

December 2000

**A Review of the Development of
Competition in Domestic Gas and
Electricity Supply**

Summary

This document explains the conclusions of Ofgem's review of the development of competition in the domestic gas and electricity supply markets, and the small business electricity market. In August 2000, Ofgem published a survey seeking quantitative and qualitative information from gas and electricity shippers and suppliers, and other interested parties, on the development of competition in the domestic gas and electricity supply markets, and the small business electricity market. This document explains the conclusions of Ofgem's analysis of that information and other information collected for this review, including from Transco and the electricity distribution companies, and from MORI's survey of customer attitudes.

Overall, Ofgem believes competition is continuing to develop well in the gas supply market, albeit, perhaps more slowly than during the previous year. Customer switching per week is 57,327 up from about 52,500 last year; BGT's number of rivals exceeds that required for competition; and most customers are able to obtain competitive offers, with available discounts of up to 20% compared to BGT's tariffs. 'Dual fuel' offers are continuing to increase in importance, and competition is continuing to develop in the electricity market. There remain barriers to entry that need to be addressed, particularly in the electricity supply market. However, Ofgem has developed plans to address most of these issues in the coming 12 months.

Since BGT's price control was removed last April, competition has continued developing for direct debit customers. Competition has also continued to develop for BGT's PromptPay and LatePay customers, with BGT's market share again falling for this group as most of these customers were able to obtain alternative competitive offers. There remain significant numbers of LatePay customers who cannot switch supplier, because of BGT's right to block their transfer as they are in debt.

Over the last year, competition has not developed significantly for prepayment customers, and BGT has retained almost all these customers, as suppliers are not offering these customers a range of competitive tariffs. Ofgem believes that suppliers blocking transfers of customers in debt has a particularly adverse effect on the development of competition for these customers.

Ofgem would welcome comments on the issues raised in this document by 10 January 2001. The process for submitting responses is set out in Chapter 1.

Table of contents

1. Introduction.....	1
Purpose of this document.....	1
Background.....	1
Outline of this document.....	2
Views invited	3
2. Background.....	4
Regulatory framework.....	4
Market developments.....	7
3. Approach.....	11
Ofgem's market survey.....	12
Assessing the development of competition.....	13
4. Customer attitudes.....	18
MORI survey.....	18
Service levels.....	21
Conclusions.....	22
5. Entry and exit of shippers and suppliers.....	24
Licensed gas shippers and suppliers.....	24
Active gas competitors.....	26
Licensed electricity suppliers.....	26
Active electricity competitors.....	27
'Dual fuel' suppliers.....	27
Marketing 'alliances'.....	27
Conclusions.....	28
6. Market shares.....	29
Domestic gas supply.....	30
Domestic electricity supply.....	38

Small business electricity supply.....	38
'Dual fuel' supply.....	40
Conclusions.....	40
7. Customer switching behaviour.....	42
Domestic gas supply.....	42
Domestic and small business electricity supply.....	45
Conclusions.....	48
8. Prices and related offers.....	50
BGT's offers.....	50
Competitors offers compared to BGT's offers.....	53
PES offers.....	58
Competitors offers compared to the local PES offers.....	60
Conclusions.....	61
9. Barriers to entry.....	62
BGT's and the PESs' market position and behaviour.....	63
The general operation of the gas market.....	67
The general operation of the electricity market.....	71
Conclusions.....	74
10. Conclusions.....	75
Appendix 1 - Gas and electricity supply licences.....	80
Gas suppliers' licence.....	80
First and second tier electricity licences.....	83
Appendix 2 - BGT's related offers.....	86

1. Introduction

Purpose of this document

- 1.1 This document sets out Ofgem's conclusions from our latest review of the development of competition in the domestic gas and electricity supply markets, and the small business electricity market. It considers the developments to date and analyses competition's prospects for the future. It then contemplates the issues that need addressing to improve the prospects for the further development of competition. This review follows the 1999 review of the designated¹ electricity market², and the 1999 review of the domestic competitive gas supply market.³
- 1.2 In August 2000, Ofgem sent a survey to all gas and electricity suppliers, and gas shippers in Great Britain, and other interested parties, requesting quantitative and qualitative information about the development of competition in the domestic gas and electricity supply markets and the small business electricity market.⁴ This information has informed this review of the development of competition in these markets.
- 1.3 Ofgem will be undertaking a further review of the development of competition in the domestic gas and electricity markets, and the small business electricity market next year. This review will help to inform Ofgem's proposals for the future price regulation of the PESs domestic electricity tariffs.

Background

- 1.4 British Gas Trading's ('BGT's') statutory monopoly to supply gas throughout Great Britain to domestic customers (defined as those customers consuming at or below 73,200 kWh of gas a year) has been gradually removed, with competition being phased in between April 1996 and May 1998. From April 2000, Ofgem removed BGT's price control for domestic gas direct debit customers because competition had developed sufficiently to allow Ofgem to use Standard

¹ The designated electricity market includes all customers who either have a maximum demand of less than 100kW a year or an annual consumption of less than 14,000kWh.

² "A review of the development of competition in the Designated Electricity Market", Ofgem, June 1999.

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

⁴ "Domestic gas and electricity supply, Market survey 2000", Ofgem, August 2000.

Condition 13 of the gas suppliers' licence and competition law to protect these customers.⁵

- 1.5 The price control for BGT's other domestic gas customers (those paying by PromptPay, LatePay and PrePayment) is due to expire on 31 March 2001. Last year Ofgem stated that it was its firm intention not to have a further price control on BGT's domestic gas customers, subject to satisfactory progress in removing the remaining barriers to entry. This review has informed Ofgem's review of BGT's domestic gas supply price regulation.
- 1.6 Proposals for the future price regulation of BGT's domestic gas tariffs have been published at the same time as this document.⁶
- 1.7 Ofgem's proposals have three elements:
- Removing specific controls on BGT's remaining price-controlled tariffs – PromptPay, LatePay and PrePayment – from 1 April 2000;
 - BGT undertaking not to widen the difference between its domestic tariffs, and to keep a combined LatePay/PrePayment tariffs at least for a further year; and
 - BGT making substantial progress in allowing customers who are in debt to switch supplier.
- 1.8 If BGT do not accept these proposals, Ofgem propose to introduce a specific price control condition which would cap the differences between BGT's Direct Debit and LatePay/PrePayment tariffs, and between BGT's PromptPay and LatePay/PrePayment tariffs, to their current levels for a further year.

Outline of this document

- 1.9 Chapter 2 outlines the regulatory framework against which competition is developing and describes recent developments affecting the regulation of the sector. Chapter 3 explains Ofgem's approach to reviewing the development of

⁵ "Review of British Gas Trading's price regulation, Licence modification", Ofgem, June 2000.

⁶ "Review of British Gas Trading's Price Regulation: Initial Proposals", Ofgem, December 2000

competition and explains the factors that were taken into account. The remaining chapters of the document look at each of these factors in turn.

- 1.10 Chapter 4 considers the available evidence on customers' awareness and understanding of competition, their future intentions with regard to changing supplier and the issues customers believe are important in determining those intentions. Chapter 5 describes the extent of suppliers' entry into, and exit from, the gas and electricity supply markets in the last year, including any ownership changes. Chapter 6 analyses suppliers' market shares and considers recent trends. Chapter 7 considers customers' switching behaviour, including movements between suppliers and payment methods. Chapter 8 analyses the range of price and other offers available to customers. Chapter 9 considers the qualitative responses to Ofgem's 2000 market survey and the remaining barriers to entry. Chapter 10 summarises the conclusions about the development of competition in Chapters 4 to 9.

Views invited

- 1.11 It would be helpful to receive responses to the issues raised in this document by 10 January 2001. Responses should be addressed to:

Nick Fincham
Director, Supply
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

- 1.12 Respondents can mark all or part of their responses as confidential. However, we would prefer, as far as possible, that responses are provided in a form that can be placed in Ofgem's library.
- 1.13 If you have any queries concerning this consultation then Giles Stevens on (020) 7901-7082 (email: giles.stevens@ofgem.gov.uk) will be pleased to help.

2. Background

Regulatory Framework

2.1 The Utilities Act 2000 was given Royal Assent in July 2000. This Act had the effect of amending the gas and electricity regulatory framework in certain key respects. In this section the new regulatory framework relevant to this review is discussed, including:

- the Gas Act 1986 (as amended);
- the Electricity Act 1989 (as amended);
- the gas suppliers' licence; and
- the first and second tier electricity licences.

The Gas Act 1986 (as amended)

2.2 Section 4 of the Gas Act 1986 (as amended) sets out the duties that the Gas and Electricity Markets Authority ('the Authority') must take into account when exercising its functions under the Act. The Authority has a principal objective to protect the interests of consumers, both existing and future, in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition, between persons engaged in, or commercial activities connected with, the shipping, transportation or supply of gas so conveyed. Subject to this duty, the Authority should have regard to the need to ensure that all reasonable demands for gas are met and the need to secure that licence holders are able to finance their activities, which are subject to obligations under the Act. In performing these duties, the Authority should have regard to the interests of, amongst others, individuals who are disabled or chronically sick, of pensionable age, of low income and those living in rural areas.

The Electricity Act 1989 (as amended)

2.3 The general duties of the Authority are set out in Section 3 of the Electricity Act 1989 (as amended). The Authority's functions are set out in sections 1 and 47 to 50 of the Electricity Act 1989 (as amended). The principal objective of the Authority in carrying out its functions is to protect the interests of consumers,

both existing and future, in relation to electricity conveyed by distribution systems, wherever appropriate by promoting effective competition, between persons engaged in, or in commercial activities connected with the generation, transmission, distribution or supply of electricity, having regard to the need to secure that all reasonable demands for electricity are met and the need to secure that licence holders are able to finance the activities, which are subject to obligations under the Act. In performing these duties the Authority should have regard to the interests of, amongst others, individuals who are disabled or chronically sick, of pensionable age, of low income and those living in rural areas.

The gas suppliers' licence

2.4 The Gas Act 1986 (as amended) provides for the licensing of gas suppliers. These licences contain standard conditions that apply to all suppliers. Most relevant for this review are:

- general obligations;
- blocking transfers of customers in debt;
- marketing;
- social obligations; and
- non-discrimination conditions.

2.5 These are summarised in Appendix 1.

The first and second tier electricity licences

2.6 The Electricity Act 1989 (as amended) provides for the licensing of first and second tier electricity suppliers. The first and second tier electricity licences contain conditions that apply to all suppliers. Most relevant for this review are:

- general obligations;
- marketing;
- social obligations; and

- non-discrimination conditions.

2.7 These are summarised in Appendix 1. The provisions allowing electricity suppliers to block the transfer to another supplier of customers in debt are contained in the Master Registration Agreement ('MRA'), which all electricity suppliers are required to sign. The provisions allowing debt blocking in the designated electricity market are the same as those applying in the domestic gas supply market.

Competition Law

2.8 The Authority has concurrent powers with the Director General of Fair Trading ('DGFT') to enforce the Competition Act 1998 and the Fair Trading Act 1973 in the gas and electricity sectors.

2.9 The Competition Act 1998 contains two prohibitions. Chapter I prohibits agreements, decisions by associations or concerted practices, whose object or effect is the restriction, distortion, or prevention of competition in the United Kingdom. Chapter II prohibits the abuse of a dominant position by an undertaking in the United Kingdom. Undertakings found to have breached the Act face a fine of up to 10% of UK group turnover for each year of the infringement, up to a maximum of 3 years.

2.10 The Office of Fair Trading ('OFT') and the sector regulators have developed guidelines to explain how the Act will be interpreted. Copies of these guidelines are available on the OFT website at www.offt.gov.uk. In May 2000, Ofgem and OFT formally consulted on the guideline explaining how the Act would be applied to the gas and electricity sectors⁷, and expect to publish the final guideline shortly.

2.11 The Fair Trading Act 1973 allows scale or complex monopolies to be examined. Ofgem may make a reference to the Competition Commission to establish whether a monopoly situation operates, or may be expected to operate, against the public interest.

⁷ "Competition Act 1998, Application to the Energy Sectors, Formal consultation draft", Ofgem and OFT, May 2000.

Recent developments

2.12 In this section, recent developments in the regulation of this sector are discussed, namely:

- the 1999 designated electricity competitive market review;
- the 1999 domestic gas competitive market review;
- BGT and the PESs' current supply price controls;
- proposed removal of supply non-discrimination licence conditions; and
- DTI research into reasons why customers switch supplier.

2.13 The National Audit Office ('NAO') has been investigating the opening of the domestic and small business electricity market to see whether there are any lessons to learn from the process and what further measures can be taken to increase the benefits customers obtain from competition. The NAO's report is expected to be published shortly.

Ofgem's 1999 designated electricity competitive market review

2.14 In June 1999, Ofgem published its review of the development of competition in the domestic and small business electricity market. The review was published only about 10 months after competition had opened in some areas and about a month after competition had opened in all areas. Nevertheless, the review concluded that the prospects for the future development of competition were good, subject to appropriate monitoring of PESs' behaviour, and in particular, their complementary products and 'dual fuel' offers.

Ofgem's 1999 domestic gas competitive market review

2.15 Overall, Ofgem believed that competition in the gas supply market was developing well. 96% of customers were aware they could choose an alternative gas supplier, 25% of customers had switched gas supplier; switching over the 12 month period leading up to the publication of the report had averaged about 32,000 customers 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 available discounts of up to 20% compared with BGT's tariffs.

- 2.16 Increasingly, the historically distinct gas and electricity supply markets were characterised by 'dual fuel' offers, with almost half of electricity and gas switchers supplied on 'dual fuel' contracts. Ofgem remained concerned about barriers to entry in the electricity supply market, many of which it planned to address over the next 18 months.

BGT and the PESs current price controls

- 2.17 BGT's prices to PromptPay, LatePay and PrePayment domestic customers are subject to a price control contained in Special Condition 3 of BGT's gas suppliers' licence. The price control caps the prices that BGT can charge customers electing to pay by the PromptPay, LatePay and PrePayment tariffs. The price control will lapse at the end of March 2001 unless Ofgem informs BGT by the end of February 2001 that it does not believe competition is sufficiently developed to protect customers. If agreement could not be reached with BGT on alternative regulation, Ofgem would have until July 2001 to refer such alternative proposals to the Competition Commission.
- 2.18 Ofgem's proposals have three elements:
- Removing specific controls on BGT's remaining price-controlled tariffs – PromptPay, LatePay and PrePayment – from 1 April 2000;
 - BGT undertaking not to widen the difference between its domestic tariffs, and to keep a combined LatePay/PrePayment tariffs at least for a further year; and
 - BGT making substantial progress in allowing customers who are in debt to switch supplier.
- 2.19 If BGT do not accept these proposals, Ofgem propose to introduce a specific price control condition which would cap the differences between BGT's Direct Debit and LatePay/PrePayment tariffs, and between BGT's PromptPay and

LatePay/PrePayment tariffs, to their current levels for a further year.

- 2.20 PESs prices to standard⁸ and prepayment customers in their areas are subject to a price control contained in Condition 3b of their licences.⁹ The price control is due to run until the end of March 2002. Standard prices are capped for 2000/1 and cannot increase in real terms in 2001/2. Prepayment prices must not exceed the standard tariff by more than £15. Ofgem has signalled its intention to remove the price control from the PESs from April 2002, subject to the development of competition.

The removal of the supply non-discrimination conditions

- 2.21 In July 2000, Ofgem proposed removing the supply non-discrimination conditions from the licences of all gas and electricity suppliers.¹⁰ Fifteen respondents to the consultation supported Ofgem's proposal because they believed that the Competition Act 1998 gave Ofgem sufficient powers to address anti-competitive behaviour in retail supply markets. Seven respondents supported retaining some form of non-discrimination condition because they believed that incumbent suppliers retained a large amount of market power and that Ofgem would be able to act more quickly against anti-competitive behaviour under its sector specific powers rather than Competition Act 1998.
- 2.22 Ofgem considered carefully the responses to the consultation and decided to confirm its proposal to remove the supply non-discrimination licence conditions in its final proposals, for the gas and electricity supply licences, that it will submit for approval by the Secretary of State for Trade and Industry ('the Secretary of State') under the Utilities Act 2000.¹¹ Ofgem believed that it was appropriate to remove the supply non-discrimination conditions because as competition develops in the retail supply markets the Competition Act 1998 provides sufficient power for Ofgem to address anti-competitive behaviour. The removal of the conditions would allow potentially pro-competitive offers to be

⁸ The standard tariff includes payment by cheque and cash quarterly.

⁹ "Review of Public Electricity Suppliers 1998 to 2000, Supply Price Control Review, Final Proposals", Ofgem, December 1999.

¹⁰ "Gas and electricity supply licences, Proposals for standard non-discrimination licence conditions", Ofgem, July 2000.

¹¹ "The Utilities Act Standard Licence Conditions Volume 1: Final Proposals", Ofgem, October 2000.

available to customers more quickly. Ofgem expects to recommend a new set of licences to the Secretary of State early next year.

The Department of Trade and Industry's ('DTI's') review of customer attitudes to switching

- 2.23 Last November the Secretary of State announced a review by the DTI to better understand customers switching attitudes, and whether any measures could encourage more customers to switch supplier and take advantage of lower prices. The review compared customers attitudes for gas, electricity, fixed line telephones, mobile telephones, car insurance, home insurance, mortgages and current accounts.
- 2.24 On 24 November 2000 the DTI published the review's conclusions. It found that the levels of switching in the gas and electricity markets was relatively high compared with the other sectors reviewed, with only car insurance, home insurance and mobile telephones having comparable levels of switching. The review found that consumers' propensity to switch depended on having information about the offers of competing suppliers. Most customers who had switched gas or electricity suppliers had faced few problems when doing so, although there was some evidence that customers found difficulty comparing prices.

3. Approach

Ofgem's 2000 market survey

3.1 In August 2000, Ofgem sent a survey to all gas and electricity suppliers, and gas shippers. It sought quantitative and qualitative information about the development of competition in the domestic gas and electricity supply markets, and the small business electricity market. The quantitative survey sought information about:

- shipper/ supplier name, ownership structure, licences held, brand names, marketing channels and the name of their gas supplier(s)/ gas shipper(s);
- tariffs, related incentives, customer numbers, volumes shipped/ supplied and customers in debt, for each PES area or other area, for the quarters ending 30 September 1999, 31 December 1999, 31 March 2000 and 30 June 2000; and
- shippers' and suppliers' expenditure in the year to 30 June 2000.

3.2 The quality of the information provided varied, although it was mostly of sufficient quality to enable Ofgem to carry out its analysis. Some suppliers had difficulty in providing information about gas supply on a regional basis, and information about the number of their customers in debt such that the supplier can block the transfer to another supplier. Ofgem has supplemented survey data with information from MORI's survey of domestic customer attitudes, and information from Transco and the electricity distribution businesses.

3.3 Due to its severe problems in billing domestic customers, Independent Energy did not provide a response to the market survey prior to entering receivership. The lack of information from Independent Energy may in some cases have had a small affect on the accuracy of some of the market shares calculated in Chapter 6.

3.4 Ofgem also sought interested parties' views on the qualitative issues that may create new barriers to entry into the gas supply market, or allow existing barriers

to remain in place, thereby adversely affecting the development of competition.

Ofgem sought specific views on:

- BGT and the PESs' market position and behaviour;
- PESs operation of the prepayment meter infrastructure; and
- competition for customers on Independent Public Gas Transporter ('IPGT') networks.

3.5 Respondents' views on these issues, and other issues raised by respondents are discussed in chapter 9. Below, we explain how the information has helped assess the development of competition.

Assessing the development of competition

3.6 The action needed to promote effective competition in supply markets and to protect customers' interests 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. Domestic customers have been able to choose a gas supplier other than BGT since the market opened in phases between April 1996 and May 1998. Designated electricity customers, including domestic and small business customers, have been able to choose an electricity supplier other than their host PES since the market opened in phases between September 1998 and May 1999. However, the removal of BGT and the PESs statutory monopolies 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 more than just the absence of a statutory monopoly.

3.7 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.
- 3.8 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 prevents 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.
- 3.9 Where competition is well developed the enforcement of general competition law should provide sufficient safeguards for customers in the gas and electricity supply markets, thereby removing the need for specific regulation under either the Gas Act 1986 (as amended) or the Electricity Act 1989 (as amended) of prices and levels of service.
- 3.10 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 supply markets in their entirety. The functioning of the markets 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.
- 3.11 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 the extent and the

nature of the market power concerned, as well as the prevailing market conditions.

- 3.12 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 smaller¹², 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.
- 3.13 In the domestic gas and electricity supply markets, 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.
- 3.14 In addition to 'organic' customer acquisition techniques, which require the customer to switch supplier, over the past 12 months customer acquisition has increasingly taken the form of acquisitions of supply businesses, and their associated customer base. During this period values – as expressed per

¹² "A Review of the Development of Competition in the Industrial and Commercial Gas Supply Market", Ofgem, August 2000.

customer – have increased reflecting raised expectations of the profitability of the inherited customer base.

3.15 While some factors – lower cost per customer, through scale and joint provision of related products – suggest continued acquisitions are good news for customers, other factors – a reduction in the number of rivals – could mean that benefits will not ultimately find their way through to customers in the form of lower prices and/ or innovation. There is also the possibility that increasing prices for acquisitions reflect a view that customer inertia is increasing. Ofgem needs to consider these factors carefully in assessing the prospects for the future development of competition.

3.16 Bearing in mind the dynamic nature of competition, Ofgem has considered in this document the following indicators of the development of competition:

- customers' awareness of the opportunity to choose an alternative supplier and the range of competing offers (Chapter 4);
- suppliers' behaviour, including entry and exit (Chapter 5);
- suppliers' performance, in particular suppliers' market shares (Chapter 6);
- customers' behaviour, including switching suppliers and payment methods (Chapter 7);
- the range of price and related offers available from new entrants, including 'dual fuel' (Chapter 8); and
- potential barriers to the development of competition (Chapter 9).

3.17 To inform Ofgem better as to whether, and for which groups of customers, price regulation on BGT may remain relevant, this review has paid particular attention to whether competition is 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.

3.18 The way Ofgem asked for information in the market 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 reduced¹³ and was reduced last year. In this document, Ofgem has classified customers using the following characteristics:

- tariffs and payment methods;
- volumes consumed;
- where they live, based on the areas of domestic gas competition rollout and PES areas;
- 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.

3.19 As discussed above, the quality of information available to look at all these splits varies.

¹³ In practice, 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.

4. Customer attitudes and service levels

4.1 This chapter discusses evidence about the:

- level of customer awareness and understanding of the competitive gas and electricity supply markets; and
- service levels offered by suppliers in the market.

MORI survey

4.2 Ofgas and Offer, and subsequently Ofgem, have commissioned MORI to undertake a number of studies of customers' awareness of, experience of, and attitudes towards the competitive gas and electricity supply markets. These surveys have complemented the views expressed by customer groups on consumers' experience of competition.

1999 Results

4.3 During September and October 1999, Ofgem commissioned MORI to undertake a survey into customers' perceptions of the development of gas and electricity competition. The results of the survey were published in January 2000.¹⁴ The main conclusions from the survey were that:

- 96% of those interviewed were aware that competition had been introduced into the domestic gas market, and 95% were aware of competition in the domestic electricity market;
- customers said they had not changed supplier from BGT in gas or their local PES in electricity, because they were happy with the price and service they received from BGT or the local PES, and could see no reason to change supplier;
- 76% of customers gave price as the main reason for switching supplier;
- only 6% of electricity switchers and 8% of gas switchers found the process for switching supplier difficult;

¹⁴ "Electricity and Gas Competition Review, A Research Study Conducted for Ofgem by MORI", Ofgem, January 2000.

- a significant minority of customers found it difficult to compare the prices of gas and electricity suppliers;
- gas and electricity customers paying through prepayment meters were less likely to have switched supplier than customers paying by other payment methods;
- the majority of customers found doorstep visits by suppliers to be very or fairly informative. 32% of gas customers and 33% of electricity customers did not find the visit informative, mainly due to the suppliers' representatives being 'too pushy'; and
- a majority of customers were happy with the level of service they received from their current gas and electricity suppliers.

2000 Results

4.4 Following the 1999 survey, Ofgem commissioned MORI to undertake a further survey of customers' attitudes to the development of gas and electricity supply competition. MORI interviewed a representative sample of 2,238 electricity and gas customers in Great Britain during September and October 2000. Ofgem has recently received preliminary results from MORI and intends to publish the full results of the survey in January 2001. The findings show that:

- 87% of those interviewed were aware that British Gas/ Scottish Gas supplied gas in their area. 61% were aware that British Gas/ Scottish Gas supplied electricity in their area. The next most recognised supplier was Powergen, with 34% of customers aware that it supplied electricity, and 19% that it supplied gas in their area. Only 2 other suppliers were known by more than one fifth of interviewees as a supplier of gas or electricity in their area. The survey did not specifically assess customers' awareness of the host PESs' activities;
- 29% of gas customers and 19% of electricity customers had changed, or signed a contract to change supplier. Of those who had not changed, about 77% gave, 'see no reason to change/ satisfied with current supplier' as one of their main reasons for not switching. Around 27% of non-switchers in electricity and 22% in gas said that changing supplier

was too much hassle. 24% of electricity switchers (21% of gas switchers) said that the ability to buy gas and electricity from the same company had influenced their decision to switch. 20% of customers who had switched gas supplier, and 17% who had changed electricity supplier, had switched more than once. 48% and 44% of those customers respectively, had returned to their original supplier, i.e. BGT or the local PES. 12% and 13% respectively said they were certain or likely not to change again in the next 12 months. About 7% of non-switchers in the gas and electricity markets said they were certain or very likely to change supplier in the next 12 months;

- 'Cheaper prices' was the most common reason for customers switching supplier, with 76% of electricity and 77% of gas switchers stating that price was one of the main reasons for switching supplier. About 71% of non-switchers said that if they were to switch, price would be a main consideration. 60% of customers said they thought that new entrants to the electricity and gas supply markets offered similar or lower prices than the incumbent suppliers;
- 89% of switchers had found it very or fairly easy to switch supplier. 70% thought it would be very or fairly easy to switch supplier;
- 60% of interviewees had not received any information on the gas and electricity prices that the various suppliers are currently charging. Of those that had seen or heard pricing information, 42% found it very or fairly easy to compare prices across the various suppliers and 33% found it very or fairly difficult;
- 33% of electricity (32% of gas) customers currently pay by monthly direct debit, and 26% (28%) by quarterly cash/cheque. Of customers who had switched supplier, 29% (29%) paid bills to their previous supplier by monthly direct debit, and 31% (35%) paid by quarterly cash/cheque. Of customers on prepayment meters, 26% of gas customers and 29% of electricity customers said they would change to a normal credit meter if this meant a price reduction. This suggests that a significant proportion of prepayment customers like this payment method as a way of budgeting;

- 62% of customers had been visited by a doorstep salesperson from a gas or electricity supplier. 12% of electricity and 13% of gas switchers said that a salesperson had influenced their decision to switch supplier.; and
- the vast majority of customers were satisfied with all aspects of service from their new supplier. The most important aspect of customer service for most interviewees was getting the supply back quickly if it is cut off.

Service levels

- 4.5 The results of the MORI survey suggest that customers are generally happy with the level of service they receive from their supplier. Prior to the introduction of competition, Ofgas and Offer set minimum standards, which all the incumbent monopoly suppliers were required to meet. These incumbent suppliers are still required to meet these standards.
- 4.6 Since competition has been introduced some suppliers have sought to differentiate their offers by varying service levels, e.g. more frequent meter readings or dual billing of gas and electricity. There has also been a concerted effort on the part of suppliers to combine gas and electricity services with other household products, e.g. telephony and financial services. From the MORI survey it appears that service levels have not deteriorated as a result of competition.
- 4.7 Due to the wide range of aspects to the service levels offered by suppliers, it is not clear that there is any one appropriate measure of service levels. However, the MORI survey provides an indication of customer satisfaction, as does the level of complaints received about different suppliers. Below is a summary of the information Ofgem publishes on its website comparing the number of complaints received about different suppliers. This information is published as a rolling average for the number of complaints against each supplier for the calendar year so far, on a quarterly basis.
- 4.8 Most complaints received by Ofgem about suppliers concern customer accounts (49%) and the transfer process (40%). There is a general downward trend in the number of complaints, but a wide variation between suppliers.

- 4.9 In gas there is an industry average of 0.08 customer account complaints per thousand customers (down from 0.12 in the last quarter of 1999), ranging from one supplier with 0.28 complaints per thousand customers to one supplier with no complaints per thousand customers. The average number of transfer complaints for gas is 5.55 per thousand transfers (down from 8.96 in the last quarter of 1999). This is affected by one very high supplier figure of 32.08, with the next highest being 14.59. The lowest figure was 1.63.
- 4.10 In electricity, the industry average was affected by the large number of complaints received about Independent Energy. It experienced severe problems with billing customers and went into receivership in September 2000. For the period January to August 2000, the average number of electricity customer account complaints per thousand customers was 0.04 (up from 0.03 in the last quarter of 1999). Excluding Independent Energy (0.75 complaints per thousand customers), individual suppliers complaints ranged from 0 to 0.38 per thousand customers.
- 4.11 Independent Energy had 15.30 electricity transfer complaints per thousand transfers. For other suppliers, the range was 0.26 to 8.54. The industry average for the period was 2.68, compared with 3.41 for last quarter of 1999.

Conclusions

- 4.12 There are mixed signals about the extent of customers' understanding of competition. It is encouraging, for example, that 60% of customers thought the prices of new suppliers were lower than those offered by the incumbents (which is broadly true). On the other hand, there were only four suppliers that more than a fifth of the population were aware supplied gas or electricity in their area.
- 4.13 A majority of switchers gave 'cheaper prices' as the main reason for switching. Further encouraging results for the further development of competition include that 89% of switchers found it easy to change supplier, and the number of non-switchers who said they were likely to change supplier in the next twelve months is very similar to last year's figure. It is slightly higher for those who have already switched. A significant proportion of switchers appear to have been attracted by the prospect of a 'dual fuel' deal.

4.14 The MORI survey suggests that the majority of customers are satisfied with the service they receive from their supplier. Ofgem's complaint statistics show that supply complaints are falling.

5. Entry and exit of shippers and suppliers

5.1 The choice available to customers in the gas and electricity markets is a fundamental feature of a competitive market. While Ofgem does not consider that there is an ideal number of competitors for a well functioning competitive market, it is important that there is sufficient rivalry within the market to ensure that customers have a choice of a range of competitive offers.

5.2 One indicator of the available choice and the level of rivalry is the number of suppliers and shippers in the gas market and the number of suppliers in the electricity market. This chapter explains the changes in the number of domestic gas shippers and suppliers, and electricity suppliers since July 1999.

Licensed gas shippers and suppliers

5.3 Table 1 shows the changes in the number of gas shippers and suppliers licensed to operate in the domestic market since July 1999.

Table 1 - The number of gas shippers and suppliers licensed to operate in the domestic market since July 1999

	Licensed gas shippers	Licensed gas suppliers
July 1999	106	26
November 2000	114	28

5.4 Since July 1999 there have been a number of new shipper licences issued. This is in part due to new companies entering the market, but it is also because current shippers have applied for additional licences. Since July 1999 there has been a small increase in the number of supply licences issued, with some entry and exit from the market.

5.5 Since July 1999 there have been a number of mergers and acquisitions that have changed the ownership structure of gas shippers and suppliers. These mergers and acquisitions have often also affected electricity supply. These mergers include:

- Scottish and Southern Energy's purchase of Swalec's supply business from British Energy;
- TXU Europe's purchase of Norweb Energi to add to its ownership of Eastern Energy;
- North Wales Gas' purchase of Energy Suppliers' UK Limited;
- Innogy's purchase of Independent Energy after it went in to receivership, to add to its npower supply business;
- Scottish Power's purchase of the Gas Supply Company, after its parent company decided to exit the gas supply market; and
- Amerada Hess' purchase of the customers of CPL British Fuels Limited.

5.6 In addition to these mergers and acquisitions, Ofgem is aware that Elf has put its gas supply business, Elf at Home, up for sale. One of the factors that some of the small gas suppliers have cited as having affected their viability is the high level of wholesale gas prices.

5.7 Over the last year, mergers and acquisitions have increased in importance as a way for suppliers to acquire additional customers, rather than through other acquisitions techniques, such as doorstep selling and telesales. The prices paid on a per customer acquired basis have increased in the recent mergers and acquisitions, reflecting a view of the increased profitability of the inherited customer base.

5.8 In evaluating the effect of mergers and acquisitions on the development of competition, Ofgem seeks to balance the prospect that such consolidations will reduce costs per customer through increased scale and the joint provision of related products, against the possibility that these benefits will not reach customers in the form of lower prices and/ or innovation, because of the reduced rivalry following the consolidation. Ofgem will seek to balance these considerations when considering the prospects for the development of competition as a result of each proposed consolidation.

- 5.9 Ofgem recognises the concerns of small gas suppliers about their continuing ability to compete in the gas supply market with current wholesale gas prices and the level of BGT's current supply price control tariff caps.

Active gas competitors

- 5.10 There is no specific requirement for licence holders to actively ship or supply gas to end users. A number of companies hold more than one shipping and/ or supply licence. Based on the results from Ofgem's survey, table 2 shows Ofgem's estimate of the change in the number of active competitors in the domestic gas market since July 1999.

Table 2 – Ofgem's estimate of the number of active shippers and suppliers

	Gas shippers	Gas suppliers
July 1999	22	21
November 2000	24	16

- 5.11 Table 2 shows that since July 1999 the number of active gas shippers has increased slightly and the number of active gas suppliers has fallen significantly, due to the mergers and acquisitions discussed above. However, there remain a significant number of suppliers.

Licensed electricity suppliers

- 5.12 Table 3 shows the changes in the number of electricity suppliers licensed to operate in the designated market since July 1999.

Table 3 - The number of electricity suppliers licensed to operate in the designated market since July 1999

	Licensed electricity suppliers
July 1999	21
November 2000	20

5.13 Since July 1999 the number of electricity supply licences issued has remained relatively constant. At present one supplier is in the process of obtaining 6 new electricity supply licences.

Active electricity competitors

5.14 There is no specific requirement for licence holders actively to supply electricity to end users. A number of companies hold more than one supply licence. Table 4 shows Ofgem's estimate of the number of active competitors in the designated electricity market.

Table 4 – Ofgem's estimate of the number of active electricity suppliers in the designated market since July 1999

	Electricity suppliers
July 1999	13
November 2000	13

5.15 Table 4 shows that since July 1999 the number of active electricity suppliers has remained relatively constant, although a number of companies have entered and exited the market during this period, as discussed above.

'Dual fuel' suppliers

5.16 Ofgem's current estimate is that there are 11 suppliers operating in both the gas and electricity markets. Chapter 6 discusses the increasing number of customers taking up 'dual fuel' offers.

Marketing 'alliances'

5.17 Although there has not been significant new entry of either gas or electricity suppliers since July 1999, a number of companies from other markets have entered the gas and electricity supply markets as partners of existing suppliers. These arrangements have taken various forms including joint ventures and partnership agreements. In all cases the customers have contracts with the supplier, although the other company is usually responsible for the marketing. These arrangements include:

- Virgin's offering of gas and electricity supply over the internet in a joint venture with London Electricity;
- BT's offer of gas and electricity supply over the internet with Scottish and Southern Energy;
- Servista's offer of gas and electricity supply over the internet with CPL British Fuels Limited; and
- Severn Trent Water's offer of gas with Amerada Hess Limited.

5.18 Ofgem generally welcomes these initiatives as increasing customer choice within the competitive gas and electricity supply markets.

Conclusions

5.19 There are currently 16 gas suppliers competing in the domestic market and 13 electricity suppliers competing in the designated market, with 11 companies offering 'dual fuel' supply. Since July 1999 there has been a fall in the number of competing gas suppliers due to mergers and acquisitions. The number of competing electricity suppliers has remained relatively constant. Ofgem believes that there are currently a sufficient number of suppliers in both the gas and electricity supply markets to ensure rivalry between suppliers to offer customers a range of competitive prices. This rivalry is also often enhanced by the new marketing alliances that have developed in the gas and electricity markets over the last year.

5.20 Ofgem recognises that some gas suppliers have faced difficult trading conditions in the recent months because of the level of wholesale gas prices and BGT's price caps.

6. Market shares

- 6.1 This chapter considers the market position of suppliers in the gas and electricity domestic supply markets and the small business electricity market. Market shares show suppliers performance at particular points in time, and trends in market shares show how that performance has developed over time. Market share is one measure of the development of competition, but it needs to be considered alongside the other evidence presented in this document.
- 6.2 Ofgem has calculated suppliers market shares for the national domestic gas and electricity markets, and the national small business electricity market, by customers supplied and volumes supplied. For electricity, Ofgem has also calculated the market shares by PES area. Ofgem has also estimated the number of customers supplied on 'dual fuel' offers and the number of customers in debt such that their supplier can object to the transfer of the customer to another supplier under Standard Condition 7(4) of the gas suppliers' licence.
- 6.3 These figures are compiled through a combination of information provided in response to Ofgem's market survey and from Transco and the electricity distribution companies. As a result the points in time at which market shares are calculated varies. The information provided in response to Ofgem's market survey was generally sufficient to allow the calculation of market shares at a number of points in time, although Ofgem has some concerns about the reliability of some of the information provided.
- 6.4 Not enough suppliers were able to provide gas information on a PES area basis to allow the calculation of market shares by PES area for gas. Instead, Ofgem has used information provided by Transco about market shares by the phases and tranches in which domestic competition was rolled out.

Domestic gas supply

National market share

- 6.5 Table 5 shows BGT's share of the domestic gas supply market as a whole by customers supplied at the end of October 2000 compared to the position at the end of October 1998 and October 1999.

Table 5 – BGT's share of the domestic gas supply market by customers supplied

	Market share (%)
October 1998	81
October 1999	75
October 2000	71

- 6.6 Table 5 shows that BGT's market share has fallen from 75% to 71% over the last year. This is a smaller fall than during the previous year, when BGT's market share fell by six percentage points.
- 6.7 Table 6 shows BGT's share of the domestic gas supply market by volumes supplied at the end of June 2000 compared to the position at the end of June 1999.

Table 6 – BGT's share of the domestic gas supply market by volumes supplied

	Market share (%)
June 1999	67
June 2000	70

- 6.8 BGT's market share by volumes supplied remains lower than its market share by customers supplied. Nonetheless, it shows a slight increase on last year.

Regional market shares

- 6.9 Table 7 shows BGT's market share by customer numbers in the regional phases and tranches in which competition was rolled out¹⁵ in September 2000 compared to September 1999.

Table 7 – BGT's share of the domestic gas supply market by customers supplied in the phases and tranches in which domestic competition was rolled out

Competition phase/ tranche	Market share at September 1999 (%)	Market share at September 2000 (%)
Phase 1	72	70
Phase 2	70	66
Phase 3 – Tranche 1	73	69
Phase 3 – Tranche 2	76	72
Phase 3 – Tranche 3	76	72
Phase 3 – Tranche 4	75	73
Phase 3 – Tranche 5	76	71
Phase 3 – Tranche 6	75	75
National	75	71

- 6.10 Over the last year the rate at which BGT has lost market share has varied across Great Britain, increasing the size of the regional variations. As the competition phases and tranches do not map closely to most PES areas it is not clear to Ofgem whether it is the behaviour of suppliers in the gas and/ or electricity markets that is causing these regional variations. There is some evidence that

¹⁵ Domestic competition was rolled out in three geographical phases (the last of which had six tranches) across Great Britain between April 1996 and May 1998.

the different timings for the opening of competition means that some of the tranches in phase 3 have lower market shares losses than the average.

Market shares by payment methods

6.11 The tables below show the market shares of suppliers operating in the domestic gas supply market in three payment method categories:

- direct debit;
- other credit payment methods; and
- prepayment.

6.12 The tables show how the market share has changed, both by customers supplied and volumes supplied, between September 1999 and June 2000. The market shares are shown for BGT, PES suppliers grouped together and other suppliers grouped together.

6.13 Due to the quality of some of the responses to Ofgem's market survey, Ofgem has had to make some assumptions about some suppliers responses, particularly with regard to which customers fall within each category. Ofgem does not believe that these assumptions will significantly affect the quality of the information provided.

6.14 Table 8 shows suppliers market shares by customers supplied.

Table 8 – Suppliers market shares by payment method by customers supplied

	September 1999			June 2000		
	BGT	PESs	Other	BGT	PESs	Other
Direct debit	70	29	1	69	30	1
Other credit	78	22	< 1	75	25	< 1
Prepayment	88	12	< 1	87	13	< 1

- 6.15 Table 8 shows that BGT has a lower market share for customers paying by direct debit than for other payment methods, with it losing least customers amongst prepayment customers.
- 6.16 Table 9 shows suppliers market shares by volumes supplied.

Table 9 – Suppliers market shares by payment method by volumes supplied

	September 1999			June 2000		
	BGT	PESs	Other	BGT	PESs	Other
Direct debit	68	31	1	74	26	< 1
Other credit	71	29	< 1	75	25	< 1
Prepayment	78	22	< 1	84	16	< 1

Note: A number of survey responses were not returned. This means that the level of BGT's market shares are overstated.

- 6.17 Table 9 shows that BGT's market share varies significantly across groups of customers paying by different payment methods.

Customers in debt

- 6.18 From responses to the market survey (and particularly BGT's response) Ofgem has been able to estimate the number of customers in debt such that their suppliers can block their transfer to another supplier under the provisions of Standard Condition 7(4) of the gas suppliers' licence. Ofgem estimates that there are about 2 million gas customers in debt. Most of these customers are supplied by BGT. A majority of BGT's prepayment customers and a significant number of its credit customers are in debt.

Domestic electricity supply

National market share

- 6.19 Table 10 shows the national market share of the main competitors in the domestic electricity market by customers supplied and volumes supplied at the end of October 2000.

Table 10 – Market shares of the main competitors in the domestic electricity market¹⁶

Supplier	Market share by customers supplied (%)	Market share by volumes supplied (%)
TXU Europe	17	18
Scottish and Southern Energy	17	15
Scottish Power	12	11
London Electricity	11	11
BGT	10	12
npower	9	8
Powergen	8	8
Seaboard	7	7
Yorkshire	6	7
Northern	3	4
Others	< 1	< 1

- 6.20 The first four companies in each list own at least two PES supply businesses, with Scottish and Southern Energy owning three. BGT is the only supplier with a national market share of more than 1% that does not own a PES supply business and has acquired all its customers through sales, e.g. doorstep selling and telesales. It has acquired customers with relatively high volumes, and therefore bills, than the average consumption level of customers, similar to the trends in the domestic gas supply market.

¹⁶ The figures in the table have been rounded up and may not equal 100%.

Regional market shares

- 6.21 Table 11 shows the host PESs' market share in each PES area by customers supplied and volumes supplied at the end of June 2000.

Table 11 – Host PES market shares by customers supplied and volumes supplied

PES area	Market share (%)	
	Customers supplied	Volumes supplied
Eastern	81	82
East Midlands (Powergen)	79	79
London	84	85
Manweb (Scottish Power)	81	86
Midlands (npower)	82	85
Northern	78	75
Norweb (Eastern)	83	81
Scottish Hydro (Scottish and Southern Energy)	89	93
Scottish Power	84	86
Seeboard	83	84
Southern (Scottish and Southern Energy)	83	85
Swalec (Scottish and Southern Energy)	84	88
Sweb (London)	89	91
Yorkshire	84	85

- 6.22 Table 11 shows that PESs market shares by PES area varied between 78% and 89% by customers supplied and 75% and 93% by volumes supplied. Although it varied between PES areas, the table does not show any clear evidence that PESs are losing more market share by volumes supplied than customers supplied.

Market shares by payment methods

- 6.23 The tables below show the market shares of the host PESs in the domestic electricity supply market in three payment method categories:

- direct debit;
- other credit payment methods; and
- prepayment.

6.24 The tables show how the market share has changed, both by customers supplied and volumes supplied, between June 1999 and June 2000.

6.25 Due to the quality of some of the responses to Ofgem's market survey, Ofgem has had to make some assumptions about some suppliers responses, particularly with regard to which customers fall within each category. Ofgem does not believe that these assumptions will significantly affect the quality of the information provided.

6.26 Table 12 below shows the host PESs market shares by customers supplied.

Table 12 – Host PES market shares by payment method by customers supplied

PES area	Market shares (%)		
	Direct debit	Other credit	Prepayment
Eastern	74	84	90
East Midlands (Powergen)	77	78	88
London	78	85	92
Manweb (Scottish Power)	78	76	94
Midlands (npower)	78	82	94
Northern	79	75	85
Norweb (Eastern)	75	85	96
Scottish Hydro (Scottish and Southern Energy)	82	91	97
Scottish Power	72	87	93
Seeboard	79	84	96
Southern (Scottish and Southern Energy)	78	85	95
Swalec (Scottish and Southern Energy)	75	84	97
Sweb (London)	81	90	98
Yorkshire	79	86	95

6.27 Table 12 shows that broadly PESs are losing more market share for customers on direct debit than other payment methods, and least for customers on prepayment. There is a significant variation between PES areas in the market share lost for each payment method. Ofgem believes that the information provided for the Manweb area is significantly inaccurate.

6.28 Table 13 below shows the host PESs market shares by volumes supplied.

Table 13 – Host PES market shares by payment method by volumes supplied

PES area	Market shares (%)		
	Direct debit	Other credit	Prepayment
Eastern	76	85	91
East Midlands (Powergen)	81	75	89
London	79	86	92
Manweb (Scottish Power)	82	86	94
Midlands (npower)	83	85	95
Northern	75	73	82
Norweb (Eastern)	74	83	96
Scottish Hydro (Scottish and Southern Energy)	88	95	99
Scottish Power	76	89	94
Seeboard	79	86	96
Southern (Scottish and Southern Energy)	80	87	96
Swalec (Scottish and Southern Energy)	82	89	96
Sweb (London)	84	93	98
Yorkshire	80	86	96

6.29 As with the market shares by customers supplied, table 13 shows that PESs have retained a larger market share for direct debit customers than other payment methods, with the lowest market share for prepayment. There is no clear

evidence that PESs are losing more market share by volumes supplied than customers supplied as is the case for BGT in gas.

Customers in debt

- 6.30 The variable quality of responses to the market survey to provide information on this issue has meant that Ofgem has not been able to estimate the number of customers in debt in electricity such that the supplier could block their transfer to another supplier.

Small business electricity supply

National market share

- 6.31 Table 14 shows the national market share of the main competitors in the small business electricity market by customers supplied at the end of June 2000.

Table 14 – Market shares of the main competitors in the domestic electricity market

Supplier	Market share by customers supplied (%)
Scottish and Southern Energy	26
London Electricity	17
TXU Europe	14
Powergen	12
npower	7
Yorkshire	6
Seaboard	6
Scottish Power	7
BGT	3
Others	2

- 6.32 Table 14 shows that as with the national market shares for domestic electricity supply, the companies with the largest market shares are generally those that own more than one PES supply business. It is also likely that at this relatively early stage of the development of competition, PESs national market shares for

small business reflect the variation in the number of small business customers by PES area.

- 6.33 Due to the varying quality of the responses provided to the market survey, it has been difficult for Ofgem to estimate the market shares in the small business market by volumes supplied, and therefore, no estimate is provided in this document.

Regional market shares

- 6.34 Table 15 shows the host PESs' market share in each PES area by customers supplied at the end of June 2000.

Table 15 – Host PES market shares by customers supplied

PES area	Market share (%) by Customers supplied
Eastern	79
East Midlands (Powergen)	83
London	89
Manweb (Scottish Power)	77
Midlands (npower)	82
Northern	-
Norweb (Eastern)	84
Scottish Hydro (Scottish and Southern Energy)	83
Scottish Power	84
Seeboard	85
Southern (Scottish and Southern Energy)	93
Swalec (Scottish and Southern Energy)	93
Sweb (London)	90
Yorkshire	81

- 6.35 Table 15 shows that as with domestic electricity supply there is a significant variation between the market shares of the PESs in area in the small business market. The market share of the PESs varies between 77% and 93%. Ofgem

was unable to calculate Northern Electric's market share due to the quality of responses to the market survey.

'Dual fuel' supply

- 6.36 In last year's review of the development of competition in the domestic gas supply market, Ofgem estimated that about 5 million customers were supplied gas and electricity by the same supplier. Of these customers about 2 million had switched electricity supplier, usually to BGT, and 3 million had switched electricity supplier, usually to the local PES.
- 6.37 Ofgem sought information from suppliers in this year's market survey about the number of customers with 'dual fuel' deals. As with last year's responses to the market survey, the quality of information received was of a variable quality. However, Ofgem has been able to estimate the number of customers supplied on 'dual fuel' deals.
- 6.38 We have assumed that all gas customers (about 21 million) also take electricity supply. Of the 6 million customers who switched electricity supplier away from their local PES, Ofgem estimates that about two thirds of these customers (4 million) are supplied on 'dual fuel' deals, usually with BGT. Of the 5.7 million customers who have switched gas supplier away from BGT, Ofgem estimates that about 60% (3.4 million) are supplied on 'dual fuel' deals. Therefore, in total Ofgem estimates that about 7.5 million customers are supplied on 'dual fuel' deals. This is an increase of 2.5 million compared to last year and shows that 'dual fuel' deals continue to grow in importance in the gas and electricity supply markets.

Conclusions

- 6.39 BGT has continued to lose market share in the domestic gas supply market over the last year, although at a lower rate than during the previous year, and currently has a market share of about 71%. Its market share by customers supplied varies by payment method, with direct debit lowest at 69%, other credit payment methods at 75% and prepayment at 87%.

- 6.40 PESs market shares in the domestic electricity supply market by customers supplied varies between 78% and 89%. There is no clear evidence that PESs have lost more market shares by volumes supplied than customers supplied. As with BGT in the domestic gas supply market, PESs have lost more market share for customers paying by direct debit and least for those paying by prepayment. PESs market shares in the small business electricity market vary between 77% and 93% by customers supplied.
- 6.41 There is evidence of continuing growth in the size of the ' dual fuel' market, with Ofgem estimating that over the last year an additional 2.5 million customers are supplied on 'dual fuel contracts.

7. Customer switching behaviour

7.1 While market share figures provide a snap shot of the position of a market at any point in time, customer switching figures can show the level of customer activity within a market. This chapter looks at:

- the extent of switching between suppliers, including churn; and
- the movement of customers between payment methods.

7.2 To consider the extent of switching between suppliers Ofgem has used information from Transco for the domestic gas market and from the electricity distribution companies for the domestic and small business electricity markets. Ofgem has not been able to distinguish between switching in the domestic and small business electricity markets. The information to consider the movement of customers between payment methods has been obtained from information provided by suppliers in response to the market survey. Generally the information provided was of a sufficient quality to allow Ofgem to analyse the trends.

Domestic gas supply

Switching between suppliers

7.3 Last year's domestic gas competitive market review found that switching rates had continued, despite concern that after the initial introduction of competition switching rates may level out or decline. There has been significant variation in switching rates during the last year. Table 16 shows the number of transfers in each of the last 12 months.

Table 16 – Transfers between gas suppliers

	Number of transfers
November 1999	194,334
December 1999	197,295
January 2000	204,991
February 2000	188,467
March 2000	269,178
April 2000	265,039
May 2000	285,680
June 2000	251,329
July 2000	248,007
August 2000	307,762
September 2000	325,075
October 2000	243,858
Total	2,981,015

7.4 The 2,981,015 transfers during the last year (57,327 per week) compares with 2,730,000 over the previous year (52,500 per week). Within the total number of transfers in each month, it is possible to separate the number of transfers into three different types, to assess the extent to which customers are churning between different suppliers or moving away from BGT. These categories of transfer are:

- transfers from BGT to another supplier;
- transfers between non-BGT suppliers; and

- transfers from non-BGT suppliers back to BGT.

7.5 Table 17 shows the number of transfers in each of these categories in the last year compared to the previous year.

Table 17 – Customer churn in the domestic gas supply market

	November 1998 to October 1999	November 1999 to October 2000
Transfers away from BGT	2,071,536 (76.4%)	1,404,058 (47.1%)
Transfers between non-BGT suppliers	225,049 (8.3%)	733,329 (24.6%)
Transfers from non-BGT suppliers back to BGT	414,849 (15.3%)	843,627 (28.3%)
Total	2,711,435	2,981,015

7.6 Table 17 shows that over the last year the number of transfers away from BGT as a proportion of the total has reduced compared to the previous year, and that BGT is winning back significantly more customers than in the previous year. As a proportion of the total number of transfers those which involve customers making a second transfer after switching away from BGT have substantially increased as a proportion of the total number of transfers.

Switching between payment methods

7.7 Some customers switch payment methods when they switch supplier to take advantage of the cheaper prices available for customers paying by direct debit and other credit payment methods. Table 18 shows how the total number of customers on each payment method has changed over the last year.

Table 18 – The number of customers paying by different payment methods

Date	Payment methods		
	Direct debit	Other credit	Prepayment
Before domestic competition was introduced	31	65	5
30 November 1997	35	60	4
30 September 1998	37	56	8
30 June 1999	37	55	9
30 June 2000	39	53	8

7.8 Table 18 shows that the number of customers paying by direct debit has increased slightly since domestic competition was rolled out, while the number of customers paying by other credit methods has fallen slightly as the number of customers paying by prepayment has doubled as a proportion of the total number of customers. This is consistent with Ofgem's information that BGT has transferred customers in debt to prepayment earlier in the debt recovery process than before. Bearing in mind the slower development of competition and the lack of competitive offers, the increase in the number of customers on prepayment meters may reduce the extent to which they are able to take advantage of the choice and value offered in the competitive market.

Domestic and small business electricity supply

Switching between suppliers

7.9 Table 19 shows the number of transfers in each month since competition for the designated market was fully opened in May 1999.

Table 19 – Transfers between electricity suppliers

	Number of transfers
June 1999	504,905
July 1999	469,385
August 1999	467,660
September 1999	308,397
October 1999	439,960
November 1999	306,600
December 1999	316,648
January 2000	390,013
February 2000	363,600
March 2000	498,153
April 2000	396,870
May 2000	484,051
June 2000	439,180
July 2000	395,944
August 2000	538,341
September 2000	461,717
October 2000	414,680
Total	7,250,104

7.10 Table 19 shows that in each month since competition was fully rolled out there have been at least 300,000 transfers between suppliers, ranging from almost 540,000 transfers in August this year to just over 300,000 transfers in September 1999. Although there has been significant variation in the number of transfers each month, there is no evidence that the number of transfers in the designated electricity market has slowed over the period since competition was fully rolled out. Switching in the electricity market continues at a higher rate per week (139,425 over the last year) than the domestic gas market (57,327 over the last year).

7.11 Within the total number of transfers in each month, it is possible to separate the number of transfers into three different types, to assess the extent to which customers are churning between different suppliers or moving away from the local PES. These categories of transfer are:

- transfers from the host PES to another supplier;
- transfers between non-host PES suppliers; and
- transfers from non-host PES suppliers back to the host PES.

7.12 Table 20 shows the number of transfers in each of these categories since November 1999.

Table 20 – Customer churn in the domestic electricity supply market

	November 1999 to October 2000
Transfers away from the host PES	4,016,369 (77%)
Transfers between non-host PES suppliers	383,124 (7%)
Transfers from non- host PES suppliers back to the host PES	838,500 (16%)
Total	5,237,993

7.13 Table 20 shows that most transfers in the designated electricity market are transfers away from the host PES to a new supplier. So far, the proportion of customers who are returning to the host PES is lower than the proportion that BGT is winning back in the domestic gas supply market.

Switching between payment methods

7.14 Some customers switch payment methods when they switch supplier to take advantage of the cheaper prices available for customers paying by direct debit and other credit payment methods. Table 21 shows how the total number of customers on each payment method has changed between September 1999 and June 2000.

Table 21 – The number of customers paying by different payment methods

Date	Payment methods (% of customers on each payment method)		
	Direct debit	Other credit	Prepayment
September 1999	35	51	14
June 2000	37	48	15

7.15 Table 21 shows that between September 1999 and June 2000 the percentage of customers paying for domestic electricity by direct debit has increased slightly, while those paying by other credit methods has fallen slightly. The percentage paying by prepayment has increased slightly. This may suggest that some customers are switching to direct debit to take advantage of the lower prices available for customers paying by this method.

Conclusions

7.16 Switching rates in the designated electricity market have been 139,425 per week over the last year compared with 57,327 in the domestic gas market. Switching rates in the electricity market are showing no signs of slowing down in either market, and indeed in the gas market switching rates have been higher this year than last year, when they were 52,500 per week. The overall switching rates do

not show the extent to which transfers are away from BGT or the host PES or are second transfers by customers who have already switched once. In the gas market, the proportion of total transfers which are second transfers is about 53%, including winbacks by BGT. In the electricity market most transfers are still first transfers away from the host PES.

- 7.17 Since competition was rolled out in the domestic gas market the number of customers on direct debit payment methods has remained broadly constant, while the number of customers paying through prepayment meters has doubled. Between September 1999 and June 2000, there has been a small increase in the number of customers paying by direct debit, which may be to take advantage of the lower prices available to customers paying by this method.

8. Prices and related offers

Introduction

- 8.1 This chapter considers BGT and the PESs current tariffs and complementary offers and compares them to the offers available from competing suppliers. It looks at the extent to which different customer groups attract and are able to take advantage of a range of competitive offers. The ability for all customers to attract a range of competitive offers is an important element of an effectively competitive market.

BGT's offers

BGT's price controlled tariffs

- 8.2 Table 22 shows BGT's bills for customers on its two price controlled tariffs at a range of consumption levels. From April 2000, BGT's domestic gas and electricity tariffs were restructured, with a change from tariffs with a standing charge and a unit charge, to tariffs with two unit charges.

Table 22 - BGT's bills

Consumption level (kWh)	PromptPay	LatePay/Prepayment ¹⁷
High (28,000 kWh)	411	441
Medium (19,050 kWh)	287	317
Low (10,000 kWh)	161	191

¹⁷ In October 1998, BGT's Standard and Prepayment tariffs were merged following Ofgem's review of BGT's request to rebalance its tariffs under its price control ("Review of British Gas Trading's Domestic Supply Tariffs, Licence Modification", Ofgas, February 1999).

BGT's non-price controlled tariffs

8.3 In addition to the two price controlled tariffs, BGT also supplies gas to domestic customers on 3 other tariffs:

- direct debit;
- ValuePlus; and
- advance payment.

8.4 These are explained in turn below.

Direct debit

8.5 From April 2000 direct debit customers were removed from the scope of the price control, when Ofgem concluded that competition for this group of customers was sufficiently developed to protect their interests. BGT's direct debit bill is £307.13 at an annual consumption of 21,980 kWh.

ValuePlus

8.6 In May 1997 BGT introduced the ValuePlus tariff in response to competition in the South West of England. It was later extended to South East England in September 1997. Initially the tariff offered a five and a half percent discount for direct debit customers. However, BGT's direct debit tariff has been gradually reduced, and since January 1998, the ValuePlus tariff does not offer a price advantage over BGT's direct debit tariff.

Advance Payment

8.7 In May 1999 BGT introduced the Advance Payment tariff which offers a two percent discount compared to its direct debit tariff, when customers pay for at least 12 months gas supply in advance.

8.8 BGT has not introduced any new gas tariffs since May 1999.

BGT's payment methods

8.9 As well as the range of payment methods that all gas suppliers are required to offer under Standard Condition 10 of the gas suppliers' licence, BGT offers a

number of other payment methods to customers. BGT's full range of payment methods and the associated tariff are set out in the table below.

Table 23 – BGT's current payment methods¹⁸

Payment method	Tariff
Monthly direct debit (equal instalments)	Direct debit
Monthly standing order (equal instalments)	PromptPay
Quarterly variable direct debit (based on actual consumption)	PromptPay
Payment on receipt of quarterly bill (by cash, cheque, postal order or gas stamps)	LatePay
Payment on receipt of quarterly bill with discount for PromptPay	PromptPay
Weekly payment instalments by magnetic card	LatePay
Fortnightly payment instalments by magnetic card	LatePay
Monthly payment instalments by magnetic card	LatePay
Fuel Direct (payments made by DSS)	LatePay
Prepayment meter (by token, coin or electronic token meters)	PrePayment
Annual payment in advance by cheque or equivalent	Advance Payment

8.10 During 2000 BGT has not increased the range of payment methods that it offers customers.

¹⁸ "Goldfish" credit card points can be used in conjunction with any of the listed payment methods except PrePayment.

BGT's related offers

- 8.11 In addition to its domestic gas supply tariffs, BGT offers a range of other products, including:
- a 'dual fuel' offer;
 - the Goldfish credit card;
 - British Gas Home Insurance;
 - BGT's and Sainsbury's initiative;
 - Joint Payment Arrangements ('JPA');
 - telecoms offer; and
 - Life Insurance.
- 8.12 These offers are explained in Appendix 2. Ofgem believes that all the above initiatives offered by BGT currently meet the requirements of Standard Condition 13 of BGT's gas suppliers' licence, general competition law and, in particular, the principles Ofgem set out when it originally considered the Goldfish credit card.¹⁹

Competitors' offers as compared to BGT

Tariffs

- 8.13 In Ofgem's December 1999 review of competition in the domestic gas market the range of offers available from BGT's competitors was shown for the three payment methods, direct debit, prepayment and 'other' credit²⁰ payment methods. For direct debit, it showed that customers were able to obtain a discount of over 10% against BGT's bill, while other credit customers were able to obtain a discount of up to 20%. However, prepayment customers were not able to obtain a discount against BGT's bill.
- 8.14 Table 24 shows the best offer available from BGT's competitors for the three payment methods, compared to BGT's current tariffs.

¹⁹ "Goldfish: British Gas Trading's credit card joint venture: A Decision Document", Ofgas, October 1997.

²⁰ This mainly includes customers who pay quarterly by cash or cheque.

Table 24 – Competitors’ bills compared to BGT²¹

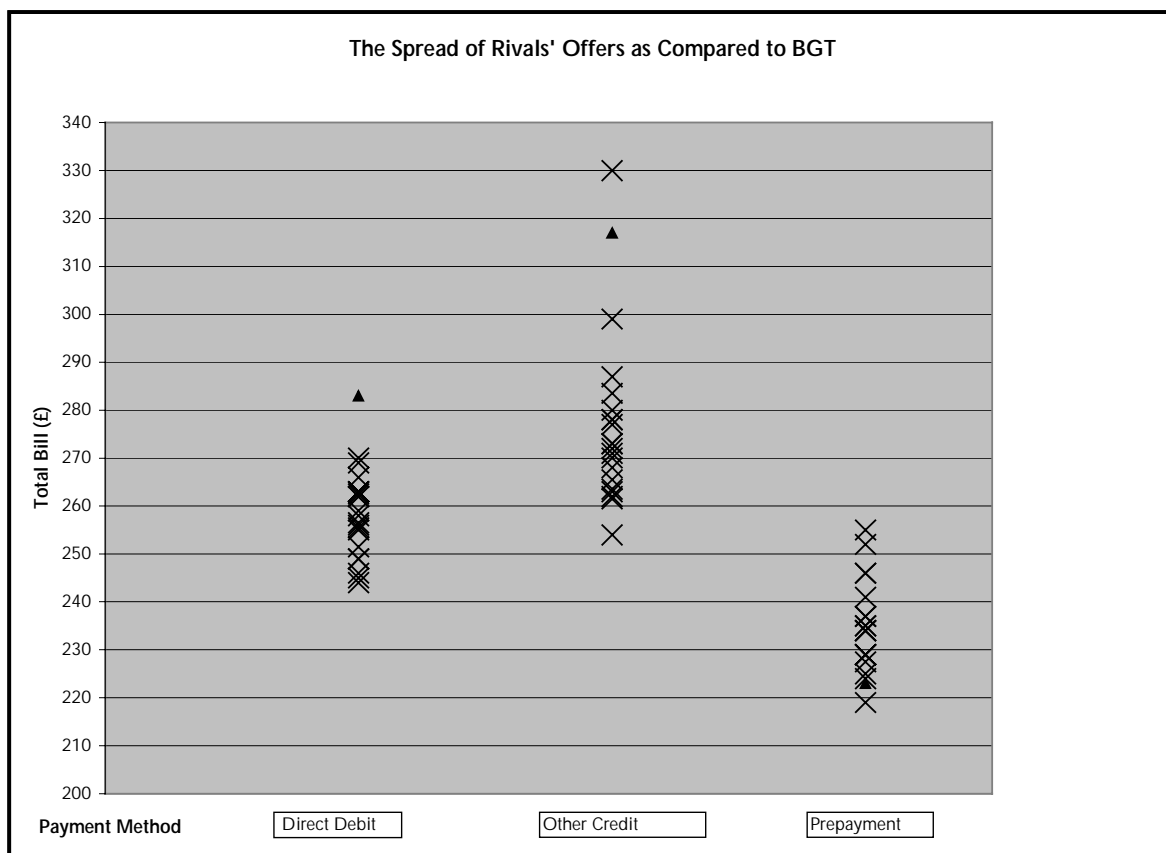
	BGT’s bill (£)	Competitors’ lowest offer (£)	Discount against BGT’s bill (%)
Direct debit	283	244	13.8
Other	317	254	19.9
Prepayment	223	194	13

8.15 The table shows that direct debit customers can still obtain a discount of more than 10% compared to BGT’s bill, while other credit customers are able to obtain a discount of almost 20%. Furthermore, prepayment customers are now able to obtain a discount of up to 13% against BGT’s bill. This discount is available on Southern Electric’s Equigas tariff, which charges the same tariff to customers irrespective of their payment method. The next best competitors’ offer is a 1.8% discount against BGT’s bill.

8.16 Although these offers represent the best available offers from competitors to BGT, they may not represent offers that are widely marketed and easily accessible for customers. Figure 1 shows the spread of competitors best offers as compared to BGT for the three payment methods. This only includes offers that are available throughout Great Britain.

²¹ For Direct Debit and Other, an annual consumption of 19,050 kWh has been assumed. For Prepayment, an annual consumption of 12,300 kWh has been assumed.

Figure 1 - Competitors' offers as compared to BGT



8.17 Figure 1 shows that for direct debit and other credit customers, with the exception of one supplier, all competitors are offering a lower bill than BGT. The majority of suppliers are able to offer a discount of more than 7% against BGT's bill for direct debit payments, while most suppliers are able to offer discounts against BGT's bill for other credit payment methods of more than 11%. However, for prepayment, only 3 suppliers offer discounts against BGT's prepayment tariff.

Competitors' payment methods

8.18 As explained in Appendix 1, Standard Condition 10 of the gas suppliers' licence requires all domestic suppliers to accept payment by cash, cheque or on a frequent payment basis, i.e. monthly or fortnightly intervals. The decision to offer other payment methods is at the suppliers' discretion unless they wish to

disconnect the customer for non-payment of their bill, in which case they must offer a prepayment meter prior to disconnection.

- 8.19 Based on suppliers' responses to Ofgem's August 2000 market survey, there is some evidence that suppliers are offering additional payment methods over and above those required under the licence. This includes payment by credit and debit card, and payment in advance. The range of payment methods offered in the gas and electricity markets is very similar.

Competitors' related offers

- 8.20 Since the introduction of competition gas and electricity suppliers, particularly in the domestic market, have sought to differentiate themselves from their competitors by offering a range of complementary products, including:

- 'dual fuel' offers;
- supply over the internet;
- offers that particularly benefit disadvantaged customers or seek to support the environment; and
- bundling gas and electricity supply with other related products.

- 8.21 These offers have generally increased customer choice in the competitive gas and electricity markets. Each of these initiatives is discussed in turn below.

'Dual fuel' offers

- 8.22 As stated in Chapter 5, there are currently 11 suppliers offering 'dual fuel' supply. About half of these suppliers offer a discount to customers to reflect cost savings of supplying both fuels, e.g. dual meter reading. Generally, prepayment customers do not receive an additional discount for 'dual fuel' supply. As discussed in Chapter 6, 'dual fuel' offers are continuing to grow in importance. However, customers can still obtain lower prices than many 'dual fuel' offers by taking their gas and electricity supply from different suppliers.

Supply over the internet

- 8.23 Over the last year a number of suppliers have started to sell gas and electricity over the internet. In some cases, e.g. Eastern Electricity and Powergen, customers receive a discount for signing up over the internet. In other cases, e.g. npower and Amerada Hess, customers sign up over the internet and their customer service relationship is managed over the internet. Customers receive a lower tariff to recognise the cost savings of supply over the internet. Internet offers are generally restricted to customers paying by direct debit.

Offers that particularly benefit disadvantaged customers or seek to support the environment

- 8.24 As competition has developed and as part of the Government's and Ofgem's initiatives to help ensure that all customers benefit from the competitive market, a number of suppliers offer gas and electricity tariffs particularly designed to meet the needs of 'disadvantaged' customers. These include:
- Eastern Electricity's 'Staywarm' tariff, which allows certain categories of customers to use as much gas and electricity as necessary for a fixed annual bill; and
 - BGT's warm-a-life offer, which gives a £15 one-off reduction to 'dual fuel' and a £5 one-off reduction to single fuel customers, who pay through a budget plan or by a prepayment meter and receive one or more of a range of government benefits.

- 8.25 Suppliers also offer, often in conjunction with their energy efficiency standards of performance ('EESoPs') measures, tariffs that meet the Government's environmental aims, including tariffs that offer energy efficient light bulbs and tariffs for which suppliers contract for renewable energy sources. So far the take-up of these tariffs has been relatively low.

Bundling gas and electricity supply with other related products

- 8.26 Since competition was introduced in the gas and electricity supply markets, a number of suppliers have offered customers other products in conjunction with their gas and electricity supply. As set out above Centrica has a wide range of

additional offers. Other companies also offer a range of products, including Powergen, which offers telecoms and internet services.

- 8.27 The offering of complementary products tends to apply to both gas and electricity customers.

PES's offers

Price controlled tariffs

- 8.28 Table 25 below shows PESs credit and prepayment offers that are currently price controlled. The bills are shown for an annual consumption of 3300 KWh for standard and 3000 kWh day units and 3600 kWh night units for Economy 7.

Table 25 - PES price controlled tariffs

PES area	Credit		Prepayment	
	Standard	Economy 7	Standard	Economy 7
Eastern	232	340	243	351
East Midlands (Powergen)	236	333	252	348
London	247	358	257	364
Manweb (Scottish Power)	263	380	279	395
Midlands (npower)	243	352	259	368
Northern	259	371	273	373
Norweb (Eastern)	242	346	258	362
Scottish Hydro (Scottish and Southern Energy)	269	398	269	398
Scottish Power	265	386	288	411
Seeboard	228	336	245	348
Southern (Scottish and Southern Energy)	255	362	269	371
Swalec (Scottish and Southern Energy)	286	396	302	411
Sweb (London)	261	374	279	394
Yorkshire	238	339	266	368

Non-price controlled tariffs

8.29 The PESs also offer a range of non-price controlled tariffs in the designated market. These are principally tariffs for domestic customers paying by direct debit and tariffs for small business users. In addition some PESs offer tariffs for customers with storage heating, which are multi-rate tariffs to reflect the different costs to purchase electricity at different times of the day. Table 26 shows the PESs direct debit offers to the domestic market.

Table 26 - PES non- price controlled tariffs

PES area	Direct debit	
	Standard	Economy 7
Eastern	226	333
East Midlands (Powergen)	226	322
London	236	347
Manweb (Scottish Power)	256	371
Midlands (npower)	236	341
Northern	249	361
Norweb (Eastern)	234	339
Scottish Hydro (Scottish and Southern Energy)	260	384
Scottish Power	274	397
Seeboard	236	344
Southern (Scottish and Southern Energy)	246	350
Swalec (Scottish and Southern Energy)	275	380
Sweb (London)	269	385
Yorkshire	251	352

8.30 Since the price control was lifted for direct debit and small business customers prices have generally remained stable or fallen slightly in nominal terms. In recent weeks a couple of PESs have notified Ofgem of reductions they intend to make to small business tariffs in response to the development of competition.

Competitors offers compared to the PESs

8.31 Table 27 shows that customers in all PES areas are able to obtain a discount against their host supplier for direct debit, credit and prepayment. Customers paying by direct debit can save up to 17% on standard tariffs and 15% on Economy 7 tariffs. Customers paying by other credit methods can save up to 14% on standard tariffs and 18% on Economy 7 tariffs. The situation for prepayment customers is similar to that in the gas market, as this market segment receives the lowest range of discounts. Customers on standard tariffs can save up to 7%, while Economy 7 customers can save up to 12%. Generally the discounts available to standard and Economy 7 customers are at a similar level.

Table 27 – Best available discounts compared to the local PES

PES area	Direct debit		Credit		Prepayment	
	Standard	Economy 7	Standard	Economy 7	Standard	Economy 7
Eastern	12.4	11.7	9.9	13.5	2.1	2.3
East Midlands (Powergen)	9.7	6.5	11	8.4	1.2	0.9
London	8.5	9.8	9.7	12.6	2.3	1.9
Manweb (Scottish Power)	10.9	10.2	11	12.1	3.9	5.8
Midlands (npower)	10.6	10.6	9.9	12.8	6.9	4.3
Northern	16.5	15.2	14.3	17.5	7.3	2.4
Norweb (Eastern)	12.8	13.3	11.2	15.1	5.8	5.5
Scottish Hydro (Scottish and Southern Energy)	15.4	8.3	12.5	8.8	6.7	10.3
Scottish Power	10.2	6	10.2	6	5.6	5.1
Seeboard	11	11.3	11	13.4	4.5	12.1
Southern (Scottish and Southern Energy)	12.6	8	12.9	11.4	4.3	7.1
Swalec (Scottish and Southern Energy)	9.1	7.9	9.8	11.4	4.3	7.1
Sweb (London)	10.7	10.4	10.8	13	5.7	6.6
Yorkshire	14.7	9.4	13.5	11.6	4.1	3.5

- 8.32 As with gas, most suppliers competing with the PESs offer discounts against the PES tariffs, except for prepayment where the picture is more mixed.

Conclusions

- 8.33 In the domestic gas market most customers can attract a range of competitive offers compared to BGT's tariffs, with suppliers offering discounts of up to 14% for direct debit, 20% for other credit payment methods and 13% for prepayment. In the domestic electricity market there is a similar range of competitive offers compared to the local PES tariffs, with suppliers offering discounts of up to 17% for direct debit, 18% for other credit payment methods and 13% for prepayment.²² For gas and electricity the levels of discounts available are similar to those available last year. For direct debit and other credit payment methods there is a much greater number of competitive offers than for prepayment. Small business electricity customers are able to attract a range of competitive offers.
- 8.34 The gas and electricity markets continue to be characterised by increased innovation in the range of payment methods and complementary products offered by suppliers, with 'dual fuel' offers continuing to be taken up by an increasing number of customers and a wide range of complementary products available for customers.

²² This discount is available on Sothorn Electric's Equigas tariff, whichb charges the same amount irrespective of customers payment methods. The next best discount against BGT's tariff is 1.8%.

9. Barriers to entry

9.1 Potential entrants to the gas and electricity supply markets and suppliers within the market will consider the return they expect to make in the gas and electricity supply markets as compared with deploying their resources in other markets. The extent of any real or perceived barriers to entry and their associated costs will be a factor that potential entrants and existing suppliers bear in mind when making their decision as to how to deploy their resources to maximise their return.

9.2 A lot of progress has, or is, being made to address barriers to entry into the gas and electricity supply markets, including the:

- separation of BG plc into separate transportation and trading businesses in February 1995, which led to the separation of Centrica plc from BG plc in 1997;
- separation of PES supply and distribution activities under the Utilities Act 2000; and
- introduction of New Electricity Trading Arrangements ('NETA').

9.3 Last year's review of the development of competition in the domestic gas supply market, showed that the remaining concerns about barriers to entry in the domestic gas supply market focused on the behaviour of BGT as the dominant supplier and the limited opportunities for customers in debt to switch supplier due to suppliers' right to object to the transfer of customers in debt. The review expressed concern that the remaining barriers to entry in the electricity supply market were greater than in gas, although Ofgem had plans in place to address these issues over the following 18 months.

9.4 In the 2000 market survey, Ofgem consulted specifically on the extent to which three particular issues constituted barriers to entry:

- BGTs and the PESs market position and behaviour;
- the PESs operation of the prepayment meter infrastructure for electricity supply; and

- the development of competition on Independent Public Gas Transporters ('IPGTs') networks.

9.5 We also asked for views on the extent to which any other issues were preventing suppliers making or customers receiving potentially competitive offers.

9.6 In this chapter we have addressed the specific issues on which we sought comments, the other issues raised by respondents to the survey, and considered the extent to which progress has been made to address the issues raised last year. We have addressed these issues under the following categories:

- BGT and the PESs market position and behaviour;
- the general operation of the gas supply market; and
- the general operation of the electricity supply market.

BGT's and the PESs' market position and behaviour

9.7 It is understandable that BGT and the PESs will seek to circumscribe competitors' success before competition is effective. The question is whether these moves are contrary to the relevant provisions of the Gas Act 1986 (as amended), the Electricity Act 1989 (as amended), the gas and electricity suppliers licences, and competition law. Such moves may be pre-emptive or directed at ongoing competition.

9.8 In defending an established dominant position, a large range of moves are open to an incumbent. A pre-emptive move in the present context is one made ahead of the opening of a market, which is intended to inhibit or delay the entry of a competitor or competitors. When competitors are present, similar moves taken together may also have the object or effect of restricting, distorting or preventing the development of competition in the domestic gas and electricity supply markets. BGT and the PESs have made several moves aimed at defending their dominant positions. In deciding whether and how to use its powers to tackle anti-competitive behaviour in supply markets, Ofgem has to distinguish moves which might be expected in the normal cut and thrust of business from those which stem from market power and constitute an abuse of market power. Such

judgements can only be made by considering the specific circumstances of the behaviour. At the present stage of competitive development, particularly in relation to electricity supply, any move must be considered in the light of its possible bearing on pre-emption.

- 9.9 In the market survey, Ofgem sought particular comments on the effect of new offers by BGT and the PESs, and their customer retention practices. Ofgem also sought comments on the concerns raised about the effect of BGT's market position on the development of gas and electricity supply competition. In particular, comments were sought on the cost of developing a national brand to compete with the 'British Gas' brand, the effect of any economies of scale available to BGT, and the effect on supply competition of BGT's upstream market position.
- 9.10 In the market survey we also sought views on the extent to which the PESs operation of the prepayment infrastructure in electricity was adversely affecting the development of competition. This followed complaints received by Ofgem about the behaviour of some PESs when operating the prepayment infrastructure.
- 9.11 Respondents' comments on these issues and Ofgem's response is set out below.

Respondents' views

BGT's and the PESs market position and behaviour

- 9.12 Eight suppliers expressed concern about the effect of BGT's market position on the development of competition. Suppliers were concerned about a number of aspects of BGT's market position and behaviour, including:
- BGT's advertising focuses on regaining customers, which increases rivals customer acquisition costs;
 - BGT's use of its dominant position in the gas market to enter the electricity market;
 - concern that BGT has a significant marketing advantage due to its brand and its ability to spend significantly more than rival suppliers on

advertising. It was suggested that BGT should be subject to marketing restrictions to allow rival suppliers to develop equally strong brands;

- that consideration should be given to breaking up BGT into smaller supply businesses or requiring the divestment of upstream assets to facilitate the development of competition;
- the effect of BGT's current domestic gas prices on the development of competition, and in particular, that BGT's prices may be predatory, thereby driving rival suppliers out of the market; and
- concern was expressed about the extent to which BGT was responsible for recent increases in wholesale gas prices.

PESs operation of the prepayment meter infrastructure in electricity

9.13 PESs generally believed that this was not an issue as they made the service available to all suppliers on non-discriminatory terms. The PESs suggested that competition could develop for the provision of this service by suppliers contracting directly with providers of payment services. One PES believed that competition would not develop in the provision of this service until Ofgem allowed PESs to set charges for the provision of the service that reflected the economic cost of providing the service.

9.14 One supplier believed that the provision of this service should be part of the PES distribution rather than supply functions to prevent anti-competitive behaviour. The technical constraints of the system reduce suppliers' ability to change tariffs for these customers. Also, the lack of supplier specific branding of this service causes customer confusion and misdirected customer payments.

Ofgem's response

BGT's market position and behaviour

9.15 Ofgem investigated BGT's marketing activity extensively in early 1999 and in the follow-up to the 1998 competitive market review of the domestic gas

market²³, we explained our concern about the effect of misleading advertising by BGT on the development of competition. This followed the upholding of 6 complaints against BGT by the Advertising Standards Authority in the previous 18 months. BGT agreed to pre-approve future advertising with the ASA, and subsequently only one complaint has been upheld by the ASA. Ofgem has noted that a number of rival suppliers to BGT are engaged in extensive marketing campaigns, and as discussed in Chapter 5 a number of suppliers have developed partnerships with other companies that have strong brand names.

- 9.16 Ofgem recognises the concern that competitors to BGT have about its market position. Ofgem generally takes the view, consistent with United Kingdom competition law, that a dominant position in a market is only a problem to the extent that it is abused. Ofgem has investigated many aspects of BGT's behaviour since competition was opened in the gas market, and if evidence is found that BGT has abused a dominant position then we will seek to use our sector specific and competition law powers as quickly and effectively as possible.
- 9.17 We would note that BGT has reported substantial losses to fund its entry into the electricity market. Ofgem has reviewed in detail BGT's current costs and prices for the domestic gas market, and these issues are discussed in the initial proposals document for the future regulation of BGT's domestic gas prices, which is published at the same time as this document.
- 9.18 Ofgem has investigated the recent increases in wholesale gas prices and did not find evidence that BGT's behaviour had caused the price increase.²⁴ Ofgem will continue to monitor wholesale prices and consider any evidence that BGT or any other shipper is behaving in an anti-competitive manner.

PESS operation of the prepayment meter infrastructure in electricity

- 9.19 Ofgem recognises the concern of some competitors to the PESS that the PESS operation of the prepayment infrastructure service, which is currently a monopoly in each PES area, may give the PES an advantage in the competitive

²³ "Review of British Gas Trading's Behaviour in the Domestic Gas Market, A Follow-up Document", Ofgem, July 1999.

²⁴ "The New Gas Trading Arrangements, A review of the new arrangements and further development of the regime, A review and decision document", Ofgem, July 2000.

supply market. However, Ofgem believes that the combination of Conditions 35A and 35B of the first tier PES electricity licence and competition law should prevent the PES from operating the service in an anti-competitive manner. Ofgem will investigate complaints received about the PESs operation of this service.

- 9.20 Ofgem recognises that the technical constraints of most of the prepayment infrastructures operating in electricity restrict the opportunities for suppliers to innovate in the tariffs they offer to prepayment customers. Ofgem will seek to use its powers to allocate tariff slots for prepayment meters to maximise the opportunity for suppliers to offer a range of competitive tariffs, within the technical constraints.

The general operation of the gas market

- 9.21 Last year's review considered three potential barriers to entry in the domestic gas supply market:

- the lack of competition for customers on IPGT networks;
- suppliers' right to object to the transfer of customers in debt; and
- Transco's prepayment meter charge.

- 9.22 The review noted that progress was being made to address the outstanding issues, e.g. the lack of electronic interfaces between suppliers and IPGTs, to allow competition to develop on IPGT networks, and this review has sought further information about progress in addressing these issues. Ofgem has taken forward during this year work to allow customers in debt to benefit from the competitive market. Ofgem continues to believe that for both the gas and electricity supply markets it is important that customers in debt are able to benefit from the choice available in the competitive market. An update on progress to address this issue is set out in the initial proposals for BGT's price control, which has been published at the same time as this document. This year, Ofgem has also taken forward work to increase the certainty about the future level of Transco's prepayment meter charges, through work to separate Transco's price control to cover transportation and metering activities in separate price

controls.²⁵ Suppliers have not raised this issue with Ofgem during this year's review.

9.23 In addition to comments on the development of competition on IPGT networks, respondents to the survey raised the following concerns about the development of competition in the gas market (some of these issues also apply to the electricity market):

- the restrictions imposed on cross selling of non-energy products to energy customers who have not specifically consented to cross selling, imposed by data protection legislation and the rulings of the Data Protection Registrar;
- concerns about the marketing of energy offers to customers due to the number who subsequently change their mind;
- the lack of clarity about the marketing of offers by suppliers' agents, e.g. Servista; and
- the lack of competition for prepayment customers and customers paying by cash or cheque on a weekly or fortnightly basis.

9.24 These issues are discussed in turn below.

Competition on IPGT networks

Respondents' views

9.25 A number of suppliers expressed concern that IPGT's charging structures caused unduly high transportation charges for customers and suggested that Ofgem should look more closely at the justification for IPGT transportation charges. Concern was also expressed that IPGT network codes were often different from Transco's and that there was no process for ensuring alignment of provisions, thereby ensuring that the network code did not unduly favour suppliers affiliated to the IPGT. There was recognition that progress had been made in improving the electronic interfaces between suppliers and IPGTs, but it was believed that

²⁵ "Securing effective competition in gas metering and meter reading services, The Director General's final proposals", Ofgem, May 2000.

further improvements could be made to the supply point administration processes. One respondent expressed concern that BGT had breached its gas shippers licence by failing to sign all of the network codes, and that it may have an anti-competitive agreement between its supply business and its PGT business. A consumer representative believed that all suppliers should operate on all IPGT networks.

Ofgem's response

- 9.26 Subject to comments on the Ofgem plan and budget, Ofgem proposes to review the level and structure of IPGTs transportation charges in 2001/2. Ofgem recognises the concern of some shippers that IPGT network codes differ from Transco's network code. However, except to recognise relevant differences between Transco's and the IPGT's networks, most IPGTs seek to align their network code with Transco's. Ofgem will consider any complaints that IPGT's network codes unfairly discriminate in favour of a related shipper.
- 9.27 Ofgem is encouraged by the number of shippers that have signed IPGT network codes over the last year, which has significantly increased the choice of supplier for customers on these networks. Ofgem will continue to work with shippers and IPGTs to facilitate the signing of further network codes.

Other issues

Respondents' views

- 9.28 One supplier expressed concern that the restrictions on cross-selling non-energy related products to energy customers without their prior consent, under data protection legislation and enforced by the Data Protection Registrar, restricted the development of competition to the ultimate detriment of customers.
- 9.29 One supplier expressed concern that when it acquires a gas prepayment customer there is no mechanism to ensure that the customer ceases to use its previous payment card, which leads to payments continuing to be made to the customers previous supplier. The supplier was concerned about the financial risk it faced as no adequate mechanism to recover incorrect payments was in place.

- 9.30 Consumer representatives were concerned that inappropriate marketing led to at least 10% of customers who had signed contracts to change supplier subsequently changing their mind and remaining with their previous supplier. One consumer representative suggested that this was largely due to doorstep selling and that Ofgem should consider banning such approaches to marketing.
- 9.31 One consumer representative was concerned that the recent entry of a number of companies to the market as agents of suppliers (e.g. Virgin Energy on behalf of London Electricity, and Servista on behalf of CPL British Fuels), rather than under their own licence, had reduced clarity with regard to who customers had contracts with, and against whom licence enforcement action could be taken.
- 9.32 A number of respondents expressed concern that competition was not developing well for prepayment customers who generally could not achieve savings by switching supplier. Concern was also expressed that suppliers did not actively market or offer attractive terms for customers paying weekly or fortnightly.

Ofgem's response

- 9.33 Ofgem recognises that bundling energy and non-energy related products has been an important aspect of the development of competition in the gas and electricity supply markets. However, it is for the government and the Data Protection Registrar to develop and implement the rules in relation to the use of customer databases. Where appropriate Ofgem will seek to ensure that such rules act to promote the further development of gas and electricity supply competition.
- 9.34 Ofgem recognises that concerns have been raised about inappropriate marketing to customers in the energy market. In response to these concerns Ofgas and Offer introduced licence conditions for all suppliers regulating their marketing activity, including doorstep selling, which Ofgem has subsequently reviewed, with a view to strengthening these provisions.²⁶ Complaints about inappropriate marketing by suppliers are currently falling (see Chapter 4), and Ofgem believes that the current licence conditions provide a deterrent to suppliers engaging in

²⁶ "Marketing gas and electricity, Decision document and proposals on the modification of licence conditions", Ofgem, June 2000.

inappropriate marketing. As discussed in Chapter 4, most customers find doorstep selling an informative and useful marketing method, and Ofgem believes that it has been an important reason for the development of competition. Ofgem does not believe that it would be appropriate to ban this marketing method.

- 9.35 Ofgem welcomes the entry of companies such as Servista and Virgin Energy, as they increase the choice available to customers in the competitive market. The relevant licence holder remains responsible for ensuring that it and its agents comply with the relevant licence conditions, and Ofgem will take enforcement action against the licensee if that is appropriate.
- 9.36 Ofgem recognises respondents' concerns that competition has not developed as quickly for prepayment customers as other domestic gas customers. Ofgem believes that this is in some part due to the ability of incumbent suppliers to block the transfer of customers in debt to an alternative supplier. As explained above, Ofgem has set out proposals to address this issue in its proposals for BGT's future supply price regulation, which have been published at the same time as this document.

The general operation of the electricity market

- 9.37 In last year's review of the development of domestic gas supply competition, Ofgem identified five issues which may have been acting as barriers to entry in to the electricity supply market and which, bearing in mind the increasing importance of 'dual fuel' offers to the development of competition, may have had an adverse effect on the development of gas supply competition. These issues were:
- access to competitive wholesale electricity markets;
 - the lack of separation of electricity supply and distribution functions;
 - the lack of competition in electricity meter reading;
 - the transmission charging regime operated by the National Grid Company, Scottish Power and Scottish Hydro-electric; and
 - PESs related offers, including 'dual fuel' and complementary products.

9.38 Ofgem is currently addressing the first issue through the introduction of NETA in a joint project with the DTI.²⁷ The Utilities Act 2000 will legally require separation of PES supply and distribution functions, and Ofgem has already engaged in significant work to ensure this separation is completed in a timely manner.²⁸ Progress to introduce competition in metering and meter reading activities has developed over the last year with the removal of the PESs monopoly in the provision of these services. Ofgem is currently reviewing the development of competition for these activities to identify the barriers to entry that need to be addressed to promote the further development of competition. NGC changed its charging structure from April 2000 to address concerns raised by new entrant suppliers about the effect of the charging structure on supply competition. Concerns raised about PESs market position and behaviour is discussed above.

9.39 Respondents to the survey raised the following issues (as explained above, some of the issues discussed in the section on the general operation of the gas market would apply to the electricity market):

- the position of customers with dynamically teleswitched meters, particularly in Scotland;
- suppliers access to MPAN data for the designated electricity supply market; and
- the lack of liquidity in the wholesale electricity market as a result of the vertical integration of suppliers and generators.

9.40 We have set out below respondents' views and Ofgem's responses on these issues in turn below.

²⁷ "New Electricity Trading Arrangements (NETA), Implementation Phase, NETA Go Live Decision Making Indicators", Ofgem, November 2000.

²⁸ "Separation of PES Businesses, Progress Report", Ofgem, November 2000.

Respondents' views

- 9.41 One supplier raised concerns about the lack of opportunities for suppliers to make competitive offers to customers with dynamically teleswitched meters. These meters allow electricity that is used for storage heating to be switched on and off to react to changes in demand and supply. They can be used either to limit the need to increase capacity on the network or by suppliers to reduce exposure to high generation purchase costs. Currently the incumbent PES suppliers control the right to switch electricity on and off, even when they do not supply the customer. As a result new suppliers are exposed to a commercial risk as they will not know when the electricity will be turned on and off. Due to this commercial risk suppliers have not sought to make competitive offers to customers with such meters. There are a disproportionately large number of these meters in Scotland.
- 9.42 One supplier expressed concern that the access to MPAN data in the electricity supply market for suppliers was not as great as access to similar data in the gas market. The supplier believed that if additional information was provided by electricity distribution businesses it would facilitate more efficient customer transfers.
- 9.43 One respondent was concerned about the lack of liquidity in the wholesale market as a result of the vertical integration of electricity generators and suppliers. The respondent was concerned that this lack of liquidity would increase prices in the wholesale market to the disadvantage of companies without generation assets.

Ofgem's response

- 9.44 Ofgem has been considering the issues raised by suppliers in relation to dynamically teleswitched meters to facilitate the further development of competition for such customers and to ensure that all suppliers have access to such technology to use in the balancing market once NETA is introduced. Ofgem will be issuing a consultation on these issues in the new year.
- 9.45 Ofgem shares the concern about the availability of MPAN information. We have just issued a consultation document discussing how we can improve the

customer transfer process.²⁹ Work is also progressing with the industry to develop standard address formats for MPAN data and for improvements in address accuracy, which has been a particular concern of suppliers. We have also identified the benefits of making MPAN data available to suppliers on-line rather than in quarterly updates. This approach has been developed in the gas industry by Transco who offer access to meter point data through their website.

- 9.46 Ofgem takes account of the need to ensure that there is sufficient liquidity in the wholesale market for effective competition in that market, when considering proposed mergers and acquisitions.

Conclusions

- 9.47 As discussed above, significant progress has been made to address many of the barriers to entry that existed when competition was first rolled out in the domestic gas and designated electricity markets. Ofgem will continue to monitor closely the behaviour of BGT in the gas market and the PESs in the electricity market to ensure that there is no abuse of a dominant position. If there is any evidence of an abuse of a dominant position, Ofgem will seek to act quickly under the Competition Act 1998.
- 9.48 There do not appear to be many significant issues affecting the general operation of the gas market, apart from suppliers right to block the transfer of customers in debt and competition on IPGT networks. The concerns about customers in debt will begin to be addressed in Ofgem's proposals for BGT's future price regulation and, as discussed above, Ofgem believes that good progress has been made over the last year to improve competitive pressures on IPGT networks.
- 9.49 Many of the issues identified last year as being barriers to entry in the electricity market have been largely addressed over the last year. There remain concerns about the lack of competition for the provision of metering and meter reading activities, the time and cost involved in passing entry tests to the electricity supply market, and the lack of competition for customers with dynamically teleswitched meters. Ofgem is working to address these issues over the next year.

²⁹ "Improving customer transfers, A consultation document", Ofgem, November 2000.

10. Conclusions

10.1 The conclusions of each of the factors we have taken into account in this review of competition are summarised below.

Customers' attitudes and service levels

10.2 There are mixed signals about the extent of customers' understanding of competition. It is encouraging, for example, that 60% of customers thought the prices of new suppliers were lower than those offered by the incumbents (which is broadly true). On the other hand, there were only four suppliers that more than a fifth of the population were aware supplied gas or electricity in their area.

10.3 A majority of switchers gave 'cheaper prices' as the main reason for switching. Further encouraging results for the further development of competition include that 89% of switchers found it easy to change supplier, and the number of non-switchers who said they were likely to change supplier in the next twelve months is very similar to last year's figure. It is slightly higher for those who have already switched. A significant proportion of switchers appear to have been attracted by the prospect of a 'dual fuel' deal.

10.4 The MORI survey suggests that the majority of customers are satisfied with the service they receive from their supplier. Ofgem's complaint statistics show that supply complaints are falling.

Entry and exit of suppliers

10.5 There are currently 16 gas suppliers competing in the domestic market and 13 electricity suppliers competing in the designated market, with 11 companies offering 'dual fuel' supply. Since July 1999 there has been a fall in the number of competing gas suppliers due to mergers and acquisitions. The number of competing electricity suppliers has remained relatively constant. Ofgem believes that there are currently a sufficient number of suppliers in both the gas and electricity supply markets to ensure rivalry between suppliers to offer customers a range of competitive prices. This rivalry is also often enhanced by

the new marketing alliances that have developed in the gas and electricity markets over the last year.

- 10.6 Ofgem recognises that some gas suppliers have faced difficult trading conditions in the recent months because of the level of wholesale gas prices and BGT's price caps.

Market shares

- 10.7 BGT has continued to lose market share in the domestic gas supply market over the last year, although at a lower rate than during the previous year, and currently has a market share of about 71%. Its market share by customers supplied varies by payment method, with direct debit lowest at 69%, other credit payment methods at 75% and prepayment at 87%.
- 10.8 PESs market shares in the domestic electricity supply market by customers supplied varies between 78% and 89%. There is no clear evidence that PESs have lost more market shares by volumes supplied than customers supplied. As with BGT in the domestic gas supply market, PESs have lost more market share for customers paying by direct debit and least for those paying by prepayment. PESs market shares in the small business electricity market vary between 77% and 93% by customers supplied.
- 10.9 There is evidence of continuing growth in the size of the 'dual fuel' market, with Ofgem estimating that over the last year an additional 2.5 million customers are supplied on 'dual fuel contracts.

Customer switching behaviour

- 10.10 Switching rates in the designated electricity market have been 139,425 per week over the last year compared with 57,327 in the domestic gas market. Switching rates in the electricity market are showing no signs of slowing down in either market, and indeed in the gas market switching rates have been higher this year than last year, when they were 52,500 per week. The overall switching rates do not show the extent to which transfers are away from BGT or the host PES or are second transfers by customers who have already switched once. In the gas market, the proportion of total transfers which are second transfers is about 53%,

including winbacks by BGT. In the electricity market most transfers are still first transfers away from the host PES.

10.11 Since competition was rolled out in the domestic gas market the number of customers on direct debit payment methods has remained broadly constant, while the number of customers paying through prepayment meters has doubled. Between September 1999 and June 2000, there has been a small increase in the number of customers paying by direct debit, which may be to take advantage of the lower prices available to customers paying by this method.

Prices and related offers

10.12 In the domestic gas market most customers can attract a range of competitive offers compared to BGT's tariffs, with suppliers offering discounts of up to 14% for direct debit, 20% for other credit payment methods and 13% for prepayment. In the domestic electricity market there is a similar range of competitive offers compared to the local PES tariffs, with suppliers offering discounts of up to 17% for direct debit, 18% for other credit payment methods and 13% for prepayment.³⁰ For gas and electricity the levels of discounts available are similar to those available last year. For direct debit and other credit payment methods there is a much greater number of competitive offers than for prepayment. Small business electricity customers are able to attract a range of competitive offers.

10.13 The gas and electricity markets continue to be characterised by increased innovation in the range of payment methods and complementary products offered by suppliers, with 'dual fuel' offers continuing to be taken up by an increasing number of customers and a wide range of complementary products available for customers.

³⁰ This discount is available on Sothern Electric's Equigas tariff, whichb charges the same amount irrespective of customers payment methods. The next best discount against BGT's tariff is 1.8%.

Barriers to entry

- 10.14 As discussed above, significant progress has been made to address many of the barriers to entry that existed when competition was first rolled out in the domestic gas and designated electricity markets. Ofgem will continue to monitor closely the behaviour of BGT in the gas market and the PESs in the electricity market to ensure that there is no abuse of a dominant position. If there is any evidence of an abuse of a dominant position, Ofgem will seek to act quickly under the Competition Act 1998.
- 10.15 There do not appear to be many significant issues affecting the general operation of the gas market, apart from suppliers right to block the transfer of customers in debt and competition on IPGT networks. The concerns about customers in debt will begin to be addressed in Ofgem's proposals for BGT's future price regulation and as discussed above, Ofgem believes that good progress has been made over the last year to improve competitive pressures on IPGT networks.
- 10.16 Many of the issues identified last year as being barriers to entry in the electricity market have been largely addressed over the last year. There remain concerns about the lack of competition for the provision of metering and meter reading activities, the time and cost involved in passing entry tests to the electricity supply market, and the lack of competition for customers with dynamically teleswitched meters. Ofgem is working to address these issues over the next year.

Summary of conclusions

- 10.17 Overall, Ofgem believes competition is continuing to develop well in the gas supply market, albeit, perhaps more slowly than during the previous year. Customer switching per week is 57,327 up from about 52,500 last year; BGT's number of rivals exceeds that required for competition; and most customers are able to obtain competitive offers, with available discounts of up to 20% compared to BGT's tariffs. 'Dual fuel' offers are continuing to increase in importance, and competition is continuing to develop in the electricity market. There remain barriers to entry that need to be addressed, particularly in the electricity supply market. However, Ofgem has developed plans to address most of these issues in the coming 12 months.

- 10.18 Since BGT's price control was removed last April, competition has continued developing for direct debit customers. Competition has also continued to develop for BGT's PromptPay and LatePay customers, with BGT's market share again falling for this group as most of these customers were able to obtain alternative competitive offers. There remain significant numbers of LatePay customers who cannot switch supplier, because of BGT's right to block their transfer as they are in debt.
- 10.19 Over the last year, competition has not developed significantly for prepayment customers, and BGT has retained almost all these customers, as suppliers are not offering these customers a range of competitive tariffs. Ofgem believes that suppliers blocking transfers of customers in debt has a particularly adverse effect on the development of competition for these customers.

Appendix 1 Gas and electricity supply licences

- 1.1 This appendix summarises the provisions of the conditions of the gas and electricity supply licences relevant to this review.

Gas suppliers' licence

- 1.2 The licence comprises a number of standard conditions, which apply to all domestic gas suppliers. The conditions that are most relevant to this review are discussed below.

General obligations

- 1.3 All suppliers are obliged to supply (and continue to supply) gas in the areas covered by their licences to every domestic customer who requests such a supply, at premises connected to the system. In addition, each supplier must make available its terms of supply on request.
- 1.4 Suppliers are required to offer payment by a range of methods, including cash, cheque or postal order, and payment fortnightly. Suppliers are not bound to offer contracts to supply through a prepayment meter, since they are entitled to insist on a credit meter, but they must offer a prepayment meter as an alternative to a cash deposit, and as an option prior to disconnection.
- 1.5 Suppliers are also required to observe certain procedures prior to exercising their statutory power to enter customers' premises. In particular, they are required to ensure that only authorised personnel exercise these rights.

The ability of gas suppliers' to prevent their customers changing to an alternative gas supplier if they are in debt

- 1.6 Suppliers are able to object to a customer switching to another gas supplier if they are in debt, providing the debt has been outstanding for more than 28 days and the customer has been sent a bill for the outstanding amount.

Marketing

1.7 A new standard condition was added to all suppliers' licences in January 1998 to establish basic principles for the conduct of direct marketing, following complaints about the actions of doorstep sales staff. The licence condition was designed to protect customers from misleading marketing during the early stages of domestic competition, and was initially introduced for two years. The licence condition covers:

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

1.8 Following consultation in January this year the condition was renewed for a further two years (until 30 March 2002). The consultation also asked for views on a number of proposed enhancements to the condition. These included requirements on licensees to:

- ensure that a customer understands that he or she has entered into a contract;
- set up procedures for the management of sales staff;
- provide gas customers who enter into contracts over the telephone with a written copy of the terms and conditions of their contract; and

- carry out an audit and provide the same safeguards for sales conducted in public places as for doorstep and telephone sales.

1.9 Licensees have now voted on these proposed enhancements. The outcome will be published in early December.

Social obligations

1.10 Gas suppliers serving domestic customers are required to adhere to a number of social obligations. These include the requirements:

- to provide energy efficiency advice on request;
- to provide special controls, adapters and advice on gas use, appliances and fittings etc, to the elderly, disabled and chronically sick on request, and facilities for blind and deaf people and to keep a register of such customers; and
- to provide credit terms for the supply of gas to those customers who are in debt through misfortune or inability to cope. This includes offering the facility to discharge their debt by instalments or a prepayment meter and general advice as to how future bills may be reduced through the more efficient use of gas.

Non-discrimination

1.11 Under Standard Condition 13 of the gas suppliers' licence, a dominant gas supplier is prohibited from showing undue preference or exercising undue discrimination against any person or class of persons, from predatorily pricing or unduly onerous pricing. Standard Condition 13 is less stringent after competition is established than before. When competition has been established, the dominant supplier is able to price in a way that is reasonably necessary to meet established competition, but not in a way that is predatory.

First and second tier electricity licences

- 1.12 The first and second tier licences comprises a number of conditions, which apply to all designated electricity suppliers. The conditions that are most relevant to this review are discussed below.

General obligations

- 1.13 All suppliers are obliged to supply (and continue to supply) electricity in the areas covered by their licences to every designated customer who requests such a supply, at premises connected to the system. In addition, each supplier must make available its terms of supply on request.
- 1.14 Suppliers are required to offer payment by a range of methods, including cash, cheque or postal order, and payment fortnightly. Suppliers are not bound to offer contracts to supply through a prepayment meter, since they are entitled to insist on a credit meter, but they must offer a prepayment meter as an alternative to a cash deposit, and as an option prior to disconnection.
- 1.15 Suppliers are also required to observe certain procedures prior to exercising their statutory power to enter customers' premises. In particular, they are required to ensure that only authorised personnel exercise these rights.

Marketing

- 1.16 A new condition was added to all suppliers' licences before the rollout of competition for designated customers, to establish basic principles for the conduct of direct marketing, following complaints about the actions of doorstep sales staff. The licence condition was designed to protect customers from misleading marketing during the early stages of domestic competition, and was initially introduced for two years. The licence condition covers:
- selection and training of sales staff who are in direct contact with domestic customers;
 - an independent audit of sales activity: a customer signing a contract following a sales visit or telephone call should be contacted within 14

days by someone else from the company to ensure that the customer is content with the sales approach and is aware of having signed a contract;

- where a sale takes place two months or more before a customer is due to change supplier, a requirement that the company should maintain contact with the customer and inform them of progress;
- a ban on using agents who seek payment in advance for arranging a supply of electricity; and
- schemes for paying compensation to customers who are victims of misleading sales.

1.17 Following consultation in January this year the condition was renewed for a further two years (until 30 March 2002). The consultation also asked for views on a number of proposed enhancements to the condition. These included requirements on licensees to:

- ensure that a customer understands that he or she has entered into a contract;
- set up procedures for the management of sales staff;
- provide electricity customers who enter into contracts over the telephone with a written copy of the terms and conditions of their contract; and
- carry out an audit and provide the same safeguards for sales conducted in public places as for doorstep and telephone sales.

1.18 Licensees have now voted on these proposed enhancements. The outcome will be published in early December.

Social obligations

1.19 Electricity suppliers serving domestic customers are required to adhere to a number of social obligations. These include the requirements:

- to provide energy efficiency advice on request;

- to provide special controls, adapters, appliances and fittings etc, to the elderly, disabled and chronically sick on request, and facilities for blind and deaf people and to keep a register of such customers; and
- to provide credit terms for the supply of electricity to those customers who are in debt through misfortune or inability to cope. This includes offering the facility to discharge their debt by instalments or a prepayment meter and general advice as to how future bills may be reduced through the more efficient use of electricity.

Non-discrimination

- 1.20 A dominant electricity supplier is prohibited from showing undue preference or exercising undue discrimination against any person or class of persons, from predatorily pricing or unduly onerous pricing. The condition is less stringent after competition is established than before. When competition has been established, the dominant supplier is able to price in a way that is reasonably necessary to meet established competition, but not in a way that is predatory.
- 1.21 A dominant supplier has to give Ofgem 28 days notice of the introduction of new tariffs/ offers or significant changes to existing tariffs/ offers. Ofgem can issue a counter-notice to prevent the introduction of the tariffs/ offers if it believes they may breach the condition.

Appendix 2 BGT's related offers

2.1 This appendix explains the main provisions of BGT's related offers.

BGT's 'dual fuel' offer

2.2 In April 1998, BGT introduced 'dual fuel' supplies to domestic gas and electricity customers (excluding electricity customers using prepayment meters). The offer allows customers who take both gas and electricity from BGT to obtain an annual discount of £13.90 off their electricity standing charge. In addition, BGT's dual fuel customers receive a price guarantee known as the 'Monster Offer', which guarantees that their electricity prices will be cheaper than those of the local PES until 2002.

Goldfish credit card

2.3 The Goldfish credit card was launched in September 1996 by Goldbrand Development Limited ('GDL'), a joint venture established by BGT and HFC bank. Goldfish credit card holders collect 'Goldfish points' and receive 1 point for every £1 spent using the credit card. Each point can be redeemed against BGT's gas and electricity bills, with each point being worth 1 pence towards the BGT bills up to a maximum of £75 in any year. Points can also be redeemed against various other products and redemption partners, e.g. Boots and Asda.

British Gas Home Insurance

2.4 British Gas Home Insurance ('BGHI') was launched in December 1997, a joint venture between Centrica and Privilege Insurance.³¹ BGHI introduced a home and contents insurance package offering a third of the first year's premium back in rebates. BGT said the average rebate is worth £71. Rebates are offered shortly after the insurance is taken up, and are offered in the form of credits towards BGT's gas and electricity bills, savings on British Gas 3 star service cover, or as Goldfish points. In addition, BGHI has promised customers £20 off

³¹ Subsequently, Centrica has changed its joint venture partner to Guardian Insurance Ltd, who are owned by AXA Insurance Ltd.

the second year's premium back in rebates (in the same form as rebates on the first year offer) if they renew their insurance.

BGT's and Sainsbury's initiative

- 2.5 In October 1998, BGT began to market its electricity supply offer in conjunction with Sainsbury's. New electricity customers are given 1000 Sainsbury's 'Reward points' which is equivalent to a credit of £10 towards purchases at Sainsbury's stores. This initiative only applies to electricity customers, irrespective of whether these customers also take gas from BGT.

Joint Payment Arrangements ('JPA')

- 2.6 Last year BGT introduced JPA whereby its direct debit gas customers who also purchase heating service cover from British Gas Services are able to pay through one direct debit.

Telecoms offer

- 2.7 BGT has formed a partnership with Torch Telecom and Cable & Wireless Communications to provide residential telecommunications services. It offers customers 1,000 free minutes (at the national weekend call rates) when customers sign up.

Life Insurance

- 2.8 In November, BGT announced that it was giving all of its gas and electricity customers automatic insurance cover for outstanding bills in the event of accidental death.