had overestimated the cost savings that would arise in offering 'dual fuel'. One supplier said that Ofgem had underestimated the level of acquisition costs for new entrants. This supplier said that Ofgem should increase its assumption of acquisition costs from £40 per customer to £80 per customer (recovered over the same 5 year period).

Ofgem's conclusions

- 2.25 Ofgem recognises that available headroom is tighter for gas only suppliers than those suppliers offering 'dual fuel' supplies. However, a key conclusion of Ofgem's Competitive Market Review was the sign of increasing convergence between the gas and electricity markets. For example, about half of customers switching suppliers do so to take up 'dual fuel' offers. Ofgem, in line with a number of industry analysts, expects this trend to continue.
- 2.26 It should be noted that by removing the remaining barriers to entry, such as removing the right of suppliers to object to the transfer of customers in debt, Ofgem aims to improve the prospects for rivals to BGT.
- 2.27 Ofgem recognises that there are necessarily some uncertainties surrounding the

headroom estimates, and will re-consider its assessment of the headroom available to competitors in its next review of the development of competition, in line with movements in new entrants' costs. These uncertainties are one of the problems of setting price controls in a market that is open to competition – for example, controls might stifle competition by leaving insufficient headroom for new entry – and are one of the reasons why it is Ofgem's firm intention to remove price controls subject to satisfactory progress being made in the removal of the remaining barriers to entry. Ofgem also intends to use its MORI survey of customer awareness and attitudes to gas and electricity competition, to understand in more detail the motivation for customers responding to rival offers.

Removal of standing charges

Ofgem's Final Proposals

2.28 Ofgem invited views on its initial assessment that BGT's proposal to remove standing charges did not breach the provisions of Standard Condition 13 of BGT's Gas Suppliers' Licence, in particular the provisions relating to predation or undue preference. Ofgem's principal concern was to ensure that BGT's proposal did not adversely affect the development of competition. Ofgem based its view on a number of factors including:

- ◆ removing standing charges was an option available to all suppliers. Indeed, some suppliers had removed standing charges prior to BGT's announcement of its proposal (other suppliers have also introduced tariffs with no standing charges since BGT's announcement);
- ◆ To the extent that BGT sought to recover revenues lost as a result of higher discounts to low volume customers, it would need to increase prices to customers consuming at higher volumes. However, this would make those customers consuming higher volumes a more attractive target to BGT's competitors, and Ofgem's 1999 Competitive Market Review found that BGT already faced relatively stronger competition at higher volumes;
- ◆ Ofgem's view that additional sector-specific regulation should become

less restrictive as competition develops, and in particular, Ofgem's firm intention to remove BGT's remaining price controls from 1 April 2001, subject to satisfactory progress being made in removing the remaining barriers to entry; and

- ◆ an assessment of predation or undue preference should in any case take account of prices and attributable avoidable costs over the expected lifetime that an identifiable class of customers will be supplied by BGT. While there is limited evidence about customers consumption profiles over time, it does appear to be the case that some customers spent only a very short period of time consuming at very low levels, e.g. houses that are empty for some proportion of the year.

2.29 Ofgem adjusted the structure of the revised tariff caps to take account of BGT's proposal to remove standing charges. Ofgem sought to ensure that the revenues that BGT accrued under its new tariff structure would be the same as would have been allowed if Ofgem's Final Proposals had been applied to BGT's former tariff structure.

Respondents' views

- 2.30 One supplier, one energy efficiency body and two customer groups supported BGT's removal of standing charges. They said that Ofgem should encourage such innovation and extension of customer choice.
- 2.31 Two suppliers and one customer group expressed concern about BGT's proposal. They were concerned that BGT's initiative was anti-competitive at very low volumes.
- 2.32 Two suppliers and two customer groups said that BGT hid a relative price rise for some customers in Ofgem's package of Final Proposals for BGT's price control review. One customer group expressed concern that BGT's proposal would not help the fuel poor, as the fuel poor did not generally consume very low volumes of gas. However, another customer group said that BGT's proposal would help some other vulnerable groups such as some elderly customers who consume very little gas.

- 2.33 One PES supplier said it was concerned that the drafting of the PES price control licence modifications prohibited it from following BGT's example and removing standing charges from its price controlled tariffs, while remaining revenue neutral. This respondent said that this could have the effect of distorting competition in the markets for 'dual fuel'.
- 2.34 An energy efficiency body commented that the removal of standing charges was a step in the right direction in terms of incentivising higher energy efficiency as it raised the effective price of consuming large volumes of gas relative to Ofgem's Final Proposals under BGT's existing tariff structure.

Ofgem's conclusions

- 2.35 Taking account of respondents' submissions, Ofgem continues to be of the view that BGT's initiative does not breach the provisions of Standard Condition 13 of BGT's Gas Suppliers' Licence. Ofgem has been principally concerned to ensure that BGT's initiative would not adversely affect the development of competition. Ofgem would expect to review its position if evidence came to light that BGT's policy was adversely affecting the development of competition.
- 2.36 Ofgem notes respondents' concerns that BGT's initiative results in relative price increases for some customers compared to Ofgem's Final Proposals under BGT's previous tariff structure. This results from BGT's policy that the removal of standing charges should leave it revenue neutral. For the same reasons as those discussed above, Ofgem does not consider this a breach of BGT's Licence. It should be noted that Ofgem's Final Proposals ensure that no customer will see an increase in their annual bill in 2000/01 and that BGT will not receive additional revenue from its initiative in excess of its price control entitlement.
- 2.37 Ofgem recognises respondents' concerns that compared to BGT's former tariff structure, BGT's initiative may not necessarily benefit fuel poor customers who consume relatively high volumes of gas. Ofgem intends to publish research on the effect on the fuel poor of no standing charge tariffs as part of its next publication for the Social Action Plan, planned for June 2000.
- 2.38 Ofgem notes the concern expressed by one PES supplier that the PESs' price

controls do not allow them the same degree of flexibility as that afforded to BGT. Although the PESs can introduce additional tariffs with no standing charge element, the PES licence conditions prohibit the PESs from raising their prices for price controlled customers at average consumption by more than a specified amount. Therefore, PESs, if they choose to follow BGT's example, would not be able to attempt to recover any foregone standing charge revenue from customers at higher volumes in excess of this specified amount, even if the move, like for BGT, left the PES revenue neutral. Now that all PESs have agreed to their licence modifications to effect Ofgem's Final Proposals for the PES supply price control review, including the PES raising this point, any adjustments would require a licence modification and statutory consultation period. It is open to all suppliers to propose a further modification.

2.39 However, Ofgem notes that the existence of this type of residual harmonisation issue is in part a reflection of the different speeds with which domestic gas and electricity markets have been opened up to competition, and that in earlier stages of this process, PESs were able to enjoy the benefits of opportunities to enter gas markets in periods when BGT was unable to enter electricity markets. Against this background, Ofgem is minded not to change the PES controls at this stage.

2.40 Table 1 below sets out Ofgem's conclusions on the level of BGT's revised tariff caps to apply to BGT's price controlled customers after adjusting for BGT's removal of standing charges. Ofgem has set a maximum price cap on BGT's unit charges. These price caps are effective from the first meter read (actual or estimated) after 1 April 2000. Prior to the first meter read date, BGT's prices for PromptPay and Standard/PrePayment will be capped at the prices in force immediately prior to 1 April 2000.

Table 1 – Ofgem’s conclusion on the level of BGT’s tariff caps for 2000/01

	Tier 1 (p/kWh)	Tier 2 (p/kWh)
PromptPay	1.766 ¹	1.327
Standard/PrePayment	2.396	1.327

1. This equates to a PromptPay discount of £7.20 per quarter if 1,143kWh is consumed.

Other issues raised by respondents

BGT’s national tariff

Ofgem’s Final Proposals

- 2.41 Ofgem’s Final Proposals were set based on BGT’s national gas tariff. This included a transportation cost allowance based on Ofgem’s estimate for Transco’s national average domestic charge in 2000/01.

Respondents views

- 2.42 One supplier expressed concern that BGT’s national tariff was unduly discriminatory because it did not reflect variations in regional transportation charges. In addition this supplier was concerned that BGT’s national PromptPay tariff could lead to BGT setting prices for its PromptPay customers that were predatory in areas where regional transportation costs were high relative to the average for Great Britain. This supplier asked Ofgem to consider whether BGT’s behaviour breached Standard Condition 13 of its Gas Suppliers’ Licence and the Competition Act 1998.

Ofgem’s conclusions

- 2.43 The maximum prices BGT can charge in any region are set by BGT’s price control. This was set by Ofgem under powers granted under the Gas Act 1986. Therefore, in the first instance, Ofgem considered the issue of potential undue discrimination and predation as a Gas Act 1986 matter rather than a Competition Act 1998 matter. In particular, Ofgem assessed whether BGT’s national tariff breached Standard Condition 13 of BGT’s Gas Suppliers Licence, which

prohibits a dominant supplier exercising undue discrimination or setting terms that are predatory.

- 2.44 Ofgem recognises that differences in regional transportation costs are not reflected in BGT's domestic gas tariffs. However, to test whether this differences constitutes undue discrimination, Ofgem assessed whether BGT's national tariff had anti-competitive effects by excluding competitors to the ultimate detriment of consumers.
- 2.45 In assessing this, Ofgem looked where possible, at similar indicators of the development of competition by region to those used in the national review of competition in December 1999. These included customer awareness, entry and exit, market shares, customer switching, price and related offers, barriers to entry and available headroom.
- 2.46 Although the headroom available for rivals to BGT can be expected to be tighter in some regions due to the higher transportation charges, in those regions, the present range of available evidence does not suggest that the combination of Ofgem's price control proposals and BGT's national tariff would have the effect of excluding competitors or otherwise preventing the development of competition. For example, BGT's current pattern of regional market share loss is not closely correlated with regional transportation costs or the time that each region has been open to competition; and a number of suppliers offer national and regional price offers lower than BGT's national tariffs, except for PrePayment.
- 2.47 Ofgem set out its approach for assessing predation in its draft Energy Guidelines.⁶ Ofgem said that it will suspect predation when prices do not cover the attributable avoidable costs. Ofgem does not have information about BGT's attributable avoidable costs of supplying PromptPay customers by region. As a proxy, Ofgem used estimates of BGT's attributable avoidable costs of supplying PromptPay customers across Great Britain with an adjustment to transportation

⁶ "Draft Energy Guidelines Under the Competition Act 1998", Ofgem, December 1999.

costs to reflect the costs of transporting gas to each of Transco's Local Distribution Zones (LDZs).⁷ Ofgem assessed avoidable gas costs against a number of measures of the longer-term spot price adjusted for swing. On this basis, Ofgem found that for all LDZs, BGT's prices cover attributable avoidable costs by a significant margin.

2.48 Ofgem, also said in its draft Energy Guidelines that predation may also occur when prices are set at a level above attributable avoidable costs depending on the result that they are designed to achieve. In the context of BGT's national tariff Ofgem assessed whether it would have the effect of excluding competitors and concluded that it did not. The same conclusion applies in response to the allegation of predatory pricing as for undue discrimination above.

2.49 Against this background, Ofgem believes that BGT's national tariff is currently consistent with the provisions of Standard Condition 13. However, given the rapid development of the market Ofgem intends to keep BGT's national tariff under review. In particular Ofgem intends to:

- ◆ seek better quality information on regional indicators of competition as part of its next review of the development of competition. Ofgem intends to publish its findings in November 2000, along with its Initial Proposals for the regulation of BGT's prices beyond 1 April 2001;
- ◆ request BGT undertakes a detailed study of the costs and time-scales of implementing regional pricing; and
- ◆ review BGT's national tariff in light of Ofgem's conclusions for its review of Transco's LDZ charging methodology.⁸

⁷ Based on Transco's October 1999 charging methodology.

⁸ Ofgem has recently published a consultation document on this issue. See "Review of Transco's LDZ Charging Methodology: A Consultation Document", Ofgem, March 2000.

Gas card charging

Ofgem's Final Proposals

- 2.50 In March 1999, BGT submitted to Ofgem a proposal to introduce charges for customers who requested a replacement Electronic Token Meter (ETM) card where the original was lost, stolen or accidentally or maliciously damaged.⁹ BGT said that the charge was aimed at altering customers' perceptions of the value of the card in order to reduce the number of replacement cards required. BGT proposed to charge customers £10 for cards sent by post and £15 for replacements that were hand-delivered.
- 2.51 Ofgem consulted on BGT's proposals in April 1999¹⁰ and said that although it did not oppose BGT's policy in principle, its application in its current form raised several concerns, including:
- ◆ discrimination. BGT's ability to object to the transfer of 70% of its ETM customers, because of debt, meant that these customers could not respond to price signals like other customers;
 - ◆ rebalancing. The effective PrePayment tariff would be raised relative to the Standard tariff. This went against the conclusions of Ofgas' rebalancing review;¹¹ and
 - ◆ review. The proposal did not include provisions for an interim review that would allow BGT and Ofgem to review the performance of the proposal.
- 2.52 In October 1999 BGT submitted a revised proposal. The main revisions to its proposal included:

⁹ BGT did not propose to charge where the cards were faulty due to reasonable wear and tear; issued to new meters or change of tenancy; or lost and subsequently found within 14 days.

¹⁰ "BGT's Proposal to Charge for Replacement Gas Cards for Electronic Prepayment Meters", Ofgem, April 1999.

¹¹ "Review of British Gas Trading's Domestic Supply Tariffs: A Decision Document". Ofgas, June 1998.

- ◆ a general policy of not charging, within a two year period, for the first replacement card;
- ◆ reducing the charge for a replacement card to £5 for cards sent by post and to £10 for those customers requiring a home visit;
- ◆ excluding GasCare customers from the scope of its proposal; and
- ◆ a review of the proposal after six months.

2.53 In the Final Proposals document, Ofgem said that it was minded to accept BGT's revised proposal.

Respondents' views

2.54 One supplier considered BGT's revised proposal reasonable and justified, particularly in view of Ofgem's firm intention to limit price controls for a further one year only. One customer group said that BGT's modifications to its proposal did not go far enough to warrant Ofgem's approval because most customers were not careless with their cards.

Ofgem's conclusions

2.55 Ofgem believes that BGT's revisions to its proposal provide sufficient protection for customers to warrant the introduction of the charges. This brings BGT's proposal into line with some similar schemes operated by the PESs. However, Ofgem has asked BGT to review the scheme after six months and is currently in the process of agreeing with BGT the type of information it should record in order to monitor effectively this scheme.

3. BGT's Revised Prices for Domestic Gas Customers

Introduction

3.1 This chapter sets out:

- ◆ BGT's revised prices for its price controlled tariffs and their compliance with Ofgem's price control conclusions; and
- ◆ BGT's revised prices for its non-price controlled tariffs and their compliance with Standard Condition 13.

BGT's new prices for its price controlled tariffs

3.2 On 22 March 2000, BGT announced its tariffs to apply from the first meter reading from 1 April 2000. The tariffs for PromptPay and Standard/PrePayment customers are set out in Table 2 below.

Table 2 – BGT's price controlled tariffs from 1 April 2000.

	Tier 1 (p/kWh)	Tier 2 (p/kWh)
PromptPay	1.766 ¹	1.327
Standard/PrePayment	2.396	1.327

1. Customers who pay their bill within 10 days of the bill issue date receive a discount of 30%, up to a maximum of £7.20 per quarter. Therefore the maximum effective charge is 1.766 p/kWh.

3.3 BGT's proposed prices are consistent with Ofgem's conclusions for BGT's tariff caps (see Table 1). BGT intends to price at the cap for Standard and PrePayment customers. For PromptPay customers BGT is offering a discount of 30% up to a maximum of £7.20 per quarter. The maximum discount is reached upon a customer consuming 1143 kWh per quarter. This compares to a discount of 26.3% up to a maximum of £7.20 at 1143 kWh under Ofgem's Final Proposals. BGT will price slightly below its PromptPay price cap for customers consuming at very low volumes.

3.4 The savings that different customers will experience depends on their annual

consumption. Tables 3 and 4 indicate the annual savings available to PromptPay and Standard/PrePayment customers at a range of annual consumption levels comparing BGT's revised bills with annual bills before 1 April 2000. At an average consumption of 16,441kWh per year, the saving for a PromptPay customer is about £8 per year or about 3.1%. At an average consumption of 15,666 kWh per year, the saving for a Standard/PrePayment customer is about £10 per year or about 3.6%.

Table 3 – Annual bills for PromptPay customers at different consumption levels

Annual consumption (kWh)	Old bill	New bill	Difference (£)	Difference (%)
3,000	59.14	52.98	6.16	10.4
6,000	100.81	99.69	1.12	1.1
9,000	142.48	139.50	2.98	2.1
12,000	184.15	179.31	4.84	2.6
15,000	225.82	219.12	6.70	3.0
16,441	248.84	238.24	7.59	3.1
18,000	267.49	258.93	8.56	3.2
21,000	309.16	298.74	10.42	3.4
30,000	434.17	418.17	16.00	3.7
45,000	642.52	617.22	25.30	3.9
73,000	1031.44	988.78	42.66	4.1

Table 4 - Comparison of Standard/PrePayment prices at different consumption levels

Annual consumption (kWh)	Old Bill	New Bill	Difference (£)	Difference (%)
3,000	90.54	71.88	18.66	20.6
6,000	132.21	128.49	3.72	2.8
9,000	173.88	168.30	5.58	3.2
12,000	215.55	208.11	7.44	3.4
15,000	257.22	247.92	9.30	3.6
15,666	266.47	256.76	9.71	3.6
18,000	298.89	287.73	11.16	3.7
21,000	340.56	327.54	13.02	3.8
30,000	465.57	446.97	18.60	4.0
45,000	673.92	646.02	27.90	4.1
73,000	1062.84	1017.58	45.26	4.3

BGT's new prices for its non-price controlled tariffs

3.5 BGT's revised tariffs for Direct Debit and Advance Payment are set out in Table 5.

Table 5 – BGT's non-price controlled tariffs from 1 April 2000.

	Tier 1 (p/kWh)	Tier 2 (p/kWh)
Direct Debit	1.840	1.281
Advance Payment	1.802	1.254

3.6 Tables 6 and 7 indicate the annual savings available to Direct Debit and Advance Payment customers at a range of annual consumption levels comparing BGT's revised bills with annual bills before 1 April 2000. These tables show that BGT's revised prices for Direct Debit and Advance Payment reduce annual bills for all customers on these tariffs. At an annual consumption level of 19,050 kWh, both Direct Debit customers and Advance Payment customers will see reductions in their annual bills of approximately £3, or about 1%.

Table 6 – Comparison of Direct Debit prices at different consumption levels

Annual consumption (kWh)	Old Bill	New Bill	Difference (£)	Difference (%)
3,000	64.40	55.20	9.20	14.3
6,000	103.25	120.42	0.83	0.8
9,000	142.10	140.85	1.25	0.9
12,000	180.95	179.28	1.67	0.9
15,000	219.80	217.71	2.09	1.0
18,000	258.65	256.14	2.51	1.0
19,050	272.25	269.59	2.66	1.0
21,000	297.50	294.57	2.93	1.0
30,000	414.05	409.86	4.19	1.0
45,000	608.30	602.01	6.29	1.0
73,000	970.90	960.69	10.21	1.1

Table 7 – Comparison of Advance Payment prices at different consumption levels

Annual consumption (kWh)	Old bill	New bill	Difference (£)	Difference (%)
3,000	63.62	54.06	9.56	15.0
6,000	101.69	100.29	1.40	1.4
9,000	139.76	137.91	1.85	1.3
12,000	177.83	175.53	2.30	1.3
15,000	215.90	213.15	2.75	1.3
18,000	253.97	250.77	3.20	1.3
19,050	267.29	263.94	3.35	1.3
21,000	292.04	288.39	3.65	1.2
30,000	406.25	401.25	5.00	1.2
45,000	596.60	589.35	7.25	1.2
73,000	951.92	940.47	11.45	1.2

3.7 Ofgem has assessed BGT's revised tariffs for Direct Debit and Advance Payment against the provisions of Standard Condition 13 of the Gas Suppliers' Licence, which prohibits dominant suppliers from exercising undue discrimination, undue preference, or from setting terms that are predatory or unduly onerous. Standard Condition 13 becomes less restrictive as competition develops. In particular, dominant suppliers are able to set terms in such a way as is reasonably necessary to meet established competition, providing the terms are neither predatory nor unduly onerous.

3.8 In the context of Direct Debit and Advance Payment, Ofgem has been particularly concerned to ensure that BGT does not price in such a way that

would be considered predatory. Following the approach to assessing predation set out in Chapter 2, Ofgem has assessed whether BGT's prices cover their attributable avoidable costs and whether such prices would unfairly exclude competitors.

- 3.9 Ofgem has concluded that BGT's Direct Debit and Advance Payment tariffs to domestic gas customers do not breach Standard Condition 13. This is because:
- ◆ BGT's prices cover Ofgem's estimate of BGT's attributable avoidable costs¹² by a significant margin for all Direct Debit and Advance Payment customers except those consuming at very low volumes. This results from BGT's removal of standing charges (see Chapter 2); and
 - ◆ Ofgem's competitive market review found that competition was sufficiently developed and relatively vigorous to protect the interests of Direct Debit customers. Although BGT's Advance Payment tariff has few direct comparisons, Ofgem does not believe BGT's revised prices will unfairly exclude competitors. The offering of a facility and discount for a large payment in advance is an option open to any supplier.
- 3.10 BGT has recently announced its revised electricity prices. Ofgem is presently assessing BGT's 'dual fuel' offer. Ofgem will want to ensure that BGT's 'dual fuel' offer complies with the provisions of Standard Condition 13 and general competition law, in particular the Competition Act 1998. Ofgem will report its findings in due course.

Differentials between customers paying by BGT's domestic gas tariffs

- 3.11 Table 8 shows the differentials in annual bills for customers on different tariffs consuming at BGT's overall domestic average consumption in 1999/00 of 18,364 kWh. It shows that BGT's revised prices narrow the differential between BGT's price controlled and non-price controlled tariffs.

¹² Gas costs were assessed at various measures of the longer-term spot price adjusted for swing.

Table 8 – Comparison of bills for customers on different tariffs (assuming an average annual consumption of 18,364 kWh)

Tariff	Old bill (£)	Diff' to Direct Debit (£)	Diff' to Direct Debit (%)	New bill (£)	Diff' to Direct Debit (£)	Diff' to Direct Debit (%)
Advance Payment	258.59	-4.77	-1.81	255.34	-5.46	-2.09
Direct Debit	263.36	-	-	260.80	-	-
PromptPay	272.55	9.19	3.49	263.76	2.96	1.13
Standard/ PrePayment	303.95	40.59	15.41	292.56	31.76	12.18

4. Way Forward

Introduction

4.1 This chapter explains the process Ofgem intends to follow to review BGT's price control over the coming year. It discusses:

- ◆ the timetable Ofgem will follow to review BGT's price control over the coming year;
- ◆ Ofgem's intended approach to assessing the development of competition over the coming year; and
- ◆ some of the issues that Ofgem will pay particular attention to in its assessment of competition.

Timetable

4.2 Ofgem's firm intention to remove all price controls from 1 April 2001 is subject to satisfactory progress being made in removing the remaining barriers to entry that prevent competition from being sufficiently developed to protect all customers' interests. Therefore, in order to assess the desirability of removing the remaining price controls, Ofgem intends to undertake an assessment of the development of competition in the gas and electricity supply markets. The timetable for this review is set out in Appendix 4. The main steps are:

- ◆ June 2000. Ofgem will invite views through a public workshop on the criteria to be used in assessing the development of competition;
- ◆ July 2000. Ofgem will publish its survey for the review of domestic supply competition. For the first time this will be a joint survey of both the gas and electricity supply markets. This will better enable Ofgem to assess competition in the single fuel and 'dual fuel' markets;
- ◆ November 2000. Ofgem intends to publish its review of the domestic gas and electricity supply markets. Based on this, Ofgem will also publish its Initial Proposals for BGT's price control review. This will

contain Ofgem's initial view of what, if any, arrangements for the regulation of BGT's prices should continue beyond 1 April 2000;

- ◆ December 2000. Ofgem will hold a public workshop to discuss its assessment of competition and its Initial Proposals for BGT's price control review; and
- ◆ February 2001. Ofgem will publish Final Proposals for BGT's price control review.

4.3 This timetable is reflected in the drafting of the agreed modification to Special Conditions 3 and 4 of BGT's Gas Suppliers' Licence. It is intended to give effect to Ofgem's 'firm intention' to remove price controls from April 2001. Paragraph 4 of the modification provides that BGT's price control will cease to apply from 1 April 2001, unless, by no later than 1 March 2001, Ofgem has notified BGT that, in its opinion, competition is not sufficiently developed to remove the remaining price controls. In the event that Ofgem notifies BGT of this opinion, Ofgem must set out alternative arrangements to apply from 1 April 2001, with the reasons for these proposals and their effect. If Ofgem cannot reach agreement with BGT on these revised arrangements by 1 July 2001 then BGT's price control will cease to apply unless Ofgem has referred the matter to the Competition Commission before that date.

Assessing the development of competition

4.4 Ofgem's review of BGT's price control will be informed by an assessment of the development of competition. Ofgem anticipates that it will adopt a broadly similar approach to assessing competition for the purpose of reviewing BGT's price control as was adopted for its 1999 annual review of the development of domestic gas supply competition.

4.5 As the development of competition is a dynamic process, characterised by constantly changing market structures, behaviour and performance, the development of competition cannot be measured against any one simple set of indicators (e.g. market shares). It is important to consider the functioning of the domestic gas supply market in its entirety. The functioning of the market

depends upon the combined effects of the actions of the incumbent, competitors and customers, as well as upon the structural conditions in which they all operate.

4.6 Bearing in mind the dynamic nature of competition, Ofgem anticipates considering a variety of indicators of the development of competition. As indicated above, Ofgem will hold a public workshop to discuss the indicators that should be used to assess competition. Without prejudice to that consultation, Ofgem expects the following indicators, which were used in last year's assessment of domestic gas supply competition, to feature in our assessment:

- ◆ customers' awareness of the opportunity to choose an alternative supplier and the range of competing offers;
- ◆ suppliers' behaviour, including entry and exit;
- ◆ suppliers' performance, such as market shares;
- ◆ customers' behaviour, including switching suppliers and tariffs/payment methods;
- ◆ the range of price and related offers available from new entrants, including 'dual fuel';
- ◆ potential barriers to the development of competition, including BGT's behaviour and the general operation of the market; and
- ◆ the ability of entrants to enter the gas supply market, by considering their potential head room.

4.7 As discussed in Chapter 2, Ofgem intends to monitor the effect on the development of competition of BGT's national domestic gas tariff. Ofgem will therefore seek to consider how these indicators of the development of competition vary between regions.

4.8 To better inform Ofgem as to whether, and for which groups of customers, price

regulation on BGT may remain relevant, Ofgem's review will pay particular attention to whether competition is developing at different speeds for different groups of customers. Examples of how customers could most appropriately be grouped include:

- ◆ tariffs and payment methods;
- ◆ volumes consumed;
- ◆ where customers live, further analysing this into PES areas, LDZ areas or the areas of domestic gas competition rollout phases and tranches;
- ◆ whether customers are supplied gas and electricity by the same supplier ("dual fuel"); and
- ◆ whether they have a debt with their supplier, which would allow the supplier to block their transfer to another supplier using the provisions of Standard Condition 7(4) of the Gas Suppliers' Licence.

4.9 The information that Ofgem requests in its survey will reflect these potential groups and depending on the quality of responses, will allow Ofgem to compare how much they are benefiting from competition.

Specific issues to consider in reviewing BGT's price control

4.10 As Ofgem concluded in Chapter 2, its firm intention to remove the remaining price controls on BGT from 1 April 2001 is subject to satisfactory progress being made in removing the barriers to entry that presently prevent all customers from benefiting fully from the competitive market. Ofgem identified some of these barriers in its 1999 Competitive Market Review. This section outlines the progress made in removing these barriers and how Ofgem intends to take the issues forward over the coming year. Broadly speaking, these barriers can be grouped as relating to:

- ◆ pre-emptive behaviour by BGT;
- ◆ the general operation of the gas supply market; and

- ◆ barriers in related markets.

Pre-emptive behaviour by BGT

4.11 Ofgem intends to monitor closely BGT's behaviour over the coming year to ensure that it does not act, or threaten to act, in a way that adversely effects the development of competition, and particularly, rivals' ability to compete and innovate. As discussed in Chapter 2, it is understandable that an incumbent will seek to defend its market position by responding to competition in a number of ways. Even when the incumbent is dominant, some responses will be in line with the general cut and thrust of everyday business. However, some responses may amount to the abuse of market power, since they may have the effect of forestalling the development of competition.

4.12 Ofgem's position on several aspects of BGT's behaviour was discussed in Chapter 2. In monitoring BGT's behaviour over the coming year, Ofgem intends to pay particular attention to three of these issues. They are:

- ◆ BGT's advertising. In the first instance, Ofgem expects to monitor whether BGT's behaviour continues to comply with the ASA and ITC codes of practice;
- ◆ BGT's upstream market power. Ofgem is currently reviewing evidence put forward by one respondent to the Final Proposals that BGT has abused its dominant position in the wholesale gas market. Ofgem also intends to consider information provided by BGT on its upstream corporate governance structure to ensure that it does not contribute to any behaviour that adversely effects the development of competition; and
- ◆ BGT's 'dual fuel' offer. Ofgem is currently reviewing BGT's 'dual fuel' offer following BGT's recent announcement of its electricity prices. Principally, Ofgem is concerned to ensure that BGT's 'dual fuel' offer in isolation, or taken together with other offers made by BGT, does not adversely affect the development of competition.

- 4.13 Ofgem expects to report on the progress of these and any other issues of concern relating to BGT's behaviour in its survey for the domestic gas and electricity markets, planned for July 2000.
- 4.14 In monitoring BGT's behaviour, Ofgem expects BGT to provide prompt, full and accurate submissions to any information requests, either formal or informal, that Ofgem requires of BGT.

The general operation of the gas supply market

- 4.15 Ofgem's December 1999 Competitive Market Review document identified a number of issues of concern. These are discussed below, with the progress made since December 1999. They are:

- ◆ the ability of suppliers to object to customers in debt transferring to another supplier by using the provisions of Standard Condition 7(4) of the Gas Suppliers' Licence. After reviewing responses to its December 1999 consultation document¹³, Ofgem recently outlined a number of proposals that it intends to put in place to ensure that customers in debt can participate more fully in the competitive market. These proposals are subject to acceptance by suppliers. The proposals end the automatic right of suppliers to block a transfer to another supplier on the grounds of debt. New procedures will permit the transfer of customers who have demonstrated their willingness to maintain agreed debt repayment plans. For those who have not, and for those with existing debts above a threshold of £300, the suppliers' right to object to transfer on the grounds of debt would remain. Ofgem will finalise its proposals once the consultation has been completed;
- ◆ suppliers' perceptions of the risk that Transco's prepayment meter charges will increase significantly before competition in gas meter provision begins. Ofgem has recently published its review of Transco's costs in

¹³ "Customers in Debt and their Access to the Competitive Market", Ofgem, December 1999.

order to separate its price control into three main services for transportation, meter provision (including installation and maintenance) and meter reading.¹⁴ This includes Ofgem's view of the maximum price that Transco can charge shippers for the installation and provision of prepayment meters over the remaining period of Transco's present price control. This document also sets out Ofgem and Transco's views about the steps and process that should be followed to introduce competition into gas meter provision. In addition, as explained in Ofgem's revised Corporate Plan document,¹⁵ it intends to undertake a Strategic Review of Metering over the coming year. Ofgem's initial document setting out its priorities and work plan will be published in July 2000; and

- ◆ customers on Independent (i.e. non-Transco) Public Gas Transporters' (IPGT's) networks. Ofgem is encouraged by the progress that the industry has made in making the Transco UK Link standard interface available for use by independent PGTs. Ofgem is still concerned that the choice of supply is potentially limited on non-Transco networks. Following a request made by Ofgem, BGT has said that it intends to offer supply to customers on all non-Centrica IPGTs, in line with its licence obligations. Ofgem proposes to conduct a competitive market review to identify any issues that prevent gas transporters, shippers and suppliers from meeting the needs of end-users on IPGT networks.

Barriers to entry in related markets

- 4.16 Ofgem's conclusion to its 1999 Competitive Market Review that the domestic gas market was increasingly being characterised by the availability and take-up of 'dual fuel' offers means that a suppliers' ability to offer both gas and electricity to customers is an important factor in determining suppliers' success in the gas supply market. It also means that a supplier will need to consider barriers to

¹⁴ "Securing Effective Competition in Gas Metering and Meter Reading Services. The Director General's Final Proposals", Ofgem, May 2000.

¹⁵ "Office of Gas and Electricity Markets Plan and Budget: April 2000 – March 2001", Ofgem, March 2000.

entry in electricity when deciding whether to enter the gas supply market. The progress made since December 1999 in removing the barriers that were identified at that time are discussed below. They include:

- ◆ access to competitive wholesale electricity markets. Ofgem is undertaking a major reform of the wholesale trading arrangements with the New Electricity Trading Arrangements (NETA). The Utilities Bill, which is required to implement NETA, has had its Second Reading in the House of Lords and is expected to receive Royal Assent by the summer of 2000. In December 1999, Ofgem published proposals¹⁶ for licence changes to implement NETA from;
- ◆ lack of separation of electricity supply and distribution businesses. The Utilities Bill will introduce separate licences for the PES electricity distribution and supply businesses. In advance of the new legislation, Ofgem amended existing PES licences to include an obligation on PESs to establish and maintain full managerial and operational independence of the Distribution Business from other PES businesses.¹⁷ PESs have prepared plans that show how they intend to comply with this licence condition. Ofgem is currently reviewing these plans;
- ◆ lack of competition in electricity meter reading. Until 1 April 2000, the Pool and Settlement Agreement required that suppliers use the services of host PESs for all of their metering and meter reading requirements. Due to IT constraints, five PESs were unable to stop providing metering services in their PES area from 1 April 2000. In the remaining seven PES areas, most PESs have set per day constraints on the number of Meter Point Administration Numbers (MPANs) that can be transferred to an alternative meter reading company. Ofgem proposes to publish a report

¹⁶ "New Electricity Trading Arrangements and Related Issues. Proposals on Licence Changes. A Consultation Document", Ofgem, December 1999.

¹⁷ "Review of Public Electricity Suppliers 1998 to 2000. Distribution Price Control Review. Final Proposals", Ofgem, December 1999.

on PES readiness by the end of August 2000;

- ◆ the transmission charging regime. Following a determination by Ofgem, The National Grid Company (NGC) has made changes to its transmission charging regime for non-half hourly metered customers to address concerns raised by new entrants that the transmission charging regime for 1999/2000 unfairly penalised new entrants;¹⁸ and
- ◆ general behaviour of PESs. Ofgem will continue to monitor the behaviour of the PESs in their 1st tier supply area. This relates primarily to the offering by the PESs of complementary products and services, including any 'dual fuel' offers. Ofgem expects to apply the principles developed during its review of BGT's Goldfish credit card offer when considering PESs new offers.

4.17 These are not the only issues which could adversely affect the development of competition. Ofgem will consult on other issues that are, or potentially could, adversely affect the development of competition, in its public workshop to be held in June and in its survey for the review of domestic supply competition, to be published in July

4.18 Overall, Ofgem is encouraged by the progress being made in removing the barriers to entry that were identified in the December 1999 competitive market review. Ofgem will report on progress again in July 2000, when it publishes its survey of the domestic gas and electricity markets. Ofgem intends to publish its initial view of whether satisfactory progress has been made in removing the remaining barriers to entry in November 2000.

In preparation for its public workshop in June 2000, Ofgem invites advance

¹⁸ "Transmission Licence Condition 10: Statements of Charges for Use of System and Connection to the System for the Year 2000/2001" The National Grid Company plc, April 2000.

views on the indicators and criteria that should be used in assessing the development of competition. Ofgem also welcomes any comments that respondents may have on Ofgem's work programme for reviewing BGT's price control in 2000/01.

**Appendix 1: Modification to Special Conditions 3 and 4 of
British Gas Trading's Gas Suppliers' Licence**

**Modification under section 23 (1) (a) of the Gas Act 1986 of
the Special Conditions of the Licence treated as granted
under section 7A(1) (a) and (b) of the Gas Act 1986 to
British Gas Trading Limited**

The Director General of Gas Supply, pursuant to section 23 (1) (a) of the Gas Act 1986 (c. 44) and with the consent of British Gas Trading Limited hereby modifies the Conditions of the Licence treated as granted under section 7A (1) (a) and (b) of that Act to that company in the manner set out in the Schedule hereto.

The Official Seal of the Director
General of Gas Supply hereunto
affixed is authenticated by: -

.....

Authorised in that behalf by the
Director General of Gas Supply

31 May 2000

SCHEDULE

MODIFICATION

For Condition 3 and 4 of the Special Conditions of the Licence treated as granted under section 7A(1) (a) and (b) of the Act to British Gas Trading Limited there shall be substituted the following Condition-

“Condition 3: Restriction of certain prices for domestic customers

1.- (1) In this Condition, unless the context otherwise requires-

“Accepted Variation”, in relation to any terms or terms and conditions, means such variation of those terms or, as the case may be, terms and conditions which-

- (a) had been made to give effect to any change in the law affecting relations between the Licensee and its domestic customers; or
- (b) had been made for the sole purpose of disapplying an Accepted Variation to which sub-paragraph 2 below applies; or
- (c) had been specified in a notice given by the Licensee to the Director accompanied by a statement of the reasons for making it and, where the variation relates to the imposition of an Additional Charge, a forecast of costs that would not be incurred by the Licensee if the Variation were made after deducting any additional costs that would be so incurred and which –
 - (i) had been consented to by the Director in a notice given to the Licensee; or
 - (ii) had not been objected to by the Director in a notice given to the Licensee within two months of the giving of the notice to the Director;

“Additional Charge” means a charge for the provision of goods or services to a particular domestic customer, or a class of domestic customers, making payment for gas supplied under any of the Regulated Terms in addition to the charge for gas supplied;

“Gas Payment Provisions”, in relation to the terms or terms and conditions referred to in paragraph 2(1)(a) below, means the provisions relating to payment of charges for gas supplied (other than the amounts to be charged) therein described;

“Regulated Term” means any of the following categories of Gas Payment Provisions-

- (a) the provisions described as Prompt Payment by cash or cheque, Quarterly

direct debit payment and Standing order payment ("Category A");

- (b) the provisions described as Late payment by cash or cheque (later than 10 days), Payment with magnetic card, Payment by Benefit Agency, Monthly repayment and Using a prepayment meter ("Category B"), being the provisions in force immediately before 1st April 2000.

- (2) Where an Accepted Variation entitles the Licensee to impose an Additional Charge, the Director may, after consulting the Licensee and taking into account any representations made by it, not later than three months after the giving of the notice by the Director to the Licensee in respect of that variation under paragraph (c)(i) of the definition of "Accepted Variation" in paragraph 1(1) above, direct that, so long as the variation remains in force, the entry in each part of the Table in paragraph 3(1) relating to any charge for gas supplied shall be treated as varied in such manner as the Director may determine for the purpose of taking into account any costs that would not be incurred by the Licensee in consequence of the making of the Accepted Variation after deducting any additional costs that would be so incurred.

2.- (1) The Licensee shall-

- (a) ensure that-

- (i) the terms on which it is prepared to enter into a contract for the supply of gas to domestic customers determined under Condition 3(1)(a) of the Standard Conditions;
- (ii) the terms and conditions on which it supplies gas to domestic customers, other than last resort customers, determined in accordance with the scheme made under paragraph 8(8) of Schedule 2B to the Act; and
- (iii) the terms and conditions on which it supplies gas to domestic customers, determined by, or in accordance with, the scheme made under paragraph 19(4) of Schedule 5 to the Act,

provide for payment of charges for gas supplied, subject to any Accepted Variation, in accordance with any of the Gas Payment Provisions comprised in the Regulated Terms; and

- (b) ensure that such of the terms or terms and conditions referred to in sub-paragraph (a) above, other than the amounts to be charged, which applied where payment of charges for gas supplied was to be made in accordance with any of those provisions immediately before 1st April 2000 apply, with any Accepted Variation, where any such payment is to be made after that day;

(2) In this paragraph "last resort customers" means customers supplied with gas pursuant to

a direction given to the Licensee by the Director in accordance with Condition 5 of the Standard Conditions.

3.- (1) The Licensee shall ensure that from 1 April 2000 (“the commencement date”) the amounts charged for the supply of gas to any domestic customer under each of the Regulated Terms do not exceed –

- (a) as regards amounts payable up to the first meter read date the amounts specified with respect to those terms in Part I of the Table below; and
- (b) as regards amounts payable after that date, the amounts so specified in Part II of that Table increased or decreased, as the case may be, by any transportation adjustments within the meaning of Condition 3(2)(b) and (c) of the Standard Conditions.

TABLE
MAXIMUM PRICES
PART I
PRICES BEFORE FIRST METER READ DATE

	Category A	Category B
Standing charge (£/customer/year)	17.47	48.87
Charge for quantity of gas supplied (p/kWh)	1.389	1.389

TABLE
MAXIMUM PRICES
PART II
PRICES AFTER FIRST METER READ DATE

	Category A	Category B
Tier 1 charge (p/kWh)	1.766	2.396
Tier 2 charge (p/kWh)	1.327	1.327

(2) The Licensee shall ensure that –

- (a) the provisions of paragraph 2(c) of Special Condition 3 of the Licence in force immediately before the commencement date are complied with in respect of any particular domestic customer until the first meter read date applying to that customer; and
 - (b) any amount for a tier 2 charge for gas supplied is the same in respect of all the Gas Payment Provisions comprised in the Regulated Terms.
 - (3) In this paragraph "first meter read date" means the first day on which the customer's meter is read or its reading falls to be estimated after the commencement date.
- 4.- (1) This Condition shall cease to have effect on 1st April 2001 unless, not later than 1st March 2001, the Director shall have notified the Licensee that, in the opinion of the Director, competition has not sufficiently developed in respect of domestic customers supplied under the Regulated Terms to justify the disapplication of this Condition on that day.
- (2) A notice given under sub-paragraph (1) above shall also contain a statement of—
 - (a) the Director's proposals to make modifications to this Condition in respect of the restriction of prices for such domestic customers and setting out their effect; and
 - (b) the reasons why he proposes to make the modifications.
 - (3) If the Director has given a notice under sub-paragraph (1) above, this Condition shall cease to have effect—
 - (a) on 1st July 2001; or
 - (b) if the Director has given a notice to the Licensee of his determination that competition will have sufficiently developed by an earlier day in respect of such domestic customers to justify the disapplication of this Condition, on that earlier day,
- unless, before 1st July 2001 or any such earlier day, the Director has made a reference to the Competition Commission under section 24(1) of the Act relating to the modification of this Condition.

Appendix 2: Relevant Background

Introduction

A.2.1 This chapter sets out some relevant background to Ofgem's Final Proposals for the future regulation of BGT's prices, including:

- ◆ the price control review consultation process;
- ◆ an overview of BGT's 1997-2000 price control;
- ◆ the Director General's Statutory Duties under the Gas Act 1986;
- ◆ Standard Condition 13 of BGT's Gas Suppliers' Licence; and
- ◆ the Competition Act 1998.

Price control review consultation process

A.2.2 This is the fourth document Ofgem has published as part of its review of BGT's price regulation. In June 1999 Ofgem published a consultation document¹⁹ on the issues to be considered in this review. Ofgem published, in November 1999, its Initial Proposals²⁰ for the regulation of BGT's prices for its domestic customers from 1 April 2000. Ofgem published its Final Proposals in February 2000.

A.2.3 To inform its review, Ofgem assessed the development of competition in the domestic gas supply market. In July 1999, Ofgem issued a survey to all domestic gas suppliers to obtain information on the development of competition.²¹ Ofgem published its conclusions to its competition assessment in December 1999^{22, 23}.

¹⁹ "Review of British Gas Trading's Price Regulation: A Consultation Document", Ofgem, June 1999.

²⁰ "Review of British Gas Trading's Price Regulation: Initial Proposals", Ofgem, November 1999.

²¹ "1999 Domestic Gas Market Survey", Ofgem, July 1999.

²² "A Review of the Development of Competition in the Domestic Gas Market", Ofgem, December 1999.

²³ All the documents in this section can be obtained from the Ofgem website: www.ofgem.gov.uk.

BGT's price control (1 April 1997 – 31 March 2000)

A.2.4 BGT's price control over the period 1 April 1997 – 31 March 2000 set a cap on the level of the standing and commodity charge for three regulated categories of BGT's tariffs.

These three categories were:

- ◆ Direct Debit. This includes customers who pay their bill by monthly direct debit and who do not have an overdue account ('Category A');
- ◆ PromptPay. This includes standing order and quarterly variable direct debit customers and those customers that pay by cash or cheque in full within ten days of the date of that bill. The customer receives a fixed reduction off their next bill for gas supplied ('Category B') and;
- ◆ Standard/PrePayment tariff. This includes customers paying by cash or cheque who pay their bill after ten days from the date of that bill; customers paying by magnetic card or DSS Direct; and customers whose gas is supplied through a prepayment meter ('Category C').

A.2.5 The form of the tariff caps had two principal elements:

- ◆ an RPI-X element. This capped the charges levied by BGT for its supply costs, such as the costs for billing, marketing, customer administration and meter reading activities²⁴. The level of X was set at 4% per year for the duration of the price control period; and
- ◆ a pass-through element. This allowed BGT to pass through to its customers the costs of its gas and storage purchases, transportation (including connections and systems extensions) and meter provision. The passthrough of these costs was subject to a requirement on BGT to purchase these services economically.

²⁴ In July 1997, BGT applied to Ofgas to have its tariff caps rebalanced. The conclusions of Ofgem's review are set out in: "Review of BGT's Domestic Supply Tariffs: A Decision Document", Ofgas, July 1998.

Gas Act 1986

A.2.6 The Director General of Gas Supply (DGGs) must fulfil the functions assigned to him under the Gas Act 1986 (as amended by the Gas Act 1995) in the manner that is best calculated to fulfil the duties described in Section 4 of that Act. These duties include:

- ◆ securing that all reasonable demands for gas are met;
- ◆ securing effective competition in the supply of gas;
- ◆ ensuring that licence holders are able to carry on their licensed activities; and
- ◆ protecting the interests of gas consumers in respect of prices charged and the other terms of supply.

Standard Condition 13 of the Gas Suppliers' Licence

A.2.7 Under Standard Condition 13, a dominant gas supplier is prohibited from showing undue preference, or exercising undue discrimination against any person or class of persons. A dominant supplier is also prohibited from setting terms that are predatory or unduly onerous. Standard Condition 13 becomes less prescriptive after competition is established. When competition is established, a dominant supplier is able to set terms in a way that is reasonably necessary to meet established competition, but not in a way that is predatory or unduly onerous.

A.2.8 The Utilities Bill is currently being passed through Parliament. Part of the Utilities Bill deals with the Standard Licence conditions that apply to all gas and electricity suppliers, attempting to make these as consistent as possible to reflect the increasing convergence of the two markets. Ofgem intends to publish a consultation document that deals with the issue of aligning the non-discrimination licence conditions in the Standard Gas Suppliers' Licence (Standard Condition 13) and the Standard Electricity Suppliers' Licence (Standard Condition 4 and 4a)

A.2.9 Standard Condition 13 deals only with issues of undue discrimination and undue preference in the terms set for gas supply, including the charges set. It does not address all aspects of anti-competitive behaviour. It complements, and does not substitute for the normal operation of UK competition law.

The Competition Act 1998

A.2.10 The substantive provisions of the Competition Act 1998 (the Act) came into force on 1 March 2000. The Office of Fair Trading (the OFT) and the sector regulators, including Ofgem, will enforce the Chapter I and II Prohibitions using their concurrent powers.²⁵ Ofgem has concurrent powers to enforce the Act in the gas and electricity industries in Great Britain.

A.2.11 The Chapter I prohibition prohibits agreements, decisions by associations or concerted practices that have the object or effect of restricting, distorting or preventing competition. The Chapter II prohibition prohibits the abuse of a dominant position.

A.2.12 It is likely that the Chapter II prohibition will be of most relevance to Ofgem in the context of BGT's prices for its domestic customers. The approach that Ofgem would take in any investigation under the Act was explained in the advance draft 'Energy Guidelines' that Ofgem published for the application of the Act to the gas and electricity markets.²⁶

²⁵ Guidelines for the application of the Competition Act 1998 are available from the OFT.

²⁶ "Draft Energy Guidelines under the Competition Act 1998", Ofgem, December 1999. Ofgem will shortly publish its Energy Guidelines for formal consultation.

Appendix 3: Issues Raised by BGT Relating to the Drafting of the Licence Modification

BGT's views

A.3.1 BGT expressed three main concerns about the draft licence modification attached to the Final Proposals. These were:²⁷

- ◆ Paragraph 2 relating to Accepted Variations. BGT said that it wanted flexibility to introduce a supplementary charge for customers on some IPGT networks because of the high costs of serving some of these customers. BGT said it did not want to use the Accepted Variation procedure, set out in paragraph 2, for introducing a more cost reflective charging structure since raising all the caps would not allow the introduction of the IPGT specific charges required. BGT said that the additional costs of supplying on the non-Centrica IPGT networks had not been included in the costs provided to Ofgem because it did not presently supply gas to these customers;
- ◆ Paragraph 3 relating to information to customers. BGT said that the protection offered by paragraph 3 relating to the obligation on BGT to provide, at least once a year, information about its other tariffs to price controlled customers was unnecessary, given that it is a licence obligation for all suppliers to make its full terms and conditions available to anyone who requests them; and
- ◆ Paragraph 5 relating to duration of the control. BGT said it was concerned about the possibility that the duration of the price control could be extended from 12 months to 15 if Ofgem held a view on 1 February 2001 that competition was not sufficiently developed. BGT suggested that the wording of the licence amendment should include reference to additional action to be taken by Ofgem in such circumstances, and that the timetable should be shortened to ensure that the price control could not last longer than 12 months including any proposal

²⁷ Paragraph numbers relate to the draft licence modification attached to the Final Proposals.

for further modification.

Ofgem's conclusion

- A.3.2 In setting the revised tariff caps, Ofgem set a revenue allowance it considered sufficient to cover all BGT's customers supplied on the remaining regulated terms. However, in some instances of IPGT charging, an Accepted Variation would mean only a very small adjustment in BGT's tariff caps, which may cost BGT more to implement than the additional revenue it would receive from the supplementary IPGT charge. In these circumstances, there might be a risk that BGT will be incentivised to price in a potentially anti-competitive manner. Therefore, Ofgem has concluded that BGT should be allowed to charge customers on IPGT networks a supplementary charge up to the amount specified in Standard Condition 3(2)(b) and (c) of the Gas Suppliers' Licence. This limits the supplement to the difference between the IPGT's charge and Transco's charge for conveying gas to a comparable premises.
- A.3.3 Ofgem does not agree with BGT that the provisions of paragraph 3 overlap with the provisions of the Standard Conditions. There is no requirement in the Standard Licence Conditions that obliges suppliers to provide details of all their tariffs and offers unless requested to do so. Nevertheless, in the context of our firm intention to remove all gas price controls from 1 April 2001, Ofgem does not consider it appropriate to maintain this additional restriction on BGT. It should be noted, however, that Ofgem is currently looking at ways of improving the information provided by all gas suppliers.²⁸
- A.3.4 Ofgem does not agree with BGT that the timetable for the disapplication procedure in paragraph 5 should be brought forward to ensure that if necessary, any reference to the Competition Commission should be made by 1 April 2001. Ofgem believes that it is prudent to allow more time to make a considered reference to the Competition Commission in the event that BGT and Ofgem could not agree a revised licence modification.
- A.3.5 However, Ofgem has sought to give greater clarity in the licence modification on the

²⁸ "Comparing Electricity and Gas Prices: A Consultation Paper" Ofgem, February 2000.

disapplication procedure. Following discussions with BGT, Ofgem has agreed to add a requirement on Ofgem to notify BGT by 1 March 2001 of the reasons and effects of any alternative arrangements for BGT's price regulation should Ofgem decide that competition is not sufficiently developed to justify the disapplication of the controls from 1 April 2000.

A.3.6 Ofgem has also made some minor drafting changes to the modification attached to the Final Proposals. These changes have been made to improve its internal consistency and clarity. These are:

- ◆ paragraph 4(1). The term '*in the year commencing on 1 April 2000*' has been changed to '*from 1 April 2000*'. This allows the price control to continue beyond 1 April 2001 if necessary;
- ◆ Part I of the table in paragraph 4. The term '*unit charge*' has been changed to '*charge for quantity of gas supplied*'. This change makes the text in the table consistent with the text in paragraph 4; and
- ◆ Paragraph 4(2)(b) relating to the second tier unit charge for PromptPay and Standard/PrePayment customers. Ofgem removed the clause '*or for an Additional Charge for the provision of particular goods or services*' on the grounds that it was unnecessary given the provisions contained within Standard Condition 13 prohibiting undue discrimination.

A.3.7 A licence modification incorporating these points is attached as Appendix 1. This has been agreed with BGT.

Appendix 4: Price Control Review Work Programme for 2000/01

A.4.1 Ofgem's process for reviewing BGT's price control over the coming year is summarised in the table below.

Table A.4.1 – Ofgem's proposed timetable to review BGT's price control in 2000/01

Date	Document/Event
May 2000	Publish Licence Modification document
June 2000	Workshop on assessing development of competition
July 2000	Publish Gas and Electricity Competitive Market Review Survey
November 2000	Publish Competition Assessment and Initial Proposals for BGT's price control review
December 2000	Public meetings/workshop on competition assessment and BGT's price control review
February 2001	Publish Final Proposals for BGT's price control review
March 2001	Publish Licence Modification (if necessary)