

**November 2001**

**Review of domestic gas and electricity  
competition and supply price regulation**

**Evidence and Initial Proposals**

## Executive summary

This document describes the results of Ofgem's 2001 review of competition in domestic electricity and gas supply. It also sets out Ofgem's initial proposals for the future regulation of British Gas Trading's (BGT's) domestic gas prices and the ex-Public Electricity Suppliers' (ex-PES suppliers') in-area domestic electricity charges, from April 2002.

### **Review of competition in domestic gas and electricity supply**

Overall, the findings from the review of domestic competition indicate that competition is now well established, effectively protecting customers' interests, and continuing to develop well.

Customer awareness levels remain high across all customer groups. Around 38% of domestic electricity customers and 37% of domestic gas customers have now switched supplier at least once. The momentum of switching has been maintained, albeit with some tailing off of net switching from BGT. Around 100,000 electricity customers switch supplier each week, and 67,000 gas customers switch supplier each week.

Customers are able to obtain significant savings by switching. Switching rates are much more evenly distributed across customer groups than in previous years. In electricity, 44% of direct debit customers have switched at least once, 32% of quarterly credit customers and 31% of prepayment customers, making an average of 38%. In gas the figures are 43% direct debit, 32% quarterly credit and 28% prepayment, making an average of 37%. There are also no significant differences in switching rates across socio-economic groups or income levels. However, pensioners continue to switch less frequently than others, and competition is still somewhat less advanced in rural areas. There are a number of specific indicators showing that competition is just as effective for electricity PPM customers as it is for those on standard terms.

The market is increasingly characterised by the sale of dual fuel supplies: 4 out of 5 all switchers now buy gas and electricity from the same company.

BGT and ex-PES suppliers continue to lose market share. Recent consolidation in the industry has reduced the number of active gas suppliers over the last year, but customers are still able to obtain a range of savings. This is also true for those paying by prepayment meter.

There remain a number of barriers to entry and other impediments to market development. Principal among these are the reform of trading arrangements in Scotland, and the desire to address problems associated with suppliers' access to arrangements for providing customers with prepayment meter facilities.

### **Ofgem's initial proposals**

Ofgem initially identified three options for future price regulation:-

- ◆ option one - retaining existing relative price caps for BGT, and revising the ex-PES suppliers' price restraints;
- ◆ option two - retaining existing relative price caps for BGT, and introducing relative price caps for ex-PES suppliers; or
- ◆ option three – replacing regulation with price controls with the use of powers of investigation and enforcement under competition law, including the Competition Act 1998.

Having carefully considered the particular circumstances that apply in relation to gas and electricity prepayment customers and electricity customers in Scotland, as well as the arguments for and against alternative forms of regulation, Ofgem proposes, from 1 April 2002, to replace regulation of gas and electricity supply via price controls with the use of powers of investigation and enforcement under competition law, including the Competition Act 1998 (option three).

**Ofgem would welcome views on this proposal, and any other aspect of this document, by Friday, 18 January 2002.**

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# PART I

## 1. Introduction

### *Purpose of the document*

- 1.1 This document describes the results of Ofgem's 2001 review of competition in domestic<sup>1</sup> electricity and gas supply. It also sets out Ofgem's initial proposals for the future regulation of British Gas Trading's (BGT's) domestic gas prices and the ex-Public Electricity Suppliers' (ex-PES suppliers') in-area<sup>2</sup> domestic electricity charges, from April 2002.

### *Background*

- 1.2 Competition was rolled out to all domestic gas customers by May 1998, and for all domestic electricity customers by May 1999. Since then, Ofgem has conducted annual reviews to assess progress in the development of competition. This year's review aims to assess whether competition has developed sufficiently to enable Ofgem to remove price caps applying to BGT and ex-PES suppliers.
- 1.3 Currently, BGT's gas prices are subject to relative price regulation. The regime caps the pence-per-unit (p/kWh) differences between BGT's combined PrePayment and LatePay prices and its PromptPay prices, and between its PrePayment and LatePay prices and monthly direct debit (known as Direct Debit) prices. These relative price caps were introduced from April 2001 for one year<sup>3</sup>.
- 1.4 Ex-PES suppliers' in-area prices are subject to price restraints, which cap the average price charged for electricity supplies to domestic credit customers. There are also separate caps on the differences between credit and prepayment charges, and further caps on standing and unit charges. The restraints do not apply to other electricity suppliers or ex-PES suppliers' charges to non-domestic customers, Direct Debit customers, or to credit and prepayment customers outside each ex PES suppliers' supply services area. The restraints were

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<sup>1</sup> The term 'domestic' refers to all premises using gas or electricity wholly or mainly for domestic purposes.

<sup>2</sup> The term 'in-area' refers to an ex-PES supplier's supply services area.

<sup>3</sup> For more details, see appendix 2.

introduced from April 2000 for two years<sup>4</sup>.

- 1.5 Ofgem's principal objective is to protect the interests of consumers, wherever appropriate by promoting effective competition. Subject to this objective, Ofgem is required to exercise its functions in a manner that promotes efficiency and economy, protects the public from dangers, and secures a diverse and viable long-term energy supply. Ofgem must also have regard to the interests of individuals who are disabled or chronically sick, individuals of pensionable age, individuals with low income, and individuals residing in rural areas. The review of competition and options for future price regulation is carried out against this background<sup>5</sup>.

### ***References***

- 1.6 Published alongside this document are the results from the customer survey<sup>6</sup>.

### ***Rationale***

- 1.7 The rationale for this review is to gain as full an understanding of the nature of competition in domestic gas and electricity retail markets as possible. In particular, a detailed review of competition in gas and electricity supply is necessary in order to gauge the extent to which different customer groups are benefiting from the operation of the competitive market.
- 1.8 A review of the alternative forms of regulation is necessary if Ofgem is to adopt the most appropriate regulation for BGT and the ex-PES suppliers. Inappropriate regulation could lead to distortions of competition that will act against the interests of customers, both now and in the future.

### ***Structure of the document***

- 1.9 The document is organised in three parts. Part I provides the introduction and background. Part II describes the review of competition in domestic gas and electricity supply. Chapter 2 sets out the approach that Ofgem has adopted for

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<sup>4</sup> For more details, see appendix 2.

<sup>5</sup> For more details on the regulatory background, see appendix 1.

<sup>6</sup> "Experience of the competitive domestic electricity and gas markets – Research study conducted for Ofgem by MORI", Ofgem, November 2001.



this year's review. Chapters 3 to 8 present the results of the review. Competition for prepayment customers is considered in chapter 9, and the degree of competition in retail electricity supply in Scotland is examined in chapter 10. Chapter 11 provides a summary of the findings. Ofgem's initial proposals for price regulation from April 2002 are identified in Part III.

### ***Timetable***

1.10 The timetable for the review is set out in table 1.1:

**Table 1.1 - Timetable**

<b>Date</b>	<b>Event</b>
11 May 2001	Public workshop to explain approach to reviews
2 July 2001	Ofgem's survey of gas and electricity suppliers issued
2 August 2001	Ofgem's information request to ex-PES suppliers issued
12 September 2001	Ofgem's information request to BGT issued
August/September 2001	Fieldwork for MORI survey carried out
26 November 2001	Publication of MORI survey
26 November 2001	Publication of review of competition in domestic gas and electricity supply and initial proposals for price regulation
7 December 2001	Public workshop to present findings of review of competition, and initial proposals
18 January 2002	Deadline for responses
19 February 2002	Publication of final proposals for price regulation, with proposed licence modifications
19 March 2002	Subject to consultation responses*, licence modifications implemented
1 April 2002	Proposals for price regulation take effect

\*If one or more companies reject proposed licence modifications, Ofgem may use its powers to refer the matter to the Competition Commission for resolution.

### ***Views invited***

- 1.11 Views are invited on any of the points raised in this review. Responses are requested by 18 January 2002, and should be sent to:

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

E-mail: [nick.fincham@ofgem.gov.uk](mailto:nick.fincham@ofgem.gov.uk)

- 1.12 Where paper copies of a consultation response have been sent, it would be helpful if responses could also be sent electronically. Unless marked clearly as confidential, all responses will be published by placing them in Ofgem's library and on Ofgem's website.
- 1.13 If you have any questions on the review of competition, please contact Shaun Kent ([shaun.kent@ofgem.gov.uk](mailto:shaun.kent@ofgem.gov.uk) or 020 7901 7199). If you have any queries on the initial proposals for price regulation, please contact Chris Bowley ([chris.bowley@ofgem.gov.uk](mailto:chris.bowley@ofgem.gov.uk) or 020 7901 7372).

## **PART II: Review of competition in domestic gas and electricity supply**

### **2. Approach**

2.1 This chapter sets out the approach that Ofgem has taken in assessing the development of competition in domestic electricity and gas supply.

#### ***Conceptual approach***

2.2 Ofgem believes that, consistent with the new principal objective under the Utilities Act 2000, consumers' interests, in terms of price, quality and variety of service on offer, will, wherever appropriate, be most effectively protected through effective competition between suppliers.

2.3 A number of important conditions, if met, will tend to promote effective competition. These include :

- ◆ the prevention of anti-competitive agreements and practices including the abuse of market power, if it exists;
- ◆ customers are aware of a range of competitive offers from suppliers; and
- ◆ new undertakings are able to enter and challenge the market.

2.4 The abuse of market power may be one of the factors that stops effective competition developing. Hence it is important that any 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 improved economic efficiency.

2.5 The development of competition is a dynamic process, characterised by constantly changing structures, behaviour and performance. The development of competition cannot be measured clearly against a single simple set of indicators, for example market shares. The functioning of the market depends upon the combined effects of the actions of the relevant distributors and suppliers, competitors and customers, as well as the structural conditions in

which they all operate.

2.6 Bearing in mind the dynamic nature of competition, Ofgem has considered a range of indicators of the development of competition in this review, which reflect the importance of considering customer, distributor and supplier behaviour, and the market conditions in which they operate. The approach Ofgem has adopted for this review is similar to the approach adopted for previous competitive market reviews, including the December 2000 review of domestic gas and electricity supply<sup>7</sup>. The factors Ofgem has considered are :

- ◆ customers' experiences;
- ◆ customer switching behaviour;
- ◆ market shares;
- ◆ price and non-price offers;
- ◆ entry and exit of suppliers; and
- ◆ barriers to entry.

### ***Practical approach***

2.7 In order to inform its review of competition, Ofgem carried out two surveys: one of domestic electricity and gas suppliers; and one of domestic gas and electricity customers.

### **Suppliers survey**

2.8 Ofgem sent a survey to all electricity and gas domestic suppliers requesting quantitative and qualitative information about the development of competition. In brief, suppliers were asked to provide information about:

- ◆ the ownership structure of each supplier;
- ◆ the number of domestic customers and volumes supplied in each ex-PES suppliers area between 1 April 2000 and 1 July 2001, split by payment

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<sup>7</sup> "A review of the development of competition in domestic gas and electricity supply", Ofgem, December 2000.

method;

- ◆ the number of dual fuel customers supplied between 1 October 2000 and 1 July 2001;
- ◆ the number of domestic customers in debt; and
- ◆ views on barriers to entry to the domestic electricity or gas markets, or other impediments to the development of competition.

2.9 Almost all domestic suppliers responded to the survey. The information provided in response to the survey was reasonably comprehensive, although some respondents had difficulty providing information split by payment method and dual fuel. Any limitations on the quality of the results due to the quality of the information provided are explained in the relevant chapters. Ofgem is grateful for the time and effort of suppliers that responded to the survey.

#### **Customer survey**

2.10 In parallel with the survey of suppliers, Ofgem commissioned MORI to undertake a sample survey of domestic electricity and gas customers. The survey was designed to gauge customers' experiences of the competitive market, including reasons for switching or not switching supplier, levels of satisfaction with suppliers, and views on payment methods.

2.11 Accordingly, MORI interviewed 2310 domestic customers during August and September 2001. Chapter 4, which discusses customer experiences, makes extensive use of MORI's findings. To coincide with the publication of this paper, Ofgem has published a separate document setting out MORI's full findings.

#### **Findings**

2.12 The rest of Part II of this document sets out Ofgem's findings on the development of competition, based on the sources described above. Findings are organised as follows:

- ◆ Chapter 3 sets out customers' experiences and perceptions of the market, as informed in the main by the customer survey;

- ◆ Chapter 4 notes the extent to which customers have switched supplier and how switching rates have changed;
- ◆ Chapter 5 considers suppliers' market shares;
- ◆ Chapter 6 sets out evidence of the price and non-price offers that are open to customers;
- ◆ Chapter 7 reviews the entry and exit of suppliers in the domestic market;
- ◆ Chapter 8 considers barriers to entry to the market and other impediments to competition;
- ◆ Chapter 9 summarises evidence on the extent to which there is competition to supply customers with prepayment meters;
- ◆ Chapter 10 reviews evidence on the development of electricity competition in Scotland; and
- ◆ Chapter 11 is a summary of all findings.

### 3. Customers' experiences

#### *Introduction*

3.1 This chapter considers evidence of the extent to which customers feel informed about the competitive gas and electricity markets, and the extent to which they feel able to or have exercised their choice to change supplier. The evidence presented draws heavily on Ofgem's customer survey. It sets out evidence collected from gas customers first, followed by evidence collected from electricity customers.

#### *Gas*

##### **Awareness**

3.2 Levels of customer awareness of gas suppliers are shown in table 3.1.

**Table 3.1 – Awareness of gas suppliers**

Number of gas suppliers customer is aware of	Proportion of gas customers (2000)	Proportion of gas customers (2001)
1 supplier	32%	27%
2 suppliers	33%	27%
3 suppliers	18%	19%
4+ suppliers	17%	23%

Base: All on mains gas and mentioning at least 1 supplier (c.1855)

3.3 Table 3.1 shows that awareness of individual suppliers is high. 42% of customers said that they were aware of 3 or more gas suppliers selling gas in their area, with 69% aware of 2 or more. These figures suggest similar awareness to 2000 (with 35% and 68% aware respectively).

3.4 Gas customers' awareness tends to be higher for those who had switched supplier and for those paying by direct debit. Awareness of suppliers by gas prepayment meter customers matches the average for all customers.

### Satisfaction levels

3.5 In putting together offers for customers, suppliers have the option of varying both prices and services. Levels of customer satisfaction are shown in table 3.2.

**Table 3.2 – Satisfaction levels**

Customer group	Satisfied	Neither satisfied nor dissatisfied	Dissatisfied
All gas customers	86%	6%	4%
By switching			
- switchers	81%	8%	6%
- non-switchers	90%	5%	3%
By payment type			
Direct Debit	88%	6%	3%
- Quarterly cash or cheque	86%	7%	4%
- prepayment	89%	5%	5%

Base: All on mains gas (c.1938)

3.6 Customers tended to report satisfaction with the overall service from gas suppliers. 86% of gas customers reported satisfaction with their current supplier.

3.7 Satisfaction levels varied between switchers and non-switchers, with switchers slightly less likely to report themselves satisfied with overall service. Even so, over 80% of gas switchers said that they were satisfied with the overall service from their supplier.

3.8 There was a slight variation in levels of satisfaction across payment methods, with prepayment customers expressing the most satisfaction. 89% were satisfied with the overall service from their current supplier.

3.9 Satisfaction levels in general show a small decrease on results obtained during



the summer 2000. Then, satisfaction levels were at 88% for gas customers.

### **Ease of switching**

- 3.10 Most gas switchers (88%) said that they found it easy to switch. Around 10% of gas switchers said that they found switching 'difficult' and the main reason cited was 'old supplier raised objections / made it difficult to leave'.

### **Reasons for switching or not switching**

- 3.11 Gas customers cited 'cheaper prices' as the main reason to switch, with just over 68% of switchers giving this reason. The ability to obtain both electricity and gas from the same supplier was the next most common reason cited by switchers for changing supplier. (The importance of dual fuel offers is also underlined by the finding that four out of five switchers take both gas and electricity from a single supplier.)

Customers who had never switched supplier tended to cite 'see no reason to change/satisfied with current supplier' as the reason for not switching. 72% of non-switchers gave this reason. 12% of non-switchers also said that 'changing is too much hassle'. 10% of gas non-switchers said that they thought it would be 'difficult' to change supplier. Only 2% of gas non-switchers reported being 'unable to switch'. Around two fifths said that they believed or had been told that those in debt with a supplier cannot change supplier.

### **Contact with gas and electricity suppliers**

- 3.12 The amount and type of contact with suppliers is set out in table 3.3.

**Table 3.3 – Contact with gas and electricity suppliers**

Type of contact	2000	2001
Doorstep salesperson	62%	61%
- Urban	64%	68%
- Rural	56%	43%
Leaflet through door	39%	33%
Telesales	22%	25%
TV advert	28%	25%
Encounter on street/shopping centre	14%	18%
None	12%	12%

Base: All respondents (c.2310), except for Urban (all urban residents (1715)) and Rural (all rural residents (549)).

3.13 A significant proportion of both gas and electricity customers reported having had some form of communication with the new gas suppliers. Three out of five of all customers said that they had been visited by a doorstep salesperson, and this varied little between customers or different payment methods. A third of all had received a leaflet through the door.

3.14 Significantly, 68% of urban gas and electricity customers had been visited by a doorstep salesperson, compared to 43% of rural customers, widening the gap since 2000.

### **Pricing information**

3.15 A third of customers say that they have been able to make their own comparisons between the prices that the various suppliers are currently charging, while around two thirds of customers say they have been approached by suppliers who have told them how prices compare. Of those that make comparisons, the next most common source of information for customers about

prices is newspapers or magazine articles, with 18% of customers using such sources. These findings broadly match the findings in 2000.

- 3.16 Just over half the customers who had received price information said that they felt 'informed' about prices, while 42% said they were 'not informed'. The proportion of customers who said that they felt 'informed' rises to 63% and 57% of those who obtained pricing information from current or competitor suppliers respectively.
- 3.17 Customers who said that they were able to make price comparisons or who had been approached with price information were also asked how easy or difficult it was to make price comparisons. 40% said they found it easy, while 35% said that they found it difficult. These proportions were similar across different payment methods, and according to whether the source of information was the current or competitor supplier.

## ***Electricity***

### **Awareness**

- 3.18 Awareness of electricity customers is shown in table 3.4.

**Table 3.4 – Awareness of electricity suppliers**

<b>Number of electricity suppliers customer is aware of</b>	<b>Proportion of electricity customers (2000)</b>	<b>Proportion of electricity customers (2001)</b>
1 supplier	22%	19%
2 suppliers	25%	24%
3 suppliers	21%	19%
4+ suppliers	32%	35%

Base: All electricity customers mentioning at least 1 supplier (c.2310)

- 3.19 Over half (54%) of domestic customers said that they were aware of 3 or more electricity suppliers selling electricity in their area. 78% said that they were

aware of 2 or more suppliers.

3.20 As for gas customers, awareness levels are higher among switchers and those paying by direct debit. Again, prepayment customers' awareness levels reflect the average for all customers.

### Satisfaction levels

3.21 Levels of satisfaction of electricity customers are shown in table 3.5.

**Table 3.5 – Satisfaction levels of electricity customers – Summer 2001**

Customer group	Satisfied	Neither satisfied nor dissatisfied	Dissatisfied
All electricity customers	87%	6%	3%
By switching			
- switchers	81%	8%	5%
- non-switchers	91%	5%	2%
By payment type			
- Direct Debit	88%	6%	3%
- Quarterly cash or cheque	86%	7%	3%
- prepayment	86%	7%	5%

Base: All electricity customers (c. 2310)

3.22 Customers were generally satisfied with the overall service from electricity suppliers. 87% of electricity customers reported satisfaction with their current supplier. As with gas, switchers were less likely than non-switchers to report themselves satisfied with overall service. Even so, just over 80% of electricity switchers said that they were satisfied with the overall service from their supplier.

3.23 86% of prepayment meter customers were satisfied with service, not

significantly different from than average. Again, the results showed a small shift from the 'satisfied' to the 'neither satisfied nor dissatisfied' category.

### **Contact with electricity suppliers**

- 3.24 Customer contact with both gas and electricity suppliers was described in paragraphs 3.15 to 3.17. In essence, the amount and type of contact with suppliers has not changed significantly as between 2000 and 2001, although the amount of contact via doorstep salespersons in rural areas has fallen relative to that in urban areas.

### **Pricing information**

- 3.25 Both gas and electricity customers' ability to compare prices was discussed in paragraphs X.XX and Y.YY. In essence a third of all customers say that they have been able to make their own comparisons between the prices that the various suppliers are currently charging, while around two thirds of customers say that they have been approached by suppliers who have told them about how prices compare (similar across payment methods).
- 3.26 Just over half of customers who have price information say that they feel 'informed' about prices, while 42% say that they feel 'not informed'.
- 3.27 Customers are still finding price comparisons between different offers difficult. 40% said they found comparing electricity prices easy, and 35% found it difficult. As in gas, these proportions were similar across different payment methods, and according to whether the source of information was the current or competitor supplier.

### **Ease of switching**

- 3.28 As in gas, 88% of electricity switchers said that they found it easy to switch. There were no large differences between payment types, with 90% of prepayment meter customers reporting it 'easy' to leave their previous electricity supplier. Of those electricity switchers (around 9%) who found it 'difficult' to switch, the main reason cited was 'problems with billing'.

### **Reasons for switching or not**

- 3.29 'Cheaper prices' and the ability to obtain both fuels from the same supplier were again the most common reasons for switching.
- 3.30 As with gas, electricity non-switchers cited 'see no reason to change / satisfied with current supplier' as the main reason for not switching. 79% of those customers gave this reason. 32% of non-switchers also said that 'changing is too much hassle'. 14% of electricity non-switchers said that they thought it would be 'difficult' to change supplier. Few non-switchers (5% in electricity) reported being 'unable to switch'. Around two fifths gave this answer because they said that they believed that they would not have been able to use or continue to use a prepayment meter after switching.

### **Dual fuel**

- 3.31 As stated above, the ability to receive electricity and gas from the same supplier is the second most important reason for switching supplier. 81% of customers who have switched now have the same supplier for both fuels. Around half of those customers had switched their gas supply to their existing electricity supplier or vice versa.
- 3.32 60% of customers who chose to be supplied with both fuels by the same company said they did so because they were offered an additional discount for taking both fuels from the same company.

## 4. Switching rates

### *Introduction*

4.1 A key measure of the degree of competition in a market is the degree of switching of customers between suppliers. This chapter considers the following evidence on the degree of switching for gas and electricity in turn:

- ◆ the level of 'gross' switching (i.e. all transfers);
- ◆ the level of 'net' switching (i.e. the number of transfers away from BGT (in gas) and 'in area' ex-PES suppliers (in electricity) after deducting transfers of customers back to BGT and 'in area' ex-PES suppliers);
- ◆ the level of churn (i.e. a breakdown of gross switching figures into three categories: transfers away from BGT (in gas) and 'in area' ex-PES suppliers (in electricity); transfers between non-incumbent suppliers; and transfers back to BGT (in gas) and 'in area' ex-PES suppliers (in electricity));
- ◆ the proportion of customers of different types who have switched gas or electricity supplier since the market was opened to competition; and
- ◆ the proportion of customers of different types who intend to switch gas or electricity supplier in the next 12 months.

4.2 Information on gross switching, net switching and churn has been drawn from Transco for the domestic gas supply market and from the electricity Meter Point Administration System (MPAS) service providers for the domestic and small business electricity supply market<sup>8</sup>. Data on the number of customers who have switched gas or electricity supplier since competition was introduced, and on

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<sup>8</sup> Prior to the implementation of the *Utilities Act 2000*, for regulatory purposes the electricity supply market was divided into two sectors, based upon the quantity of electricity that customers consumed: the designated sector was made up of domestic and small business customers that had an annual consumption of less than 12,000KWh. For the period covered by this review, Ofgem has therefore considered switching activity in the domestic and the small business electricity sectors in combination.

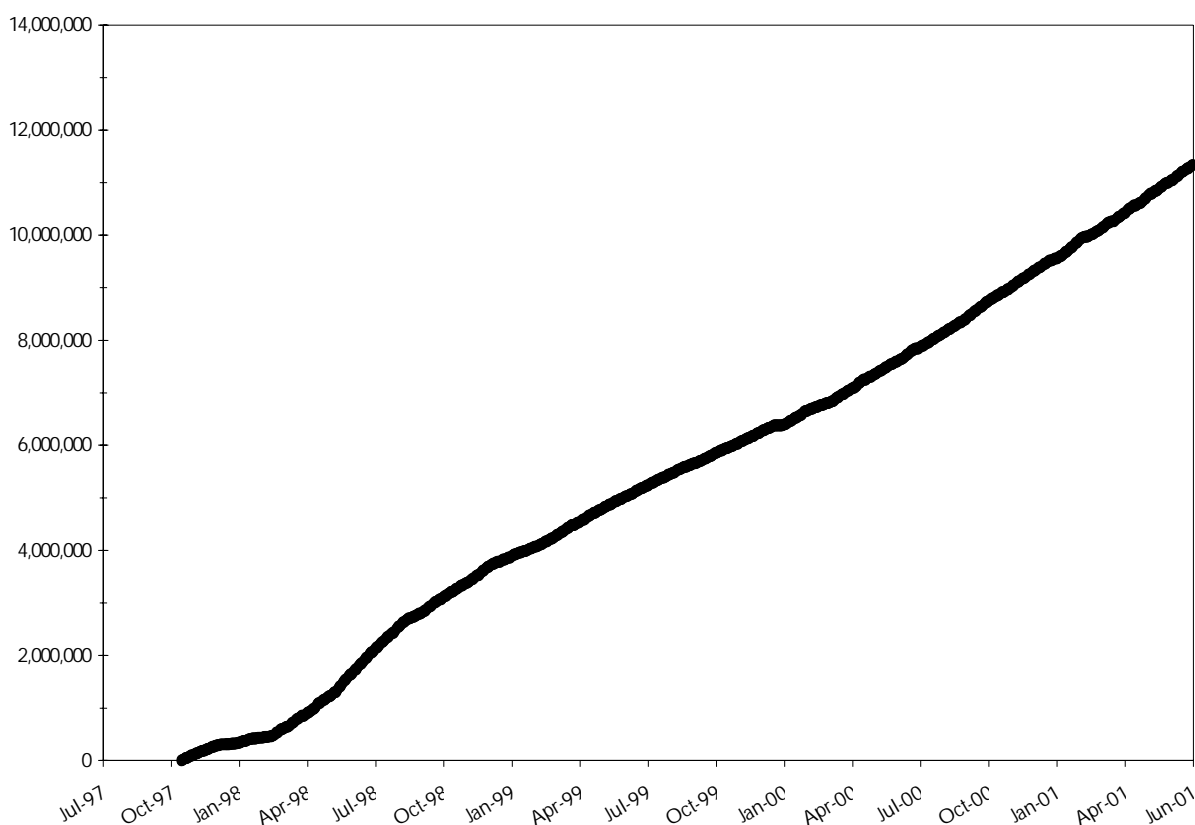
the number who intend to switch in the next 12 months was collected as part of Ofgem's customer survey<sup>9</sup>.

## *Gas*

### **Gross switching**

4.3 The number of transfers of customers from one gas supplier to another since domestic gas supply was opened to competition is set out in figure 4.1.

**Figure 4.1 – Gross switching of gas customers – 1997 – 2001**



4.4 Figure 4.1, shows that, in the domestic gas market, there have been over 11 million transfers of gas customers in total. It also shows that the rate of transfers continues to occur at a constant rate of around 3.7 million customers a year, or about 70 000 transfers a week in the year to September 2001. This compares to

<sup>9</sup> "Experience of the competitive domestic electricity and gas markets – Research study conducted for Ofgem by MORI", Ofgem, November 2001.

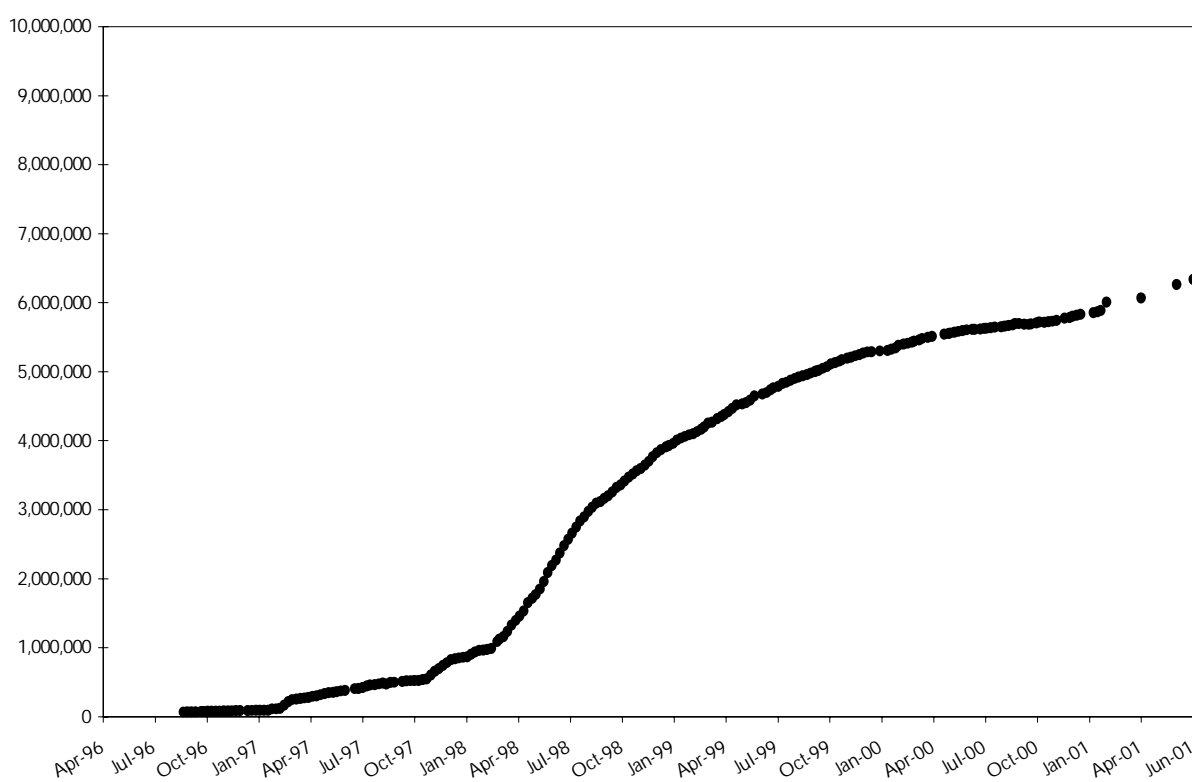


an equivalent gross switching figure of 56 000 a week in the year to September 2000, showing that gross switching in the domestic gas supply has increased over the last year.

### Net switching

4.5 Figure 4.2 shows the amount of net switching away from BGT since domestic gas supply was first opened to competition in 1996.

**Figure 4.2 – Net switching of gas customers – 1996 – 2001**



4.6 Figure 4.2 shows that rapid increases in net switching occurred in 1998, as the roll-out of competition in domestic gas supply was completed. Since then, net switching away from BGT has dropped to a lower rate of around 0.7 million customers a year, or about 14 000 gas customers a week for the year to September 2001. This compares to an equivalent net switching figure of about 12 000 a week in the year to September 2000, showing that net switching away from BGT, although considerably lower than gross switching, has again

increased during the last year.

### Customer 'churn'

- 4.7 Table 4.1 provides a breakdown of the gross switching figures, including the amount of churn, for the 12 months to September 2000 and the 12 months to September 2001.

**Table 4.1 – Gas customer 'churn' in domestic gas supply (October 1999 – September 2001)**

Type of transfer	October 1999 to September 2000	October 2000 to September 2001
Transfers away from BGT	49%	46%
Transfers between non-BGT suppliers	23%	28%
Transfers from non-BGT suppliers back to BGT	28%	26%

Source : Transco

- 4.8 In last year's review of competition, it was noted that the number of transfers away from BGT as a proportion of the total had been declining, and that the proportion of gross transfers accounted for by churn and by customers being won back by BGT had increased. Evidence from this year's review – as shown in table 4.1 - suggests that these trends have stabilised.

- 4.9 Ofgem's customer survey produced further evidence on churn. It found that among those customers that had switched gas supplier, 28% had switched more than once. Of this group, 46% said that they had switched back to BGT. This finding – that roughly half those gas customers who switch twice or more are returning to BGT, and half to another non-BGT supplier – is consistent with the evidence presented in table 4.1.

### Proportion of gas customers who have switched

- 4.10 The customer survey during August and September 2001 found that, on average, 37% of all domestic gas customers had switched supplier, compared to 29% in the survey conducted a year earlier. The survey also highlighted differences in

switching among special groups of customers, customers on different payment methods, and according to whether customers are in debt.

*Switching among special groups*

4.11 Table 4.2 shows the proportions of customer in special groups that had switched supplier, at summer 2001, compared with a year earlier.

**Table 4.2 – Proportion of gas customers in special groups that have switched supplier**

Customer Group	Proportion of group that have switched (%)	
	Summer 2000	Summer 2001
All domestic gas customers	29	37
Socio-economic groups		
AB	25	37
C1	29	40
C2	32	37
DE	28	36
E	28	32
Very low income customers <sup>10</sup>	24	38
Disabled customers	32	35
Single parent families	31	39
Pensioners	25	29
Geographic area		
Urban	29	38
Rural	29	35

4.12 Table 4.2 shows that switching rates have tended to become more even across socio-economic groups. Customers with very low incomes have 'caught up' with other customer groups, and now appear just as likely to switch as domestic gas customers as a whole. Customers who are disabled and single-parent families continue to switch at around average levels. As at summer 2001, a smaller proportion of pensioners, those in socio-economic group E and rural customers have switched gas supplier.

4.13 Results from the customer survey on the degree of switching among different customer groups are discussed in more detail in Ofgem's customer survey.

Overall, however, it is encouraging that, as customers become more familiar with the competitive market, they appear to be increasingly willing to switch supplier.

*Switching by payment method*

4.14 At the end of June 2001, there were in Great Britain around 8 million monthly direct debit gas customers, 10 million standard credit gas customers (including customers on BGT's LatePay and PromptPay tariffs) and 1.7 million prepayment meter customers. This reflects an increase in the proportion of customers paying by monthly direct debit over the past year. Table 4.3 shows the extent to which customers using different payment methods have switched.

**Table 4.3 – Proportion of gas customers using different payment methods that have switched supplier**

Customer Group	Proportion of group that have switched (%)	
	Summer 2000	Summer 2001
Average	29	37
Direct Debit	33	42
Standard credit	27	32
Prepayment	11	28

4.15 Customers on all payment types appear to be taking advantage of the competitive market. The customer survey conducted by MORI found that at summer 2001, among gas prepayment meter customers, 28% had switched supplier. This compared with 32% of standard credit customers and 37% of all domestic gas customers that had switched. These results showed a narrowing of the differential in the level of switching between prepayment customers and gas customers generally: the previous customer survey showed that, at summer 2000, 11% of prepayment meter customers had switched, compared to the average for all gas customers at that time of 29%.

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<sup>10</sup> Very low income customers are defined as those with an income of less than £4,500 per annum.

### *Switching by customers in debt*

- 4.16 Ofgem has been particularly concerned to ensure that customers in debt are not unnecessarily excluded from taking advantage of the competitive market. Ofgem has been working towards reducing the ability of electricity and gas suppliers to object to a switch to another supplier if the customer concerned has an outstanding debt with his or her supplier.
- 4.17 Ofgem's supplier survey asked suppliers to provide information on the number of their customers, in each payment category, that had an outstanding debt for 28 days or more. The results showed that there were, at 1 July 2001, 2.5 million customers in debt nationally.<sup>11</sup> The incidence of these customers across payment methods is summarised in table 4.4.

**Table 4.4 – Proportion of gas customers with an outstanding debt by payment method**

<b>Payment method</b>	<b>Proportion of customers in debt (%)</b>
Average	12
Direct debit	7
Standard credit	10
Prepayment	58

- 4.18 Table 4.4 shows that gas prepayment customers are far more likely to be in debt than gas customers paying by other means, although it should be noted that in absolute terms there are fewer gas customers in debt using prepayment meters (around 1 million) than gas customers in debt paying by other methods (around 1.5 million). This conclusion corresponds with information Ofgem has received from suppliers in its monitoring of Codes Of Practice under the Social Action Plan.
- 4.19 While there remains a proportion of gas customers that have an outstanding debt, evidence from this year's customer survey contrary to evidence received in previous years suggests that having a debt is not necessarily a significant barrier to switching between suppliers (see table 4.5).

**Table 4.5 – Proportion of gas customers with an outstanding debt or difficulty paying who have switched supplier**

Customer Group	Proportion of group that have switched (%)	
	Summer 2000	Summer 2001
Average	29	37
Outstanding debt or have experienced difficulty paying bills	35	35

4.20 Table 4.5 shows that of customers that said that they had difficulty in paying their bills or had an outstanding debt, 35% had switched supplier. This compares to the average of 37% more than 6 months old for all gas customers questioned.

#### **Likelihood of switching gas supplier**

4.21 Ofgem's customer survey asked customers about their likelihood of switching supplier in the next twelve months. The results are set out in table 4.6.

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<sup>11</sup> Although a minority of companies were not able to provide information on the numbers of their customers in each payment category that had an outstanding debt, there was almost complete provision of information by suppliers on the total number of their customers in debt.

**Table 4.6 – Likelihood of gas customers switching within the next 12 months**

Customer Group	Proportion of group that are likely to switch (%)	
	Summer 2000	Summer 2001
Average	10	11
By switching group		
- Switchers	12	15
- Non-switchers	8	6
By payment method		
- Direct Debit	11	10
- Standard Domestic	9	11
- Prepayment	8	8
By country		
- Scotland	8	10

4.22 Table 4.6 shows that, in summer 2001, of those domestic gas customers that had switched supplier, 15% responded that they were likely or certain to switch supplier in the coming twelve months. Among prepayment meter customers that had switched, 11% stated that they were likely or certain to switch in the coming twelve months.

4.23 Among gas customers that had not yet switched supplier, 6% responded that they were likely or certain to switch in the coming twelve months. Among prepayment customers that had not yet switched, 5% responded that they were likely or certain to switch supplier in the coming twelve months.

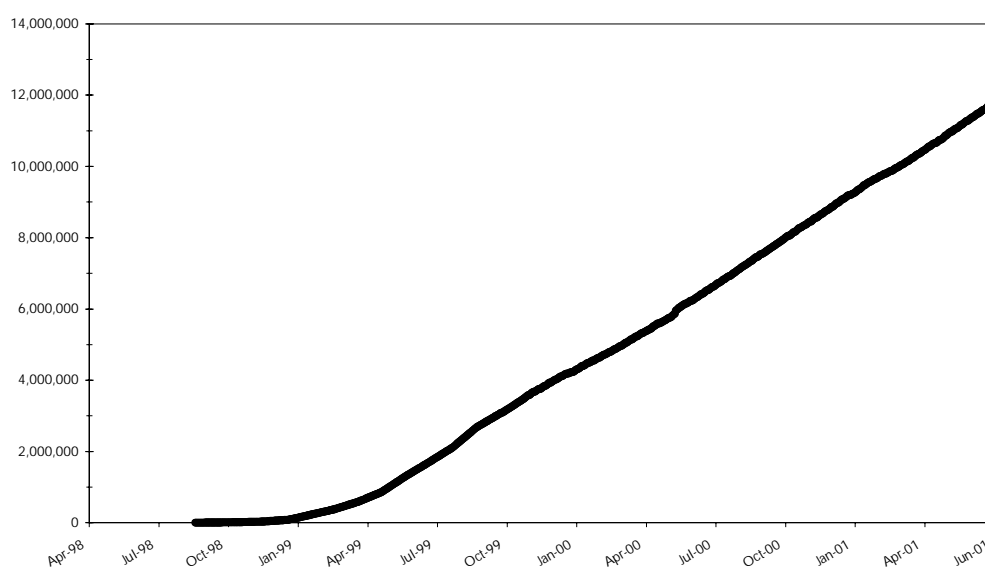
### ***Electricity***

#### **Gross switching**

4.24 The total number of transfers that have occurred from one electricity supplier to another since electricity supply to customers with a maximum demand of less than 100 kW was opened to competition is set out in figure 4.3.

4.25 Figure 4.3 shows that in this sector of the market, there have been approximately 11 million gross transfers in total. The rate of transfers continues at a steady rate over time of about 5 million transfers per year, or about 100 000 per week to September 2001. This compares to a switching rate of about 94 000 per week in the year up to September 2000, suggesting that gross switching rates have increased slightly.

**Figure 4.3 – Gross switching of electricity customers 1998 - 2001**

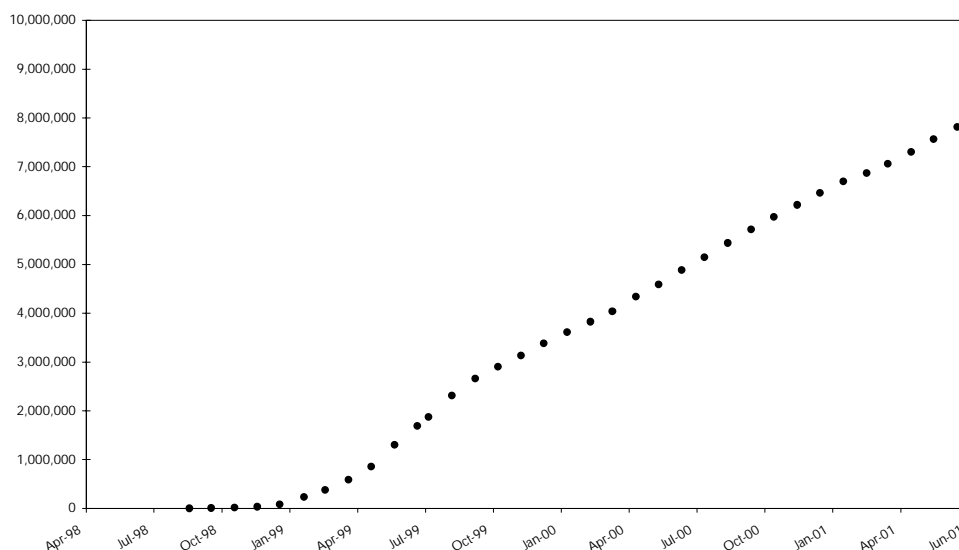


### **Net switching**

4.26 Figure 4.4 shows the extent of net switching since the under 100 kW electricity market was opened to competition. As in gas, switching rates rose initially, reflecting the phased introduction of competition. Since about October 1999, net switching rates have steadied. Over the year to September 2000, just over 3 million net transfers occurred, or about 59 000 per week. Over the year to September 2001, there were around 2.9 million net transfers, or about 55 000 per week.



**Figure 4.4 – Net switching of electricity customers**



4.27 Net switching has therefore been maintained at a fairly steady rate since the introduction of competition, and shows little sign of slowing.

**Customer ‘churn’**

4.28 Table 4.7 gives a breakdown of gross switching data, indicating the extent to which there has been ‘churn’ between ex-PES suppliers ‘in area’, and ex-PES suppliers ‘out of area’ and new entrants, and how this has changed between two years.

**Table 4.7 Electricity customer ‘churn’ in electricity supply**

	<b>August 1999 to June 2000</b>	<b>July 2000 to June 2001</b>
Transfers away from ‘in area’ ex-PES suppliers to other suppliers	79%	74%
Transfers between other suppliers	6%	9%
Transfers from other suppliers back to ‘in area’ ex-PES suppliers	15%	16%

### **Proportion of electricity customers who have switched**

- 4.29 The customer survey found that 38% of domestic electricity customers had, at August / September 2001 switched supplier one or more times since the introduction of competition. This compares with 19% as at September / October 2000. These numbers are not directly comparable because data for 2000 was weighted to reflect estimates of gross switching rates prevailing at that time and which had the effect of slightly underestimating the headline switching rate. As for gas, the customer survey also allowed analysis of switching rates by different customer groups, again summarised here under the headings of special customer groups, payment method, and according to whether customers are in debt.

### **Switching among special customer groups**

- 4.30 Table 4.8 shows the proportion of customers in special groups that had switched supplier, at summer 2001, compared with a year earlier.

**Table 4.8 – Proportion of domestic electricity customers in special groups that have switched supplier**

Customer Group	Proportion of group that have switched (%)	
	Summer 2000	Summer 2001
All domestic electricity customers	19	38
Socio-economic groups		
AB	20	36
C1	19	38
C2	20	41
DE	19	36
E	18	37
Very low income customers <sup>12</sup>	13	43
Disabled customers	21	44
Single parent families	19	43
Pensioners	20	30
Geographic area		
Urban	20	41
Rural	17	32

4.31 Table 4.8 shows that switching rates have tended to become more even between the listed groups over time. Customers with very low incomes, disabled customers, and single parent families are now switching at rates in excess of the average. Pensioners and electricity customers in rural areas continue to switch at lower than the average rate.

#### **Switching by payment method**

4.32 At the quarter ending June 2001, there were in Great Britain around 8.9 million domestic electricity customers paying by monthly direct debit, 11.3 million standard credit customers and 3.6 million customers paying by prepayment.

<sup>12</sup> Very low income customers are defined as those with an income of less than £4,500 per annum.

Table 4.9 sets out the extent to which customers on these different payment methods have switched supplier.

**Table 4.9 – Switching rates of electricity customers by payment method**

Customer Group	Proportion of group that have switched (%)	
	Summer 2000	Summer 2001
Average	19	38
Direct Debit	23	44
Standard credit	19	32
Prepayment	9	31

4.33 Switching rates across customers of all payment types have increased significantly compared with last year. There has been a large degree of evening out of rates compared with the average, reflecting an acceleration in the switching rate for those paying by prepayment meter. Over the last 12 months, around 23% of prepayment customers have switched supplier, compared with around 27% of Direct Debit customers. Prepayment meter customers are now equally likely to have switched as standard credit customers.

#### **Switching by customers in debt**

4.34 Table 4.10 sets out the proportion of customers by payment type that are 'in debt'. Data comes from suppliers, who were asked to give customer numbers in debt as at 1 July 2001, where debt is defined as the customer having an outstanding debt for 28 days or more.

4.35 Suppliers reported that, in aggregate, there are 2 million electricity customers in debt. The incidence of debt is fairly evenly spread across payment method. Unlike gas, there is no concentration of debt levels among prepayment meter customers.

**Table 4.10 Proportion of electricity customers with an outstanding debt by payment method**

Payment method	Proportion of customers in debt (%)
Average	8
Direct debit	12
Standard credit	11
Prepayment	9

4.36 The extent to which customers in debt might or might not be excluded from the market can be gauged to some extent from the customer survey. Results suggest that customers in debt and / or with difficulty in paying are more likely than average to switch supplier. Table 4.11 sets out the figures.

**Table 4.11 – Proportion of electricity customers in debt who have switched supplier**

Customer Group	Proportion of group that have switched (%)	
	Summer 2000	Summer 2001
Average	19	38
Outstanding debt or have experienced difficulty paying bills	19	53

#### **Likelihood of switching electricity supplier**

4.37 As for gas, Ofgem's customer survey asked customers about their likelihood of switching supplier in the next twelve months. Table 4.12 sets out the results.

**Table 4.12 – Likelihood of electricity customers switching within the next 12 months**

Customer Group	Proportion of group that are likely to switch (%)	
	Summer 2000	Summer 2001
Average	10	11
By switching group		
Switchers	13	14
Non-switchers	7	7
By payment method		
Direct Debit	11	12
Standard Domestic	9	9
Prepayment	8	12
By country		
Scotland	7	12

4.38 Electricity switchers show a considerably higher propensity to switch over the next 12 months compared with non switchers (14% against 7%). The relative propensities of each of these groups is unchanged from 2000. Of the prepayment meter customers who have not yet switched 9% said they were likely or certain to switch over the next 12 months.

### ***Conclusions***

4.39 The average level of gross switching in the designated electricity market was 100,000 per week in the year up to the end of September 2001, compared with about 94,000 per week in the same period a year earlier. In the domestic gas market, the average level of gross transfers was about 70,000 per week in the year to the end of September 2001, compared with 56,000 per week in the same period a year earlier. The level of gross switching in both markets showed has therefore slightly increased in the period covered by this review.

- 4.40 On a net basis, switching continued at a steady pace in both markets as well, and appears to have accelerated slightly in the gas market compared to the previous year. The average level of net switching in the domestic and small business electricity market was about 55 000 per week in the year to the end of September 2001, compared with 59 000 per week for the same period the previous year. In the gas market, the average level of net switching away from BGT was 14 000 per week in the year up to the end of September 2001, compared with 12 000 per week for the equivalent period one year earlier.
- 4.41 Although BGT has been losing customers on a net basis, the proportion of gross transfers in the gas market accounted for by 'winbacks' by BGT was considerably higher than the equivalent figure in the electricity market, and this trend accounted for the slower pace of net switching in gas compared with electricity.
- 4.42 Evidence from the customer survey showed that the differences in the rates of switching among various customer groups had narrowed since 2000. This trend was particularly notable, in both the electricity and gas markets, for customers using prepayment meters and those on very low incomes. Among standard credit customers, at summer 2001, 32% in the domestic gas market and 32% in the domestic electricity market had switched supplier. Among prepayment meter customers, at summer 2001, 28% in the domestic gas market and 31% in the domestic electricity market had switched supplier.
- 4.43 Evidence on customer debt suggests that gas customers using prepayment meters forms the group with the highest incidence of debt. In electricity, the incidence of debt is lower on average, and more evenly spread across customer groups in terms of payment method. Indirect evidence from the customer survey suggests that any incidence of debt does not appear to be impeding customers from switching, since around 35% of gas customers in debt and 53% of electricity customers in debt have switched supplier.
- 4.44 Customers appear to have maintained their interest in the market as measured by their likelihood to switch. The proportion of both gas and electricity switchers saying that they are likely to or certain to switch again in the next 12 months has remained much the same as for 2000, at 15% of these groups. Non-switchers

show a reduced propensity to switch in the next 12 months, but at about 7% this is much unchanged from 2000.



## 5. Market shares

### *Introduction*

- 5.1 This chapter considers the market position of suppliers in the gas and electricity domestic supply markets. Market shares show suppliers' performances at particular points in time, and trends in market shares show how those performances have 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.
- 5.2 This chapter sets out BGT's and ex-PES suppliers' market shares by customers supplied and volumes supplied. The chapter further considers market shares analysed by the payment methods and tariff types (i.e. standard or economy tariffs) used by customers. For electricity, each ex-PES suppliers' in-area market share has been calculated. The chapter also considers customers supplied on dual fuel offers.
- 5.3 The results in this chapter draw on information provided in response to Ofgem's supplier survey<sup>13</sup>, and from Transco and the electricity Meter Point Administration System (MPAS) service providers.

### *Gas*

#### **BGT's market share by customer numbers and by volume**

- 5.4 Table 5.1 shows BGT's share of the domestic gas supply market by customers supplied, at the end of September 2001, compared to the position at the end of September in the preceding three years.

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<sup>13</sup> "Domestic gas and electricity supply market survey 2001", Ofgem, July 2001

**Table 5.1 – BGT’s share of domestic gas supply by customers supplied**

	<b>Market share (%)</b>
September 1998	84
September 1999	75
September 2000	71
September 2001	67

Note: Data from Ofgem’s market survey indicated that there were 20.4 million domestic gas customers in total at June 2001.

5.5 Table 5.1 shows that BGT’s market share has fallen from 84% to 67% over a period of three years. The decline in BGT’s market share has been less rapid recently than in the early stages of competition.

5.6 Table 5.2 shows BGT’s share of the domestic gas supply market by volume of gas supplied, at the end of March 2001, compared to the positions at the end of March 2000.

**Table 5.2 – BGT’s share of domestic gas supply by volume supplied**

	<b>Market share (%)</b>
March 2000	72
March 2001	70

5.7 BGT’s market share by volume is broadly the same as its market share by customers supplied, and as in the case of its market share by customers, has been in a declining trend.

#### **BGT’s market share by payment method**

5.8 Tables 5.3 and 5.4 show how BGT’s share of the market in each payment method has changed, both by customers supplied and volumes of gas supplied, since September 1999.

**Table 5.3 – BGT’s share of domestic gas supply by customers supplied by payment method**

	BGT share (%)			Other suppliers share (%)		
	Monthly Direct Debit	Standard credit	Prepayment	Monthly Direct Debit	Standard credit	Prepayment
September 1999	70	78	88	30	22	12
March 2000	69	75	84	31	25	16
September 2000	67	74	83	33	26	17
March 2001	64	73	82	36	27	18
June 2001	63	71	82	37	29	18
October 2001	n/a	n/a	79	n/a	n/a	21

Note: Due to incomplete data, in a small number of cases assumptions have been made as to which categories customers on certain payment types fall within. About 2% of customers nationally identifiably used some other form of payment method, and these have been excluded from the analysis. ‘n/a’ = not available.

5.9 Table 5.3 shows that BGT has a lower market share for customers paying by monthly direct debit than for other payment methods, and conversely, over the whole period shown has retained its greatest market share among prepayment customers. It also suggests that competing suppliers have been most successful in winning Direct Debit customers. This is, at least partly, due to the fact that some customers opt to change their payment method to Direct Debit at the same time as they switch to a new gas supplier. Ofgem’s customer survey found that among domestic gas customers that had switched supplier, 47% stated that they paid by monthly direct debit; however, only 36% stated that they had been a direct debit customer before switching.

5.10 Table 5.4 shows BGT’s and other suppliers’ market shares by volumes of gas supplied.

**Table 5.4 – Market shares by payment method by volumes of gas supplied**

	BGT share (%)			Other suppliers share (%)		
	Direct Debit	Standard credit	Prepayment	Direct Debit	Standard credit	Prepayment
March 2000	70	75	76	30	25	24
March 2001	67	74	77	33	26	23

Note: Due to incomplete data, in a small number of cases assumptions have been made as to which categories customers on certain payment types fall within. About 2% of customers nationally identifiably used some other form of payment method, and these have been excluded from the analysis.

5.11 Table 5.4 shows that BGT's market shares by volume, across the three categories of payment method, broadly follow the same pattern as its market shares by customers supplied. Again, the most marked decline in BGT's market share has been among direct debit customers.

### ***Electricity***

#### **Market shares across Great Britain**

5.12 Table 5.5 shows the market shares of the principal electricity supplier groups in domestic electricity supply across Great Britain as a whole. It shows market shares by customer numbers and by volumes supplied at the end of September 2000, March 2001, and September 2001.

**Table 5.5 – Principal electricity supplier groups shares of domestic electricity supply in Great Britain by customers supplied and by volumes supplied**

Group	September 2000		March 2001		September 2001	
	Market share by customers (%)	Market share by volumes supplied (%)	Market share by customers (%)	Market share by volumes supplied (%)	Market share by customers (%)	Market share by volumes supplied (%)
Innogy	8	8	15	14	19	n/a
Yorkshire Electricity	7	5				
Northern Electric	4	4	4	3		
BGT	14	10	16	13	17	n/a
TXU Energi	17	16	17	15	15	n/a
SSE Energy	14	14	14	15	14	n/a
London	10	10	10	10	10	n/a
Scottish Power	10	21	10	15	10	n/a
Powergen	8	7	8	8	8	n/a
Seeboard	6	6	6	7	6	n/a
Other suppliers	< 1	< 1	< 1	< 1	< 2	n/a

Notes: The figures in the table have been rounded and may not equal 100%.

5.13 It shows that having successfully acquired the supply businesses of two former PESs (Yorkshire and Northern), Innogy is now the largest electricity supplier in Great Britain. BGT is the second largest domestic electricity supplier, followed by TXU Energi, SSE Energy, London and ScottishPower each of whom owns two former PES supply businesses, with the exception of SSE Energy which owns three.

#### **Market shares by region**

5.14 Table 5.6 shows the market shares of ex-PES suppliers in-area at the end of September 2001, compared to the position at the end of September 1999, September 2000 and March 2001. It disaggregates the shares to show how much each supplier has lost in each area.

**Table 5.6 – Market shares by customers supplied of the ex-PES suppliers ‘in area’**

<b>Group</b>	<b>Area</b>	<b>Market share at September 1999 (%)</b>	<b>Market share at September 2000 (%)</b>	<b>Market share at March 2001 (%)</b>	<b>Market share at September 2001 (%)</b>
Innogy	Midlands	89	78	74	68
	Yorkshire	91	80	75	69
	Northern	89	75	70	64
TXU Energi	Eastern	89	78	75	71
	North West	91	79	73	67
SSE Energy	Southern	91	80	76	71
	North Scotland	94	89	86	83
	South Wales	90	82	78	72
London	London	92	82	78	73
	South West	95	85	80	75
ScottishPower	South Scotland	93	82	76	72
	Merseyside and North Wales	90	79	74	68
Powergen	East Midlands	88	76	71	66
Seeboard	South East	89	81	76	70
All areas	All areas	90	80	75	70

5.15 Table 5.6 shows some significant regional variations. It appears that in those regions that are less densely populated, in particular in the north of Scotland, the development of competition has been slower than in the more urbanised central and southern English regions. One possible explanation for fewer customers switching supplier in this region is because fewer of them are connected to the mains gas supply, and therefore are not able to take advantage of dual fuel offers when deciding whether or not to switch supplier away from the ex-PES supplier. Moreover, as noted in chapter 3 there appears to be less doorstep selling to customers living in rural areas. Notwithstanding regional variations, table 5.6

shows that the in-area market shares of all the ex-PES suppliers are declining steadily, and that they are losing market share at approximately 10% a year.

### Ex-PES suppliers' market shares by payment methods

5.16 Table 5.7 compares the in-area market shares over time, by payment method, of the ex-PES suppliers against those of new entrants.

**Table 5.7 – Average market shares by customers supplied by payment method of ex-PES suppliers 'in area' compared to other suppliers**

	Ex-PES suppliers 'in-area' market share (%)			Other suppliers share (%)		
	Direct debit	Other credit	Prepayment	Direct debit	Other credit	Prepayment
March 2000	78	85	94	22	15	6
September 2000	72	80	90	28	20	10
March 2001	67	76	85	33	24	15
June 2001	64	73	80	36	27	20

Note: Due to incomplete data, in a small number of cases assumptions have been made as to which categories customers on certain payment types fall within. About 3% of customers identifiably used some other form of payment method, and these have been excluded from the analysis.

5.17 Table 5.7 shows that ex-PES suppliers have lost the greatest relative market share among customers that pay by monthly direct debit. As for the domestic gas supply market (see table 5.3), new entrants to the electricity supply market have taken most market share among direct debit customers. Again, it is likely that new entrants' market share among Direct Debit customers is partly explained by a proportion of customers choosing to switch payment method to Direct Debit (often because of discounts on offer) at the same time as they switch supplier. The customer survey found that, at summer 2001, among electricity customers that had switched supplier, 45% stated that they paid by monthly direct debit; however, only 34% stated that they had been a monthly direct debit customer before switching.

## Market shares by tariff type

5.18 Table 5.8 shows the proportion of customers supplied on the two principal tariff types (standard domestic and day/night economy tariffs) in each area, and the market shares of the ex-PES suppliers in each area at the end of March 2001.

**Table 5.8 – Market shares by tariff type of ex-PES suppliers ‘in-area’**

Group	Area	Standard tariffs		Day/night tariffs	
		Proportion of all customers supplied (%)	Market share of incumbent (%)	Proportion of all customers supplied (%)	Market share of incumbent (%)
Innogy	Midlands	84	77	16	85
	Yorkshire	91	79	9	90
	Northern	92	73	8	90
TXU Energi	Eastern	65	75	35	83
	North West	89	77	11	89
SSE Energy	Southern	86	77	14	93
	North Scotland	69	83	31	98
	South Wales	92	80	8	93
London	London	92	79	8	90
	Swab	80	83	20	94
ScottishPower	South Scotland	83	77	17	96
	Merseyside & North Wales	93	76	7	90
Powergen	East Midlands	54	72	46	79
Seeboard	South East	68	77	32	85
All areas	All areas	80	77	20	87

5.19 A previous review of competition in the electricity supply market found that 23% of domestic customers nationally were supplied on day/night tariffs at the end of March 1999<sup>14</sup>. It can be seen from table 5.8 that this proportion had

<sup>14</sup> "A review of the development of competition in the designated electricity market", Ofgem, June 1999



fallen to 20% in the intervening two years.

- 5.20 Table 5.8 also shows indicates that the ex-PES suppliers have consistently retained a higher market share among economy-tariff customers than among standard-tariff customers. In part, this may be because new entrants to the electricity supply market have placed less emphasis on attracting them. It may also be, in part, because economy-tariff customers have less incentive to choose dual fuel offers (because they consume more electricity for heating purposes).

### **Dual fuel supply**

- 5.21 In Ofgem's review of the development of competition in 2000, it was estimated that approximately 7.5 million customers were supplied gas and electricity by the same supplier, i.e. they were dual fuel customers. It was noted, however, that the quality of the information upon which the estimate was based, i.e. the responses received to last year's supplier survey, had been highly variable.
- 5.22 In this year's supplier survey, electricity and gas suppliers were again asked to provide information on the numbers of domestic customers that were on dual fuel deals. This information has allowed Ofgem to make more reliable estimates of the number of dual fuel customers in 2000 and 2001. It is estimated that there were between 7.3 million and 7.5 million dual fuel customers nationally at July 2001<sup>15</sup>. In light of the more recent information from the market survey, Ofgem has revised its previous analysis of the number of dual fuel customers, and estimates that there were up to 6.8 million such customers at October 2000. Based upon the estimate of 7.5 million dual fuel customers at July 2001, approximately 36% of domestic gas customers nationally, and 30% of domestic electricity customers nationally, are on dual fuel deals.
- 5.23 Underlying these averages were significant variations among suppliers in the proportions of their customers that were on dual fuel deals. Among suppliers in the gas market, with the exception of BGT, dual fuel customers make up more than half the customer base in the majority of cases. Among electricity suppliers, there were only four examples where over half their customer base comprised dual fuel customers.

## *Conclusions*

- 5.24 BGT has continued to lose market share in the domestic gas supply market in the year up to the end of September 2001, at approximately the same pace as in the previous year. By September 2001, BGT's share of the market by customers supplied was 67%. The primary driver of BGT's loss of market share has been the success new entrants have had in acquiring direct debit customers: among this group of customers, BGT's market share was 63% at the end of June 2001.
- 5.25 Among the fourteen electricity supply services areas, there was significant variation in the development of competition; however, in average terms, the ex-PES suppliers had lost a market share ('in area') of 30% up to the end of September 2001. This market share has been declining steadily, at approximately 10% a year. As with BGT, ex-PES suppliers have lost a proportionately greater market share among customers paying by direct debit than among other types of customers. Ex-PES suppliers have retained a relatively higher market share among customers on day/night and restricted tariffs.

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<sup>15</sup> The lower figure is based on the actual data reported by respondents to Ofgem's market survey and is the most conservative estimate; the higher figure includes customers that were not reported upon by suppliers, and is based on the assumption that all such customers were 'dual fuel' customers.

## 6. Price and non-price offers

### *Introduction*

- 6.1 This chapter considers the range of price offers available to domestic customers and how these have changed over the past year. The existence of a range of offers would tend to suggest that customers are able to benefit from the operation of the competitive market. Competitive pressures, responsiveness to demand, and innovation may also be indicated by the existence and range of non-price offers.

### *Gas*

#### **BGT's pricing relative to price cap**

- 6.2 As noted in Part I, in April 2001 the price caps on BGT's two price controlled tariffs, PromptPay and LatePay/Prepayment, were replaced by relative price caps. These cap the differentials between BGT's Direct Debit and LatePay/PrePayment tariffs, and between BGT's PromptPay and LatePay/PrePayment tariffs. As described in Appendix 2, the LatePay/PrePayment tariff is not permitted to exceed the other two tariffs by certain differentials set in unit rates.
- 6.3 Table 6.1 shows BGT's bills (excluding VAT) and price cap levels classified by payment method for different levels of consumption. Direct debit remains the lowest tariff across the board, followed by PromptPay. LatePay/Prepayment prices are higher by about £30 across consumption levels. The difference between BGT's LatePay/PrePayment prices and its Direct Debit prices is very close to the maximum allowed differential. However, the LatePay/Prepayment tariff currently sits at around 1% below the maximum allowed level, given the current level of the PromptPay tariff.

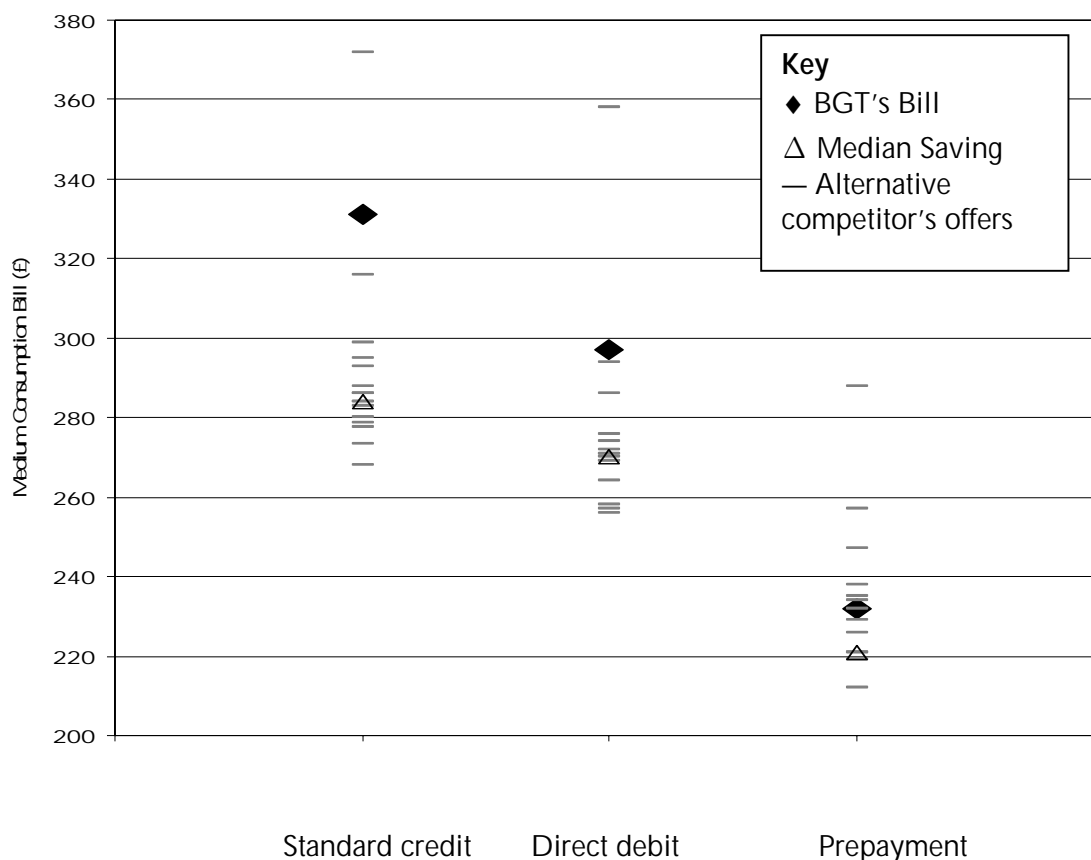
Table 6.1 – BGT’s prices and price caps, August 2001 (Excluding VAT)

Consumption level (kWh)	BGT’s Prices			Price Caps Expressed as maximum annual bill for LatePay/Prepayment relative to:			
	Direct debit	PromptPay	LatePay/Prepayment	Direct debit marker price	PromptPay marker price	Under Direct debit cap %	Under PromptPay cap %
Low (10,000)	£160.95	£159.28	£189.52	£189.12	£191.75	0%	1%
Medium (19,050)	£282.86	£285.00	£314.96	£314.90	£317.59	0%	1%
High (28,000)	£402.86	£408.81	£439.05	£439.29	£442.04	0%	1%

#### Range of price offers

6.4 Nationally there are around 14 active domestic gas suppliers, offering a range of prices over the main payment methods. Figure 6.1 shows the range of offers available for a medium consumer of gas as at October 2001. All gas suppliers except one are offering discounts on BGT’s standard credit and direct debit tariffs. Median savings for standard credit and direct debit customers who switch away from BGT are 14% and 9% respectively. The number of suppliers offering prepayment discounts on BGT’s prices has doubled since October 2000 to six in October 2001, with a median saving of 5%.

Figure 6.1: Range of offers for gas by payment method (medium consumption)<sup>16</sup>



### Recent changes in price offers

- 6.5 Almost all gas suppliers have increased prices for standard credit and direct debit since October 2000 following increases in the wholesale price of gas. BGT increased its prices by 4.2% for standard credit, 4.7% for direct debit and 3.9% for prepayment from April 2001. However, for prepayment customers on medium consumption about half of the suppliers have either not changed prices or reduced them in nominal terms since October 2000.
- 6.6 The fall in the number of active gas suppliers, due mainly to merger activity, and the reduction in the level of price differentials between suppliers, indicates market consolidation. The ratio of suppliers offering a discount as a proportion of total suppliers fell slightly from 0.90 in October 2000 to 0.88 in October 2001 for both Direct Debit and standard credit payment categories. This slight decrease reflects market consolidation. For prepayment customers this ratio has

<sup>16</sup> In this graph medium consumption is defined as 19,050kWh per annum for standard credit and Direct debit, and as 12,300kWh per annum for PPM customers.

increased significantly from 0.14 to 0.38 reflecting an increase in the number of suppliers offering discounts even with market consolidation.

### **BGT non-price offers**

- 6.7 BGT has continued to expand into other home services in addition to gas and electricity, for example it acquired 'One.tel' this year, a telecoms operator. BGT offers a range of bundled home services with combinations of gas, electricity, home telephone, internet and mobile phone deals. BGT continues to offer a £15 discount to new electricity customers, a yearly discount of £14.50 for dual fuel customers and it still guarantees a cheaper bill than ex-PES suppliers offer 'in-area' until 2002 if customers opt for a dual fuel deal. In addition to their Goldfish credit card joint venture BGT has continued to expand into home finance and has recently gone into partnership with Charcol online mortgage search. British Gas Personal Finance also offers personal loans.
- 6.8 Competitors' non-price offers are covered below.

### ***Electricity***

#### **Pricing Relative to Price Cap<sup>17</sup>**

- 6.9 The current price controls came into effect on 1 April 2000 in the form of a cap on Standard Domestic and Domestic Economy 7 prices.<sup>18</sup> The controls apply to the ex-PES suppliers 'in area'. The level of the cap is based on allowances for generation, transmission, distribution, supply business costs, Fossil Fuel Levy, and a margin for profit. For prepayment meter customers a surcharge<sup>19</sup> of £15 above the prices for the corresponding credit tariff is allowed. The level of any discount for direct debit payment is not regulated.

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<sup>17</sup> For further discussion of current price controls see Appendix 2

<sup>18</sup> For further details please refer to 'Review of Public Electricity Suppliers 1998 Supply Price Control Review: Final Proposals' December 1999, Ofgem.

<sup>19</sup> For SSE Energy Supply Limited and TXU UKL Ltd the surcharge is £0 and £11.22 respectively.

**Table 6.2: Domestic electricity price controlled prices and price caps**

Region	Average Annual bill April 2000	Maximum average annual bill allowed by price caps April 2000	Under Price cap by	Average annual bill April 2001	Maximum average annual bill allowed by price cap April 2001	Under price cap by
	£	£	%	£	£	%
Eastern	219.39	219.48	0.0	219.38	223.81	2.0
East Midlands	224.79	226.91	0.9	224.80	229.88	2.2
London	234.95	235.06	0.0	234.96	238.69	1.6
Manweb	256.11	256.14	0.0	251.06	251.10	0.0
Midlands	231.76	231.79	0.0	231.76	236.25	1.9
Northern	236.80	236.83	0.0	240.34	242.65	1.0
NORWEB	230.29	230.28	0.0	230.27	231.96	0.7
SEEBOARD	224.93	224.93	0.0	224.93	228.92	1.7
Southern	239.66	239.71	0.0	240.87	242.95	0.9
SWALEC	272.69	272.76	0.0	267.23	271.39	1.5
South Western	253.24	253.27	0.0	256.11	257.10	0.4
Yorkshire	231.92	231.92	0.0	231.92	232.02	0.0
Sc Power	259.35	261.82	0.9	264.92	264.92	0.0
Sc Hydro	253.84	253.87	0.0	259.45	261.00	0.6

6.10 Table 6.2 sets out prices restricted by the price cap and associated price caps for the Standard Domestic tariff. It shows that most supply companies are setting prices slightly lower than the capped maximum price. In 2000 the majority of supply companies were pricing at the cap whereas currently only Manweb, Yorkshire and Scottish Power are doing so. The picture is similar for Domestic Economy 7 customers although the prices are slightly further below the caps.

6.11 The ex-PES suppliers have lost customers supplied on the price controlled tariffs, customer losses mirror switching trends generally.

### **Range of price offers**

6.12 There are around 10-12 active domestic electricity suppliers per supply region offering a range of prices over the three main payment methods. Figures 6.2, 6.3 and 6.4 show the range of price offers available to Standard Credit, direct debit and Prepayment Meter electricity customers at a medium consumption level for October 2001. There are many discounts relative to the ex-PES supplier 'in area' available to standard credit and direct debit customers in all supply areas. Although the range of offers is smaller for Prepayment customers, all supply areas contain at least two suppliers that offer discounts against the ex-PES

supplier 'in area', with most areas containing more than two.

- 6.13 The median discounts available on the incumbent supplier range from 5-13% for the standard credit tariff, and 6-14% for direct debit. For prepayment customers the lowest median discount is 1% in the East Midlands area, but all other areas have a higher median discount on the incumbent price, the highest being 8% in the Manweb region.



Figure 6.2: Range of offers for standard credit customers (medium consumption)

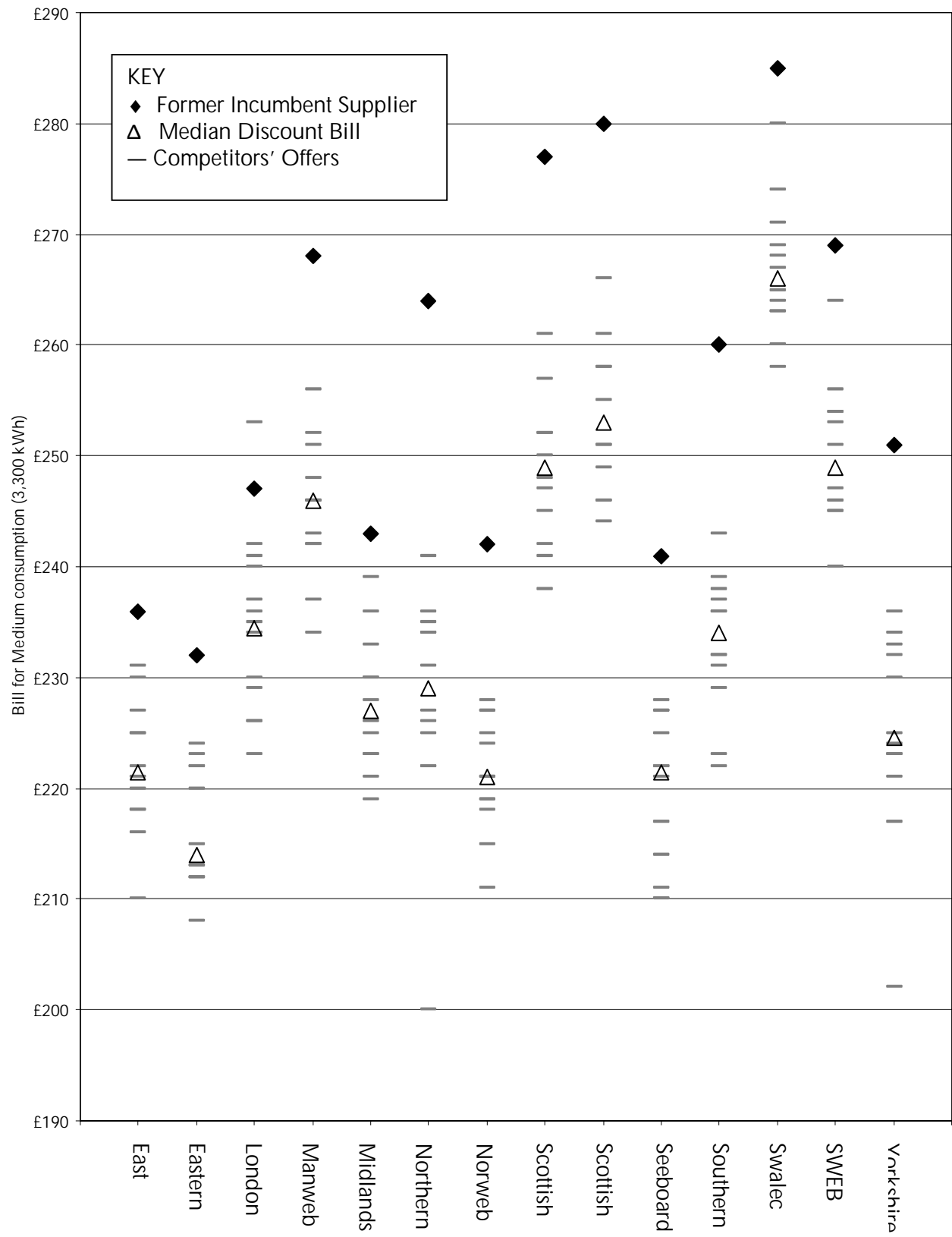


Figure 6.3: Range of offers for direct debit customers (medium consumption)

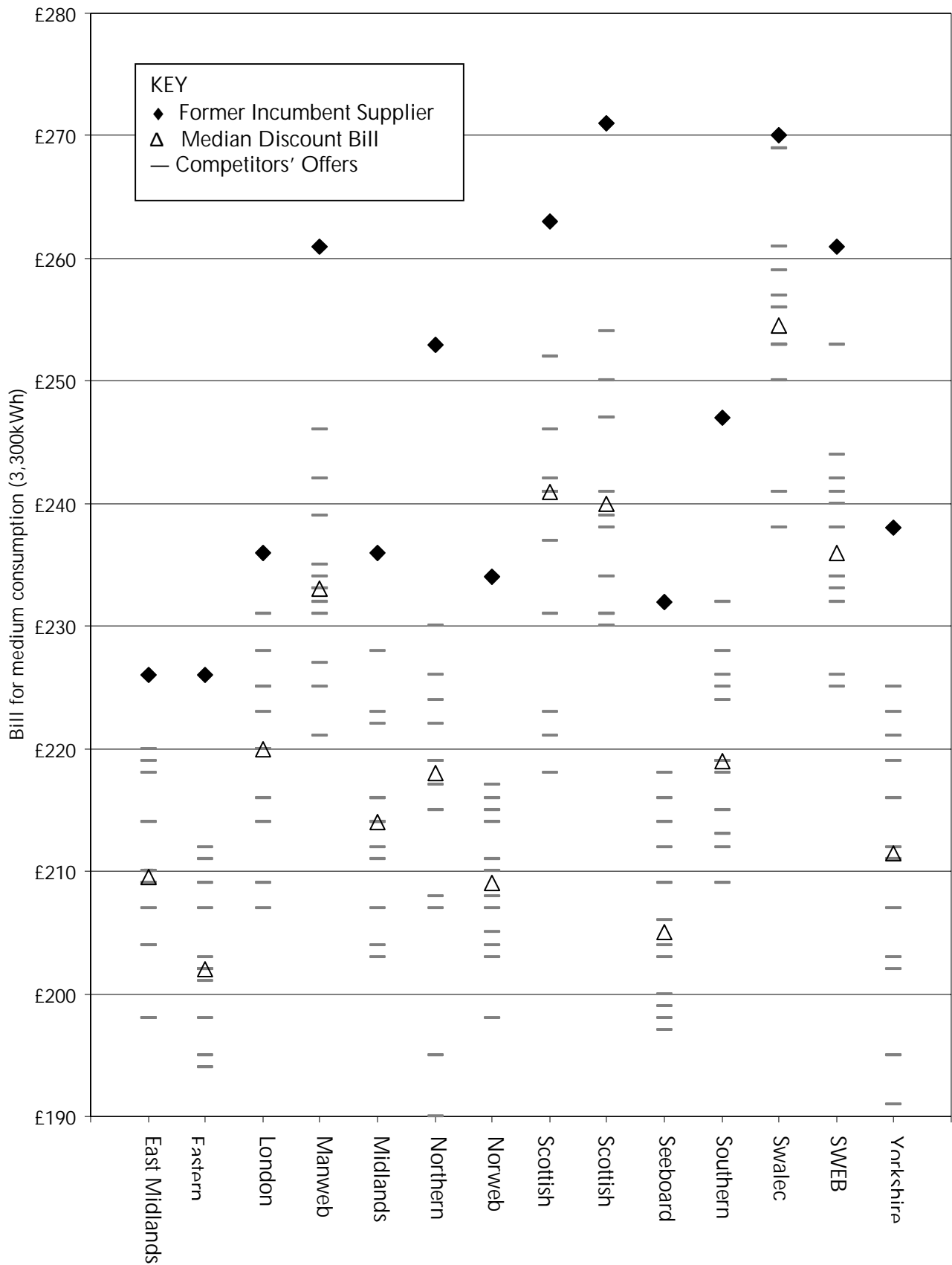
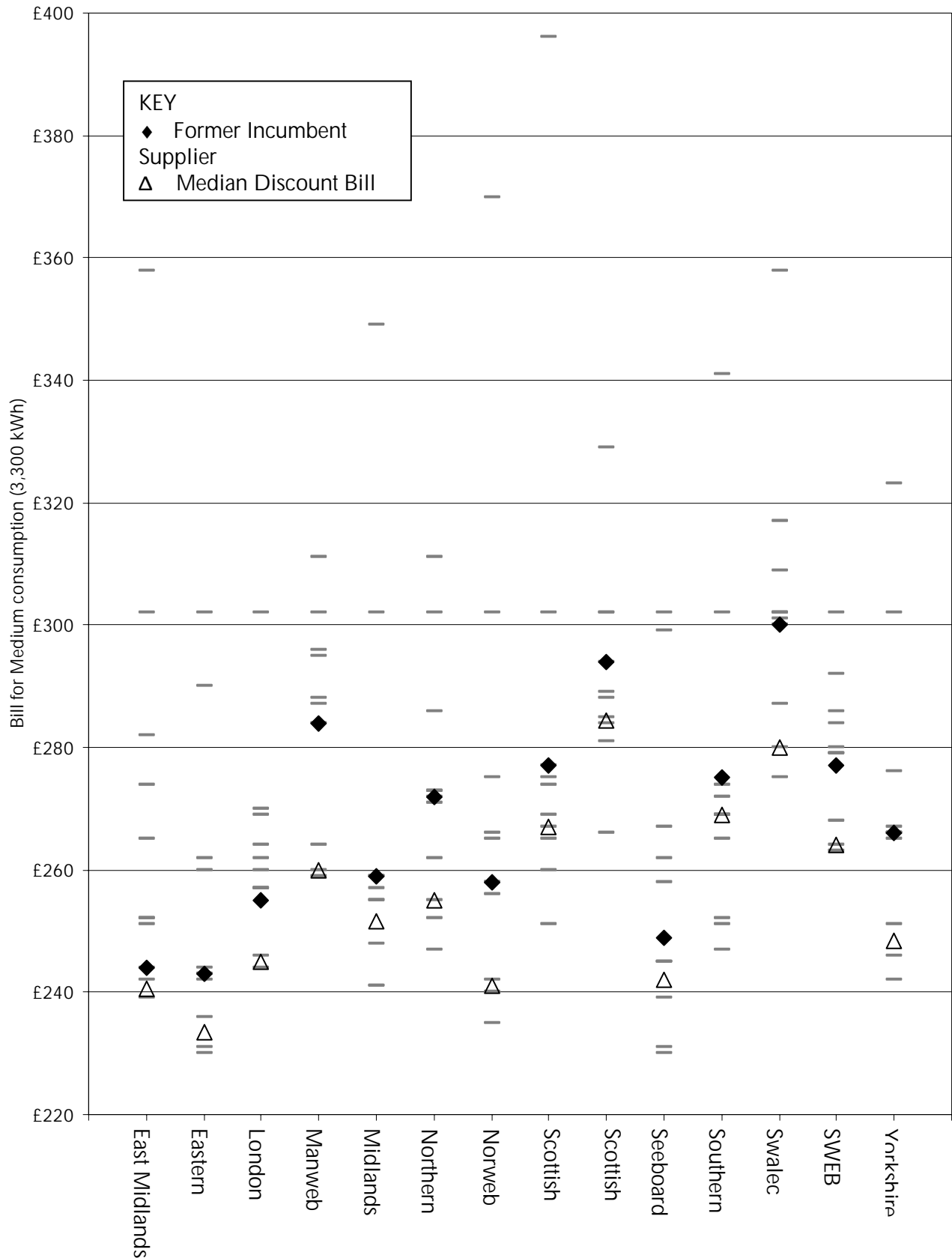


Figure 6.4: Range of offers for prepayment customers (medium consumption)



6.14 The ex-PES suppliers' 'in area' prices have remained relatively stable in nominal

terms. Competitors have tended to reduce prices and it is possible to get a discount of 10-15% on the former incumbent suppliers in most areas.

- 6.15 Since October 2000 standard credit and direct debit incumbent in-area prices have either remained stable or increased slightly in nominal terms. Prepayment price variations have been more mixed with several price reductions. SWALEC is the only company to have reduced prices across all payment methods, which may reflect SSE's take-over – SSE Southern's and SSE Scottish Hydro's prices are lower than SWALEC's. TXU, Midlands, Norweb and Yorkshire have not changed their prices since October 2000. East Midlands, London and Sweb have reduced prepayment prices only, leaving standard credit and direct debit unchanged. Northern has increased all prices except prepayment, which has been reduced. Manweb, Scottish Hydro, Scottish Power, Seeboard and Southern have increased their in-area prices for all payment methods.
- 6.16 Since October 2000 the savings available for customers who switch away from the ex-PES suppliers have shown increases in nominal terms in almost all supply regions for standard credit customers and direct debit customers. The picture for Prepayment customers is more mixed but the savings on offer have generally increased.

#### **Non-price offers<sup>20</sup>**

- 6.17 The range of tariffs and offers available to customers has continued to widen and become more innovative. Certain offers have been in existence for several years, such as green tariffs, energy efficiency deals, offers targeted at disadvantaged customers, complementary products such as dual fuel tariffs, affinity deals and online services. Such established offers have been taken up by more suppliers and have become more responsive to customer demands.
- 6.18 In addition to these developments new innovations have emerged including loyalty cards, offers aimed at students, and no standing charge offers in electricity supply. Also some switchers who have not made a saving since switching can benefit from double the difference offers. Some of these recent

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<sup>20</sup> This section does not aim to give a comprehensive list of all offers available, but to give an idea of the current range of offers and new innovations.

developments are discussed in more detail below.

### **Green tariffs**

- 6.19 Many suppliers are now offering 'green tariffs', that is, tariffs that are designed in some way to promote sustainable electricity generation or other environmental objectives. There appear to be two main types of green tariff. The first involves the supplier pledging to match energy volumes consumed by the customer with renewable generation sources. The second includes some form of donation to an environmental fund (possibly set up by the supplier to fund environmental projects) or charity. There is usually a premium to pay for a green tariff since the first tariff type requires the purchase of often more expensive renewable energy, and the second type incorporates the donation. Suppliers are starting to combine these tariff types by offering donations and matching energy consumed with energy from renewable sources, for example TXU Energi in their Ecopower tariff and Powergen with their Green Plan tariff.
- 6.20 Another new innovation in the green energy field is TXU Energi's offer to buy back excess solar energy generated by customers in their homes under their 'Solarnet' scheme.

### **Energy efficiency offers**

- 6.21 Many supply companies are offering tariffs including low energy light bulbs, such as the Seaboard Green Light offer. Npower Yorkshire offer a discount on low energy light bulbs for current customers and a new fridge/fridge freezer trade-in offer for disadvantaged customers. Such offers are generally allied to suppliers' obligations under Energy Efficiency Standards of Performance.

### **Offers aimed at particular customer groups**

- 6.22 Offers aimed at pensioners include TXU Energi's Stay Warm tariff which allows customers over 60 to pay a fixed amount for their fuel throughout the year, irrespective of actual consumption, spread evenly over the year. TXU have also conducted a trial tariff for students marketed through PrudentStudent.com.
- 6.23 Another new innovative scheme is SSE's Equigas. This offers a uniform unit price for gas across all payment methods with no standing charge. This tariff is

designed to help prepayment meter customers, by pooling revenues from direct debit and standard credit customers.

### **Bundled/Complementary offers**

- 6.24 Many suppliers are diversifying into other home services. Insurance offers are commonly offered by many suppliers. Combined bills including electricity, gas and home telephone are also increasing, such as Powergen's 'Onebill' and npower Yorkshire's 'EnergyTalk' discount.

### **Online services**

- 6.25 Almost all suppliers offer a cheaper online tariff and online meter reading is also available from many suppliers. Internet shopping is available through many suppliers' websites and SEEBOARD offer a loyalty card which customers can use to get discounts online.

### **Affinity deals**

- 6.26 Many suppliers are teaming up with established loyalty card offers such as Sainsbury's and Scottish Power. This deal enables customers to earn Sainsbury's Reward Card points on their energy bills. SSE offer a tariff whereby customers can collect one Air Mile for every £2 they pay on their bill.

### **Dual fuel offers**

- 6.27 At least 11 suppliers offer dual fuel deals and discounts in each region, enabling customers to make savings by combining their gas and electricity suppliers. Yorkshire Electricity and Scottish Power for example offer a £10.50 annual discount to dual fuel customers. Powergen's OneBill offers an annual discount of £2.50 for each service provided to a customer.
- 6.28 Other non-price incentives, which build on existing offers, are available to customers considering a dual fuel deal. For example SSE offer 25 Air Miles for every three months a customer stays with them under their Air Miles tariff if they switch to both gas and electricity. Under their green tariff SSE also offer a £10 donation to the RSPB for every service switched to.

## ***Conclusions***

- 6.29 Overall price competition is developing well in the domestic gas and electricity markets, offering customers a range of offers and discounts on the ex-PES suppliers. Direct debit offers are particularly marked. Prices have tended to remain stable for electricity, but increased for gas in nominal terms. Electricity pricing by the ex-PES suppliers below the levels allowed for by the price caps is consistent with the development of competitive pressures.
- 6.30 Despite prepayment customers typically having a more limited choice of discounts than customers on other payment methods, the number of suppliers offering a discount has increased.
- 6.31 The range of non-price offers is another indication of strong competition in both gas and electricity. More suppliers are offering dual fuel deals and bundling other household services such as telecommunications. The development of established tariff schemes, such as green tariffs, is a positive sign indicating that the suppliers are responding to consumer demand.

## 7. Entry and exit of suppliers

### *Introduction*

- 7.1 The availability of a range of offers from a number of suppliers will tend to provide customers with a choice of prices and services. Rivalry between suppliers for customers business will tend to result in the protections of customers' interests in terms of price and service. Hence the number of competing suppliers and changes in the number can be a useful indicator of the degree of competition.
- 7.2 Entry to the market can also be a useful indicator that incumbent suppliers face losing market share to new entrants if they are not sufficiently competitive, and that they are unable to act in ways unconstrained by competitor response. This chapter notes the changes that have taken place in the number of domestic gas shippers and suppliers and the number of electricity suppliers since October 2000.
- 7.3 This chapter considers recent market developments, changes in the number of licensed and active domestic suppliers, and considers the prospects for new entry to the market.

### **Recent market developments**

- 7.4 Since Ofgem's last published review of domestic competition in December 2000, there have been a number of significant developments in terms of participation in the domestic market. A number of mergers and acquisitions have been completed for example, and there has been other entry and exit.
- 7.5 Relevant activity since December 2000 includes :
- ◆ Innogy Holding plc's purchase of the Yorkshire Power group to add to its ownership of Npower Limited and Npower Gas Limited;
  - ◆ Innogy Holdings plc's purchase of Northern Electric plc's supply business;
  - ◆ The sale of Elf at Home's gas supply portfolio's to London Electricity plc;



- ◆ Scottish and Southern's purchase of Gas West's operations;
- ◆ Atlantic Electric and Gas' entry into the domestic electricity and gas markets; and
- ◆ Scottish Power's marketing alliance with Sainsburys.

7.6 This activity has altered to some extent the structure of the domestic electricity and gas market and in some cases has created conglomerates owning a number of companies.

### **Consolidation**

7.7 The consolidation of companies through mergers and acquisitions may be used as a technique to broaden the customer base of suppliers, as opposed to conventional methods such as doorstep selling and telesales.

7.8 The acquisition of larger customer bases may lead to lower costs through increased economies of scale or scope. At the same time however the level of rivalry within the market may be reduced and so perhaps reduce the likelihood of passing through such savings to customers. In considering further merger and acquisition activity Ofgem continues to take these factors into account in forming relevant policy, and in providing advice for the Office of Fair Trading.

### ***Licensed and active domestic suppliers***

7.9 Two approximate measures of the number of and changes in the number of firms can be taken from the number of licensed domestic suppliers and the number of active domestic suppliers.

7.10 Table 7.1 shows the changes in the number of gas shippers and suppliers licensed to operate in the domestic market since July 2000.

**Table 7.1 – The number of gas shippers and suppliers licensed to operate in the domestic market since October 2000**

	Licensed Gas Shippers	Licensed gas suppliers
October 2000	111	28
October 2001	112	31

7.11 Since October 2000, there has been a little change in the number of existing for gas shippers or suppliers.

***Active gas competitors***

7.12 Although a large number of companies have the licence necessary to ship and/or supply gas to end consumers, there is no specific requirement for licence holders to be active within the market. Some companies hold more than one licence to ship/supply gas and therefore do not make use of all licences granted to them. Table 7.2 shows the changes that have taken place in the number of active gas shippers and suppliers since July 2000.

**Table 7.2 – Ofgem’s estimate of the number of active shippers and suppliers**

	Gas Shippers	Gas Suppliers
October 2000	24	16
October 2001	22	14

7.13 Table 7.2 shows that the number of active gas shippers in the market has remained fairly constant since October 2000. However, the figures regarding gas suppliers highlight that a number of licences previously active in the supply market in October 2000 are no longer in use. This is explained by referral to two factors. One is that a number of companies who previously supplied gas to domestic customers have exited the market. The other explanation is that mergers and acquisitions in the market have created conglomerates, which subsequent to their amalgamation have begun to supply under a single licence. With this increasing consolidation of companies into conglomerates it is evident that there are not actually as many competing groups in the market as it first appears.

### ***Suppliers' domestic gas price offers***

- 7.14 Active gas suppliers are making a range of offers to domestic gas customers. Appendix 3 sets out how these have changed between October 2000 and October 2001, in the form of discounts available against BGT. The histograms are intended to represent visible offers to customers and so there are some small differences in the number of suppliers from the number of active suppliers given above because of differences in the interpretation of 'offer' and 'active' supplier.
- 7.15 Customers paying by standard credit facilities or direct debit are still able to choose from a range of discounts in excess of 10%. The number of these offers has fallen, reflecting the reduction in the number of suppliers. This reduction in the number of offers however has not significantly affected the range available.
- 7.16 The number of discounts relative to BGT available to customers paying by prepayment meter has increased over the period, although the range of offers has contracted. This partly reflects BGT's decision to increase its prices from April 2001. It may also partly reflect an increasing interest by gas suppliers to expand their customer bases by targeting PPM customers.

### ***Licensed electricity suppliers***

- 7.17 Table 7.3 shows the number of electricity suppliers licensed to operate in the designated market since October 2000.

**Table 7.3 – The number of electricity suppliers licensed to operate in the designated market since July 2000**

	Licensed Electricity Suppliers
October 2000	20
October 2001	29

- 7.18 Since October 2000 the number of licences granted to electricity suppliers has increased significantly. This can be mainly attributed to the entrance of new companies into the market, which will effectively serve to aid the development of competition.

### ***Active electricity competitors***

7.19 Although a number of suppliers operate within the electricity market there is no specific requirement for them to be active. Similarly, as in gas, some companies will hold more than one supply licence and therefore will not make use of all licences granted to them. Table 7.4 shows Ofgem's estimate of the number of active electricity suppliers in the designated market since July 2000.

**Table 7.4 – Ofgem's estimate of the number of active electricity suppliers in the designated market since July 2000**

	England and Wales	Scotland
October 2000	13	13
October 2001	12	10

7.20 Table 7.4 shows that the number of active electricity suppliers within the market has fallen slightly since October 2000. Awareness should be ensured that due to the increasing consolidation of the market the figures quoted above relate to the number of groups that supply electricity to consumers as opposed to individual companies.

***Suppliers' domestic electricity price offers***

7.21 Appendix 3 contains histograms which summarise, over ranges of discounts, the number of suppliers offering discounts or premiums compared with the incumbent in each of the supply services areas, by payment method and comparing October 2000 with October 2001. Overall, the number of suppliers making offers of any kind has fallen, which reflects the reduction in the number of active suppliers over this period. As for gas, there are some small differences in the number of suppliers from the number of active suppliers because of differences in the interpretation of 'offer' and 'active' supplier, and because supplier activity varies between supply services areas.

7.22 Despite the small reduction in the number of active suppliers, customers are still able to make choices over a reasonable spread of offers. There are suppliers offering discounts of up to 10% in all areas for payment by Direct Debit and in most regions for payment by Standard Credit. Suppliers that were in October 2000 making price offers in excess of the local incumbent have now either left the market or reduced prices so as to offer a discount to the incumbent.

7.23 More suppliers are now offering price discounts against the incumbent to customers paying by prepayment meter, despite the small reduction in the overall number of active suppliers and offers. In almost all areas, the number of suppliers offering discounts has increased over the period. In some cases, the range of price discounts available has also increased. A number of suppliers therefore appear to be more actively targeting those paying by prepayment meter, compared with last year.

## 8. Barriers to entry

### *Introduction*

- 8.1 The greater the anticipated return from entry to the electricity or gas supply markets, compared to all other investments, the greater is the likelihood that potential entrants will enter either or both of these markets. New entry will tend to protect the long term interests of customers through promoting competitive rivalry and reinforcing improvements in service and downward pressure on prices.
- 8.2 One important determinant of the anticipated return is the extent to which potential entrants perceive there to be barriers to entry to the market. These are factors which tend, directly or indirectly, to increase the costs of becoming active in a market.

### *Issues raised*

- 8.3 Ofgem's July 2001 document invited respondents to comment on barriers to entry and other impediments to the development of competition. This chapter sets out the issues raised, respondents' views, and Ofgem's position, under the following headings :
- ◆ BGT's and the ex-PES suppliers' market position and behaviour;
  - ◆ domestic electricity supply competition in Scotland;
  - ◆ the general operation of the gas market;
  - ◆ the general operation of the electricity market; and
  - ◆ debt blocking.

### *BGT's and the ex-PES suppliers' market position and behaviour*

#### **Respondents' views**

- 8.4 A number of electricity and / or gas suppliers argued that BGT continues to be dominant in the supply of domestic gas. These suppliers argued that BGT's

dominance is effected or demonstrated by one or more of the following :

- ◆ BGT supplies around two thirds of domestic gas customers;
- ◆ BGT supplies over 50% by volume of all domestic electricity and gas;
- ◆ significant advantages in terms of, for example, its national brand and its advertising spend per customer have allowed BGT to reinforce its dominant position; and
- ◆ BGT's ownership of a significant portion of primary gas production may give it significant market power across all levels of the supply chain and that, if such market power exists, it may have abused this power.

8.5 BGT noted that recent merger and acquisition activity has resulted in the creation of six suppliers, each serving over 2.5 million electricity and gas customers and that there were unlikely to be significant economies of scale accruing from serving more than three million customers.

8.6 One respondent expressed the view that recent merger and acquisition activity in the electricity market had left the domestic market dominated by a few suppliers. This respondent also argued that large suppliers had significant advantages in terms of brand and advertising spend, making it relatively more difficult for smaller suppliers to enter the market.

#### **Ofgem's view**

8.7 Ofgem notes that one precondition for effective competition is that any market dominant position is not abused. Examples of abuse might include excessive, discriminatory or predatory pricing. However, abuse of a dominant position is prohibited by the Competition Act 1998. Ofgem has powers for example to investigate and fine companies under the Act if abuse is found to occur. Against this background, the extent to which BGT may have a dominant position in gas and electricity supply is not in itself a cause for concern.

8.8 There appears to be little evidence that recent consolidation within the electricity domestic supply market is, in itself, a strong barrier to entering the market. Although such consolidation might tend to indicate the presence of

economies of scale or scope in the supply of domestic electricity and gas, this does not preclude new entrants from identifying and targeting relevant smaller portions of the market. It is also open to new or existing entrants to leverage business from existing brand names by, for example, entering strategic partnerships with established firms.

### ***Domestic electricity supply competition in Scotland***

#### **The issues**

##### *Trading arrangements*

- 8.9 At present, arrangements for wholesale electricity trading and balancing differ between England and Wales, and Scotland. These differences may have implications for domestic electricity supply competition in Scotland.
- 8.10 There is no directly competitive wholesale market for generation in Scotland. Suppliers wishing to purchase wholesale electricity in Scotland must negotiate with those holding generation plant in Scotland, acquire generation plant in Scotland, or import electricity from England and Wales via the interconnector. Scottish Power Generation Ltd and SSE Generation Ltd control, directly or by contract, 98% of generation sources in Scotland as well as the bulk of interconnector capacity with England and Wales. They are bound to grant contracts to suppliers for wholesale electricity at prices referenced to those prevailing in England and Wales. However, the absence of transparent rules governing the use of the interconnector may inhibit new entrant suppliers from importing electricity from England and Wales to Scotland or from exporting from Scotland to England and Wales.
- 8.11 Moreover, the generation and supply businesses of Scottish Power UK plc and Scottish & Southern Energy plc are not subject to the same balancing arrangements within their own settlement areas as other independent generators and suppliers competing in Scotland. At present SP Transmission Ltd and Scottish Hydro- Electric Transmission Ltd provide system and energy balancing services in their respective areas. Their grid codes require them to call on any generators to provide these services, but in practice Scottish Power Generation Ltd and SSE Generation Ltd will provide these services. As a result of this



obligation to balance the system, the two host generating companies are never exposed to imbalances when trading with suppliers in their own areas. However, all independent supply and generation companies are potentially exposed to imbalance volumes.

#### *Shared unmetered supplies*

- 8.12 In the north of Scotland, there have been difficulties in establishing competition for customers who consume a portion of electricity from a shared and unmetered source (hence Shared Unmetered Supplies or 'SUS'), generally for the purposes of communal lighting. In the north of Scotland only, this unmetered supply is billed for by adding to each SUS customer's metered bill the share of unmetered supply, using estimates supplied by the distribution business. The additional processes and costs for competitor suppliers to participate appear to have dissuaded suppliers from competing in the market for SUS customers. The issue affects around 35,000 electricity customers in the north of Scotland.

#### *Dynamic teleswitched heating loads*

- 8.13 Some domestic tariffs have a control unit that switches the metered supply remotely by radio teleswitch without the customer being notified of the times by the supplier. The 'Total Heating Total Control' tariff of SSEnergy Supply Ltd in the north of Scotland, where the supply has a separate heating load circuit controlled by dynamic radio teleswitch, is an example of this type of tariff. The Radio Teleswitching Access ('RTA') Provider, a function of the relevant distribution business in Scotland, controls the radio switches and hence heating load following instruction from the host supplier. This arrangement potentially gives the host supplier an information advantage over other suppliers for customers on these types of tariffs, and may dissuade other suppliers from competing for these customers. There are around 78 000 teleswitched customers in the north of Scotland.

#### **Respondents' views**

- 8.14 A number of suppliers and *energywatch* noted that they would welcome a speedy implementation of consistent trading arrangements across Great Britain.

Some suppliers noted for example that the different trading arrangements in Scotland effectively enhance the position of the two Scottish ex-PES suppliers, impede domestic competition, and are a barrier to entry. Another suggested that there were shortcomings in the Scottish wholesale market, but said that this had not affected its sales strategy or pricing policy in the domestic retail market.

- 8.15 One supplier noted that it was not competing for SUS customers because of the additional administrative costs involved. This supplier suggested that Ofgem should encourage simplification of the arrangements, such as splitting metered from shared unmetered supplies.
- 8.16 Regarding radio teleswitched heating load supplies, some suppliers noted that the increased administrative burden associated with radio teleswitch customers effectively reduced the incentive for suppliers to compete for such customers. One supplier argued for dissemination by the host distribution business of historic patterns of use of radio teleswitches, so that competing suppliers could make better assessment of generation costs associated with the supply of radio teleswitch customers. This supplier further argued for a formal process involving all suppliers and the host distribution business regarding switching actions, and that such arrangements would promote competition for radio teleswitch customers.

### **Ofgem's views**

- 8.17 Ofgem recognises that there is a lack of competition in wholesale generation and balancing in Scotland. That is why Ofgem is presently reviewing the Scottish trading arrangements with a view to aligning arrangements in Scotland with those in England and Wales. Ofgem has published three documents<sup>21,22,23</sup> relating to its review of trading arrangements.
- 8.18 Ofgem is presently further developing its policy on the appropriate form and implementation of BETTA. Ofgem intends to publish shortly a further document setting out developments since the consultation in August 2000, and will seek

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<sup>21</sup> "Initial proposals and issues for consideration on the reform of Scottish trading arrangements", Ofgem, May 2000.

<sup>22</sup> "Interim proposals for reform of Scottish trading arrangements : BETTA", Ofgem, August 2000.

<sup>23</sup> "Reform of Scottish trading arrangements : BETTA A summary of responses to the August 2000 document", Ofgem April 2001 31/01

views on the operational and organisational arrangements that might best achieve the implementation of BETTA. While the absence of competition in wholesale generator markets limits the competitive advantage that supplies can gain from sharper purchasing, it does not remove the ability of suppliers at the retail level to compete in other aspects of the supply offering, e.g. brand, billing, and offering 'dual fuel' products.

- 8.19 Regarding SUS and teleswitching, Ofgem consulted on the issues of Shared Unmetered Supplies and dynamic teleswitched heating loads in May 2001<sup>24</sup>. Ofgem will shortly publish proposals setting out ways to facilitate customer transfer and supplier entry in these areas. SSE plc has been asked to consider implementing the proposals on SUS by April 2002. It is currently Ofgem's intention that proposals on teleswitching be incorporated into a future GB-wide consultation on teleswitching, although as an interim measure Ofgem is considering whether, in relation to teleswitching, the distribution business in north Scotland can interact on an equivalent basis with all suppliers.

### ***The general operation of the gas market***

- 8.20 Respondents raised concerns connected with competition on gas transportation networks operated by companies other than Transco, and with the provision of prepayment meter infrastructure facilities in the domestic gas market. Concerns were also expressed about the effect on domestic gas competition of the use of entry capacity auctions.

### **Competition on gas transportation networks operated by companies other than Transco**

#### *The issue*

- 8.21 A number of companies are licensed by Ofgem to be Gas Transporters (GTs). These companies are able to build, own and operate natural gas transportation pipes which are connected directly to end users, including some domestic customers. The largest and best known of these GTs is Transco, which provides gas transportation services to the overwhelming majority of all gas customers in

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<sup>24</sup> "Supply competition for electricity customers with shared unmetered supplies and dynamic teleswitched heating loads in the north of Scotland" Ofgem, May 2000

Great Britain. There are presently 10 other companies, including Transco, that are also licensed to transport gas, some of whom hold more than one licence. Ofgem estimates that around 240 000 supply points are connected to these Independent Gas Transporter (IGT) systems.

- 8.22 Transporters charge gas shippers transportation charges in order to convey gas to end user premises. The level of charges made by Transco is subject to a price control licence condition. The level of charges by IGTs are not price controlled, although Ofgem has the power of veto over any changes the IGT may make to the methodology it uses to set charges.
- 8.23 In addition, each Transporter is able to charge for connection of premises to its network. Connection charges may be a source of revenue for Transporters who are building entirely new gas transportation networks. Often such new build is to provide gas transportation network facilities for new commercial, industrial or domestic developments.
- 8.24 Retail competition for gas customers connected to such networks depends, among other things, on a supplier's ability to access the network. Transporters are required by the terms of their licence to offer such access, as well as the structure and level of the transportation charges. A number of suppliers have raised concerns regarding the terms of this access and the consequent effect on retail competition.

*Respondents' views*

- 8.25 A number of suppliers said that their incentive to acquire customers served on non-Transco networks is reduced by one or more of the following factors
- ◆ the lack of common administrative arrangements across GTs results in manually intensive and expensive administration of customers;
  - ◆ the lack of consistency and unpredictability in and between GTs' transportation charges creates pricing difficulties for suppliers; and
  - ◆ the relative expense or difficulty of providing prepayment meters to customers on these networks.

- 8.26 Two suppliers also suggested that since networks are often built to service new building developments, competition on non-Transco networks tended to be for new connections. This, the suppliers said, resulted in new connection charges being relatively low, and transportation charges being relatively higher. Suppliers and so customers are subject to these higher transportation charges.
- 8.27 Suppliers suggested that industry wide communication / administrative arrangements would help to reduce the administrative costs of serving non-Transco customers. One supplier suggested that the provision by network operators of their M Number database to suppliers would expedite the registration of customers on these networks. Another supplier recommended placing some form of price control on transportation charges.

*Ofgem's view*

- 8.28 Ofgem recognises many of the concerns raised by respondents. Indeed Ofgem is reviewing the appropriate regulatory treatment of charges by IGTs. Ofgem intends to publish a consultation document on these matters in the near future.
- 8.29 Regarding the provision of services to suppliers on these networks, Ofgem recently directed IGTs to release their M number databases. The publication of IGT M number data may result in increased supplier marketing activity across IGT networks. That is, suppliers may commit more resources to targeting customers located on IGT networks. An increase in transfer activity may raise supplier concerns about the administration costs of processing customer transfers utilising IGT faxed based Supply Point Administration (SPA) processes.
- 8.30 Ofgem understands that the majority of IGTs are planning significant connection growth across their networks. Projected total growth (based on IGT estimates) suggests close to 500,000 customer connections in the next three to five years, current connections figures are close to 250,000 customers. Ofgem is concerned that fax based SPA services may not adequately manage customer transfer activity arising from either increasing IGT connections or increased marketing activity.
- 8.31 Ofgem would welcome shipper/supplier feedback on particular IGT problem areas. For example, transfer related problems arising from IGT SPA processes,

understanding the costs of acquiring customers on IGT networks when compared to costs of customer acquisitions on Transco's network and the quality and accuracy of published IGT M number data.

### **Prepayment meter infrastructure facilities**

#### *The issue*

- 8.32 Domestic gas suppliers wishing to provide prepayment meter facilities to customers are able to use a central facility – the Quantum Office – to provide and administrate gas prepayment meters and payment facilities anywhere in Great Britain. Siemens owns and operates the Quantum office and so is the de facto monopoly provider of gas PPM services. Siemens (or meter manufacturers operating under licence from Siemens) is also the de facto monopoly supplier of gas PPMs.

#### *Respondents' views*

- 8.33 One supplier argued that the size of the annual charge for gas prepayment meter facilities is high in comparison to the equivalent charge for electricity prepayment meter facilities of £15 per customer per year. This supplier noted that the nationwide operation of the gas facility might introduce economies of scale not available for the regional electricity PPM providers.

#### *Ofgem's view*

- 8.34 Ofgem's present review of metering competition<sup>25</sup> has identified the issue of creating choice in prepayment metering, which in the longer term should place downward pressure on charges for use of these facilities. Ofgem for example in November 2001 held a seminar on the issues involved, and is actively considering views expressed on creating choice in prepayment metering.

### **Entry capacity auctions**

#### *The issue*

- 8.35 Charges by Transco for short term entry capacity for the gas National Transmission System (NTS) are determined by periodic auctions of capacity.

There have been five such auctions since September 1999, with the latest completed in September 2001.

- 8.36 Transco's price control, which effectively caps the total revenue that Transco is allowed to derive from a set of charges, used to include revenue from auctions in the set of charges. Auction revenues which were large therefore had the effect of necessitating a reduction in Transco's other charges. This may have had the effect of reducing charges for some Transco customers (for example shippers who pay transportation charges) but not for others (for example shippers who pay only entry charges). The arrangement might also have had the effect of distorting the original bids at auction, where bidders are aware that charges may be rebated at a later stage.
- 8.37 Ofgem has since May 2000<sup>26</sup> been considering the introduction of long term sales of capacity and the signals and incentives on Transco to provide and allocate this capacity efficiently and in a non-discriminatory manner. The process has culminated in Ofgem's March 2001<sup>27</sup> publication of detailed proposals to improve the long term signals and incentives for investment in Transco's National Transmission System (NTS).

*Respondents' views*

- 8.38 Some suppliers argued that the auctions for short term capacity have affected competition in gas supply. One supplier argued that the auction process results in Centrica receiving preferential treatment for access to the Barrow entry terminal. Another supplier argued against any changes to the auction process that would reduce auctioned capacity and so increase prices. This supplier also suggested that the auctions had eliminated the predictable seasonal profile of wholesale gas prices.

*Ofgem's view*

- 8.39 Ofgem has recently accepted a Transco proposal to modify the treatment of revenue from capacity auctions. Between October 2001 and March 2002, any

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<sup>25</sup> see for example Ofgem's strategy for metering Report on progress and next steps October 2001 62/01

<sup>26</sup> Long term signals and incentives for investment in transmission capacity on Transco's National Transmission System : A consultation document, Ofgem May 2000

over recovery from auctions will be used by Transco to fund 'buy back' of capacity that it has sold but subsequently finds that it is unable to provide. This method should avoid many of the distortionary effects of the previous revenue rebate mechanism.

- 8.40 In addition, Ofgem's March 2001 proposals, due for implementation from April 2002, should introduce a long term mechanism for the allocation of and efficient investment in NTS capacity which provide appropriate and non discriminatory price signals.

### ***The general operation of the electricity market***

- 8.41 Respondents raised a number of issues relating to the operation of the domestic electricity market and the potential effects on competition. Issues raised can be summarised under the following headings

- ◆ separation of electricity distribution and supply;
- ◆ supplier agency services and the provision of prepayment meter infrastructure services;
- ◆ the effect of New Electricity Trading Arrangements;
- ◆ the Renewables Obligation; and
- ◆ the introduction of competition for metering.

### **Separation of electricity distribution and supply**

#### *The issue*

- 8.42 The Utilities Act 2000 provides that the same person may not be the holder of both a distribution and a supply licence. Such separation will facilitate competition in electricity supply. This is because separation minimizes incentives and opportunities for owners of both distribution and supply businesses to allow the former to discriminate in favour of the latter.

#### *Respondents' views*

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<sup>27</sup> Long term signals and incentives for investment in transmission capacity on Transco's National



- 8.43 Two suppliers argued that effective separation of electricity distribution and supply functions is essential in fostering effective competition in retail supply. They therefore called for continued vigilance by Ofgem in monitoring and enforcing the separation. Another supplier argued that progress on separation means that the separation issue is no longer a barrier to entry, while another stated that it was receiving equal treatment from all electricity distributors.

*Ofgem's view*

- 8.44 Ofgem notes that the Utilities Act 2000 prohibits the simultaneous holding of a distribution and a supply licence. In addition, licensed distributors are bound by the terms of their licences to maintain managerial and operational independence of the distribution business, and to appoint a compliance officer to ensure compliance with these relevant obligations. Ofgem continues to monitor distribution companies' independence from other businesses and will take action where necessary to enforce it.

**Supplier agency services**

*The issues*

- 8.45 Electricity distributors and Gas Transporters are obliged by the terms of their licences to provide certain services in order to enable suppliers to supply customers. Electricity distributors are for example obliged to provide a Metering Point Administration Service (MPAS). This service enables suppliers, among other things, to administer the transfer of customers between suppliers. The distributors are also obliged, if requested by a supplier, to provide metering services for all meter points. Gas Transporters are required, on request, to provide and operate meters.
- 8.46 In April 2000 agent competition was introduced to the electricity market, allowing suppliers to choose who provides them with metering services. Suppliers are now able to contract with any accredited metering service provider for the functions of meter operator (MOP), data collector (DC) and data aggregator (DA).

8.47 Ex-PES suppliers have a supply licence obligation to make available a prepayment meter infrastructure service to all suppliers, on a non-discriminatory basis. This enables other suppliers to have access to services to provide domestic customers with a prepayment meter facility. In gas, prepayment meter infrastructure services are provided by Siemens Metering Services. All suppliers contract with Siemens for these services.

*Views expressed*

8.48 Some smaller suppliers have argued that the services provided by ex-PES distributors and suppliers should not favour the host supplier and should be operated in a way that facilitates the operation of the competitive market. These suppliers have also suggested that the level of service by the supplier agency services and prepayment meter infrastructure services of the ex-PES suppliers and/or distributors to other suppliers is poor, and might represent preferential treatment by a host distribution business of its associated ex-PES supplier.

8.49 A number of suppliers expressed dissatisfaction with the ex-PES suppliers supply businesses' provision of PPM infrastructure services. Views expressed included :

- ◆ an argument that the location of prepayment meter infrastructure provision within the ex-PES supply business gave little incentive to this business to maintain an adequately functioning PPM infrastructure service evidenced for example by the ex-PES supplier running short of competitor suppliers' charging cards;
- ◆ noting that present arrangements result in suppliers incurring charges for changing prices to PPM customers unless prices are changed in April or October;
- ◆ there are high costs to a supplier of issuing payment cards to PPM customers, particularly given that domestic customers can change supplier with 28 days notice;
- ◆ views that the operation of the PPM infrastructure by ex-PES suppliers has resulted in some discriminatory practices, such as using recharging

of PPM payment cards as an opportunity to promote the ex-PES suppliers' brand;

- ◆ the view that the existence of 'unsupported' prepayment meters (perhaps, for example, coin meters) means that customers using such meters who wish to change supplier must also change meter, which impedes the change of supplier process; and
- ◆ noting that it is difficult to outsource the provision and encoding of the payment card away from the ex-PES supplier and to have this outsourcing recognised in lower PPM infrastructure provision charges, which would help to make such outsourcing worthwhile.

#### *Ofgem's view*

8.50 Supplier agency service providers are required under the terms of their licences to provide such services on a non-discriminatory basis. Ofgem will take action where it finds or is given any evidence of discriminatory provision.

8.51 Suppliers are able to change metering and data service providers, and that this provides one way for suppliers to seek better service levels. Moreover it is important that suppliers are able to change such suppliers without undue risk. This is partly being addressed by work undertaken by ELEXON to address the generic problems identified with the Change of Agent process<sup>28</sup>.

### **The effect of New Electricity Trading Arrangements**

#### *The issue*

8.52 New Electricity Trading Arrangements (NETA) for the trading of wholesale electricity were introduced on 27 March 2001. These replaced the previous Electricity Pool, where all trades were co-ordinated centrally, with the opportunity for electricity generators and purchasers to trade directly with each other. A 'balancing market' was also introduced which through the use of, among other things, market clearing prices ('imbalance charges'), enables electricity generation and demand to be maintained in continuous equilibrium.

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<sup>28</sup> See "Ofgem's strategy for metering Report on progress and next steps" Ofgem October 2001

### *Respondents' views*

8.53 A number of smaller suppliers argued that NETA tends to disadvantage small suppliers because of one or more of the following reasons :

- ◆ the level and volatility of imbalance charges puts a disproportionately large risk on participants trading relatively small volumes. Larger suppliers have economies of scale in, for example, forecasting demand and access to historic data on demand, both of which allow them to minimise their exposure to the balancing market;
- ◆ the trading granularity is too large, which can result in small suppliers buying relatively large volumes and trading residual volumes at volatile prices. Power exchanges have not developed sufficient liquidity to provide for smaller trades; and
- ◆ there is a delay in the feedback of information to suppliers about volumes taken, which makes it difficult to optimise continuously purchase volumes.

### *Ofgem's view*

8.54 NETA was introduced on 27 March 2001. The new trading arrangements are based upon bilateral trading between generators, suppliers, traders and customers. In addition to the Over the Counter (OTC) contracts market which allows participants to strike contracts several years ahead there are also a number of short term power exchanges allowing participants to fine tune their contract positions in an easy and accessible way. The Balancing Mechanism is one of the tools that NGC as System Operator (SO) uses to ensure that the electricity system remains in balance. Imbalance settlement prices (derived from the costs of accepting bids and offers in the Balancing Mechanism and the SO's forward contracts) are charged to participants whose contracted positions do not match their metered volumes.

8.55 The introduction of NETA has resulted in a large and rapid development of the wholesale market. NETA has created a more transparent wholesale contract market that is closer to the way other commodities are traded. Year on year there has been a 315% increase in the number of contracts traded and an increase in

the variety of products offered – in 2000 24 different products were reported, by 2001 this had grown to 148 an increase of 517%. A number of power exchanges have been established and there have been significant developments in liquidity in both these power exchanges and in the OTC market. Prior to Gate Closure, participants can hedge risk through a number of ways. Most power exchanges offer trades for small volumes of electricity, e.g. UKPX offers trades in ½ MW/h lots per half hour. Forwards, futures and spot markets have evolved and are expected to continue to evolve in response to the requirements of participants.

8.56 The experience of the first six months of NETA has been that only 5% of energy purchases have been made through the Balancing Mechanism. NGC has tended to find at Gate Closure that generators were intending to generate more power than was required to meet national demand (i.e. the system was long). In some half hours, however, a sudden, unanticipated and short duration increase in demand has occurred. As a result, during the first three months, NGC has, on occasion, needed to instruct very flexible generation units to increase frequency at very short notice and at relatively high cost.

8.57 Ofgem considers that it is important that the costs of electricity imbalances are targeted to those participants whose contracted position is not equal to metered volumes; this is consistent with the relevant objective of promoting competition by preventing cross subsidisation. Recent modifications to the energy imbalance calculations should ensure that they are more cost reflective and reflect only the electricity balancing costs. Overall the trend of the spread between the System Buy Price and System Sell Price is reducing over time. Since April 2001 the average monthly difference between the two has fallen from £69.80 to £16.83 in October 2001.

### **The Renewables Obligation**

#### *The issue*

8.58 The Utilities Act 2000 gives the Secretary of State the power to make an order requiring licensed electricity suppliers in Great Britain to supply a certain percentage of their total sales from certain qualifying renewable sources. This power has been devolved to the Scottish Executive in respect of suppliers in

Scotland. The Renewables Obligation for England and Wales (RO) and the Renewables Obligation for Scotland (ROS) will replace the present arrangements for encouraging renewables and non-fossil fuel generation, the Non-Fossil Fuel Obligation (NFFO) orders and the Scottish Renewables Obligation (SRO). Existing NFFO and SRO contracts will however continue as before on the same terms. Ofgem will be responsible for the implementation and administration of the provisions of all orders under the RO and ROS<sup>29</sup>.

- 8.59 The Department of Trade and Industry and the Scottish Executive have recently consulted on and made proposals for the implementation of and the parameters for the RO and ROS. The papers can be obtained from the websites [www.dti.gov.uk/renewable/pdf/energymaster.pdf](http://www.dti.gov.uk/renewable/pdf/energymaster.pdf) and [www.scotland.gov.uk/who/elld/ROS\\_confinal.asp](http://www.scotland.gov.uk/who/elld/ROS_confinal.asp). The closing date for responses was 12 October 2001.
- 8.60 The proposals set out the percentage target for both the RO and the ROS, and draft Orders. The Government has proposed that the Obligation will start on the first day of the month immediately following approval of the Orders, possibly 1 January 2002, and that it will remain in place until March 2027.
- 8.61 It is presently anticipated therefore that between 1 January 2002 and 31 March 2003, all electricity suppliers will be obliged either to supply 3% of their sales to customers from qualifying renewable sources, or to pay for 'buyout'. The 3% proportion is expected to be increased each year so that it reaches 10.4% in the financial year 2010/11, subject to the cost to consumers being acceptable.
- 8.62 Suppliers can demonstrate their compliance with purchasing sufficient renewable sourced generation by obtaining Renewables Obligations Certificates (ROCs). These can be obtained directly from renewable generators when contracting with such generators. ROCs will also be tradable, and so suppliers may be able to purchase ROCs on a secondary market as a way of meeting the Renewables Obligation.
- 8.63 Suppliers that do not meet the Obligation by presenting ROCs can instead meet their Obligation by paying a 'buyout' price to Ofgem for volumes that should

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<sup>29</sup> For an explanation of Ofgem's anticipated role, see "The Renewables Obligation – Ofgem's procedures A consultation paper" Ofgem, August 2001

have been sourced from renewables. The buyout price has been set at £30 / MWh until 1 April 2003 and thereafter will be adjusted in line with the Retail Price Index. Revenues from such buyouts will be returned to suppliers in proportion to ROCs presented, and so provide an incentive to source generation purchases from renewable generation.

- 8.64 Suppliers in England and Wales will have access to a relatively large volume of renewables generation (compared with the initial 3% target) and hence ROCs through the auction of renewable generation capacity resulting from the operation of the Non-Fossil Fuel Obligation (NFFO) orders. The next auction, in respect of capacity for the first financial year of the Obligation, is scheduled to be held in December 2001.
- 8.65 As presently structured, the Scottish settlement system does not support the auction of the output of individual SRO generating stations together with the climate change Levy Exemption Certificates (LECs) and ROCs. In addition trading between suppliers and other qualifying renewable generators exposes suppliers to the risk of residuals that can be avoided by contracting solely with the host generator in each of the two settlement areas in Scotland. As an interim measure the Scottish Executive has consequently proposed that the ROCs themselves are auctioned, rather than the renewable output.
- 8.66 One disadvantage of this interim proposal is that most suppliers who do not buy qualifying renewable generation output (irrespective of ownership of ROCs) will be unable to take advantage of LECs which are attached to that output (and which must be traded with the electricity), and which may be sold at a premium to Industrial and Commercial customers. In the case of LECs attaching to SRO output the Scottish Executive is considering a mechanism to capture the benefit of the LEC so that it is used to reduce the fossil fuel levy in Scotland. The suppliers that do take output from Scottish renewable generation are, in the main, the two Scottish ex-PES suppliers. These suppliers will retain the LEC advantages associated with the SRO output, even if they hold no associated ROCs.

#### *Respondents' views*

- 8.67 One small supplier argued that the Renewables Obligations favour large

suppliers, because there is presently insufficient renewable generation available to meet the obligation and that much of it is owned by suppliers who therefore have no incentive to make it available to other suppliers. This supplier further argued that development of new renewable generation sources is likely to be backed and taken by large suppliers, because such suppliers are more easily able to finance the associated risks.

#### *Ofgem's view*

- 8.68 Ofgem notes that all suppliers will have access to a relatively large volume of ROCs through the auction of renewable generation capacity or ROCs, as described above. Suppliers will also be able to fulfil their Renewables Obligations by purchasing ROCs on the secondary market.
- 8.69 However it may be, or may become over time, relatively more difficult for new entrant or small suppliers to obtain access to renewables generation. Accordingly, Ofgem has suggested in its submission to the DTI's consultation paper that the RO should apply only to a supplier serving more than a threshold number of customers.
- 8.70 Ofgem is aware of the relative disadvantages of the approach of auctioning only ROCs in Scotland rather than renewable output itself, and also the relative difficulty of changing in the short term trading arrangements in Scotland in order to accommodate a fuller auction process. Ofgem is presently considering how it might take forward the issue.

### **The introduction of competition for metering and metering services**

#### *The issue*

- 8.71 In March 2001, Ofgem published for consultation its strategy for metering<sup>30</sup>. The strategy set out eight strands of work with the collective aim of promoting choice, innovation and new investment in the provision of metering and meter reading services. The successful implementation of the strategy would facilitate the removal of these activities from the scope of direct regulation. Ofgem

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<sup>30</sup> Ofgem's strategy for metering A consultation paper March 2001 28/01



published in October 2001 its report on progress and next steps<sup>31</sup>.

#### *Respondents' views*

- 8.72 One respondent argued that the complexity involved in introducing arrangements required for metering competition would result in higher costs for suppliers which would be passed through to customers, which the supplier suggested was not in the interests of customers.

#### *Ofgem's view*

- 8.73 Ofgem considers that the introduction of competition into metering and metering services will provide significant benefits to customers. The provision of existing services costs around £800 million per year. It is likely that the introduction of competition will provide downward pressure on the costs and charges for these services, and provide pressure for providers to deliver improved standards of service. Competition in metering also has scope to facilitate progress towards wider objectives, such as the reduction of fuel poverty and the promotion of energy efficiency, through the introduction of more innovative metering products.

#### ***Debt blocking***

##### **The issue**

- 8.74 At present, domestic electricity and gas suppliers may object to the transfer of one of their customers to another supplier if the customer has an outstanding debt. In electricity, the ability to object on grounds of debt is given in clause 16.1.2 of the Master Registration Agreement, to which all suppliers must be signatories. In gas, the ability to object is given in standard condition 30 of the Gas Suppliers Licence. In both electricity and gas, 'debt' is defined as a debt that has remained unpaid for 28 days or more after a written demand has been made by the supplier in respect of amounts owing.
- 8.75 The objection to the transfer of customers on the grounds of debt may impede the ability of customers in debt to take advantage of competitive market offers. This may be particularly true of domestic gas customers paying using a

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<sup>31</sup> Ofgem's strategy for metering Report on progress and next steps October 2001 62/01

prepayment meter, where levels of indebtedness are generally higher than for gas customers using other payment methods.

- 8.76 As part of its Social Action Plan, therefore, Ofgem has taken steps to encourage domestic suppliers to stop objecting to the transfer of customers on the grounds of debt<sup>32</sup>. The major retail suppliers have agreed to participate in a working group, which is chaired by British Gas Trading, on the development of trials of a new process, to be operated through an industry Code of Practice, to enable customers to transfer with their debts. In order to provide an incentive on acquiring suppliers to take customers in debt, it is proposed that the debt be factored at around 90% from the old supplier. Ofgem has participated in the working group and is fully supportive of the trials. Ofgem's overall objective, if the trials are successful, is to seek the agreement of all domestic electricity and gas suppliers to an amendment to the standard licence conditions, making the process permanent.
- 8.77 The initial trial, which will concern prepayment meter customers, will commence on 1 December for three months. Until experience is gained, it is unclear whether the process can be extended to credit customers, and subsequently adopted throughout the industry.

### **Respondents' views**

- 8.78 Respondents were mixed in their views about the issue. A number of suppliers for example supported Ofgem's efforts and/or the trial to reduce the incidence of debt blocking. Some noted that they favoured progress through a Code of Practice which would set out the relevant parameters for the transfer of debt.
- 8.79 Others suggested that debt blocking is not a major impediment to the development of competition or a barrier to entry. Two suppliers noted that many customers in debt were already able to switch supplier, provided that the debt is paid off, and so the real problem is one of income or affordability. Some suppliers suggested that efforts should be made to encourage suppliers to manage customers' debts so that large debts are not built up.
- 8.80 A number of suppliers suggested that any arrangements that were put in place

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<sup>32</sup> see for example Social Action Plan Annual Review March 2001 30/01 Ofgem

that allowed customers in debt to transfer supplier may be relatively disadvantageous to smaller or new entrant suppliers, because incumbents would in effect be able to offload debt customers on to these suppliers.

### **Ofgem's views**

- 8.81 Ofgem continues to work with domestic suppliers in order to encourage suppliers to stop objecting to the transfer of customers on the grounds of debt, although satisfactory arrangements must be found to safeguard the commercial interests of suppliers who have a right to payment. Ofgem is encouraged by the agreement of suppliers to commence trials from 1 December 2001, and will be looking to make significant progress on this issue following completion of the trials.

## 9. Competition for prepayment customers

### *Introduction*

9.1 This chapter considers prepayment customers' experiences of domestic competition. It considers for example the extent to which these customers were aware of competition, the extent to which they have switched supplier, and the extent to which there are existing competitive offers aimed at attracting these customers' business. It is particularly relevant to compare the experiences of prepayment meter customers against those paying by the more traditional means of standard credit (quarterly cash or cheque).

### *Domestic gas customers' experiences*

9.2 Gas prepayment customers were generally as aware of competing suppliers as all gas customers or gas customers paying by standard credit. For example, 69% of all gas customers were able to name at least two gas suppliers, compared with 60% of gas prepayment customers and 63% of standard credit gas customers. 42% of all gas customers could name at least three gas suppliers, compared with 36% of gas prepayment customers and 37% of standard credit gas customers.

9.3 Regarding contact with suppliers, again gas prepayment customers were generally as likely to have had some form of contact as those using other payment methods. For example, 63% of gas prepayment customers said that they had been visited by a doorstep salesperson, compared with 61% of all customers, and 67% of standard credit gas customers.

9.4 Around one third of all customers said that they had been able to make their own comparisons between the prices that the suppliers were offering. Around two thirds said that they had been approached by suppliers telling the customer how prices compared. These proportions were broadly the same for customers paying by prepayment or standard credit, except for electricity prepayment customers, where only around one quarter (26%) said that they had been able to make their own price comparisons.

9.5 Of those customers who had been able to make price comparisons, or been approached with price information, just over half (53%) said that they felt

'informed' about the different prices. Gas prepayment customers were equally likely to report feeling 'informed', with 53% doing so. This compares with 48% of standard credit gas customers. For each of these customer groups, just over 40% reported feeling 'uninformed' about prices.

- 9.6 Most customers report being 'satisfied' with the overall service that they receive from their gas supplier. 86%, 89% and 86% of all gas customers, gas prepayment customers, and standard credit gas customers respectively said that they were 'satisfied'.

### **Gas prepayment customers' switching**

- 9.7 The customer survey suggested that 28% of gas prepayment customers have switched supplier one or more times. This compares with 32% of standard credit electricity customers.
- 9.8 Switching rates among gas prepayment customers have however been about equal with those for all gas customers over the last year. Around 20% of both gas prepayment customers and all gas customers have switched in the last year, compared with only around 15% of standard credit gas customers. Gas prepayment switchers were equally as likely to have switched twice or more as all gas switchers, with around 30% of both groups having done so. This compares with about 25% for standard credit gas switchers.
- 9.9 Intention to switch does not vary much according to payment method for gas non-switchers, since around 5% – 7% of all gas non-switchers, gas prepayment non-switchers, and standard credit gas non-switchers say they are likely or certain to switch in the next 12 months. Gas prepayment customers who have already switched at least once are slightly less likely than average to report being likely to or certain to switch again in the next 12 months, the proportions being 11% for gas prepayment customers and 15% for all gas switchers. Around 14% of standard credit gas switchers say that they are likely to or certain to switch again in the next 12 months.

### **Gas market share by payment method**

- 9.10 Chapter 5 noted BGT's market share by payment method. The switching rate among gas prepayment customers has been translated to some extent into a loss

in BGT's share of the prepayment market, which fell by 5% between March 2000 and October 2001 to 79%. This compares with a 4% fall to 71% in market share for gas customers paying by standard credit methods between March 2000 and June 2001. This latter fall reflects some BGT standard credit customers changing their payment method to direct debit. Evidence from the customer survey suggests that prepayment customers in the main do not change payment method to the same degree.

### **Price offers and changes for gas prepayment customers**

- 9.11 Chapter 7 noted the number of suppliers offering discounts compared with BGT and the range of these offers, and how these had changed between October 2000 and October 2001. It noted that, although the number of active suppliers had fallen slightly, customers are generally still able to obtain a range of offers and discounts.
- 9.12 Regarding gas prepayment customers, over the period October 2000 to October 2001, the number of discounts against BGT increased by three to six. Two of these suppliers are offering discounts of between 5% and 10% compared with BGT's prices. Suppliers appear to have increased their willingness over the last year to seek out customers paying by prepayment. This has been reflected in increased prepayment switching rates.

### ***Domestic electricity customers' experiences***

- 9.13 Just over three quarters (78%) of all electricity customers could name two or more electricity suppliers supplying electricity in their area. Electricity customers using prepayments were equally aware, with 75% able to name two or more suppliers. This compares with 71% of standard credit electricity customers. 54% of all electricity customers could name 3 or more suppliers, which again compares well with electricity prepayment customers (50%) and standard credit electricity customers (44%).
- 9.14 In general, electricity prepayment customers had levels of contact with suppliers similar to those using other payment methods. 61% of all customers for example said that a doorstep salesperson had visited them, compared with 62% for electricity prepayment customers and 59% for standard credit electricity

customers.

- 9.15 Paragraph 9.4 above noted that a third of all customers had been able to make their own price comparisons, and two thirds had been approached by suppliers making comparisons. Taking these two groups together, just over half (53%) reported feeling 'informed' about prices. Proportions are comparable both with electricity prepayment customers (50%) and standard credit electricity customers (51%). As with gas, just over 40% of each of these groups reported feeling 'uninformed' about prices.
- 9.16 Most customer groups appeared to be satisfied with the overall service that they were receiving from their electricity supplier. 87% of all electricity customers for example said that they were 'satisfied', against 86% of electricity prepayment customers and 86% of standard credit customers.

#### **Electricity prepayment customers' switching**

- 9.17 The customer survey results suggest that electricity prepayment customers are not far behind the average for all customers in their propensity to switch, and about equal with standard credit electricity customers. For example, 31% of prepayment electricity customers report having switched supplier one or more times, compared with 32% of standard credit electricity customers.
- 9.18 The switching rate among electricity prepayment customers reflects a marked acceleration in switching for this group over the past year. For example, 75% of electricity prepayment customers who have switched report having done so in the last year, meaning that about 23% in total have switched in the last year. By contrast, around 60% of all electricity customers (62%) and standard credit electricity customers (59%) had switched in the last year. Electricity prepayment switchers were also equally as likely as all electricity switchers to have switched twice or more (just over 21% of either group having done so).
- 9.19 This accelerated switching among electricity prepayment customers seems set to remain, with 9% of electricity prepayment customers that have not switched reporting that they are likely to switch over the next 12 months. This compares with 7% of all electricity non-switchers and 4% of standard credit electricity non-switchers. Of electricity switchers, around 15% of all switchers, of

prepayment electricity switchers, and of standard credit customers say that they are likely to or certain to switch again in the next 12 months.

### **Electricity market share by payment method**

- 9.20 Chapter 5 compared the market share by payment method of the ex-PES suppliers against those of the new entrant and 'out of area' suppliers. Here, the ex-PES suppliers 'in area' held 94% of the electricity prepayment market in March 2000, but only 80% in June 2001. This compares well with loss of market share of 14% in that period for direct debit customers, and for credit customers market share loss of 12%. As with gas, the reduction in market share for credit customers is likely to reflect changes in payment method to direct debit as well as switching. Prepayment customers are more likely to have remained on the same payment method and so the reduction in market share is more likely to reflect switching behaviour.

### **Price offers and changes for electricity prepayment customers**

- 9.21 Chapter 7 set out descriptions of the number of suppliers offering discounts compared to the former incumbents in each area, and noted changes between October 2000 and October 2001. Regarding prices for prepayment customers, in general, the number of discounts available relative to the incumbent increased between October 2000 and October 2001. In half of regions, the range of discounts available to customers became greater. There was no significant shrinkage in any region of the range of discounts available.
- 9.22 The change in discounts available partly reflects reductions made by a number of suppliers over the period. BGT, Powergen, and Seeboard for example all reduced prices for payment by prepayment, using a medium consumption level as a benchmark.
- 9.23 Hence customers paying by prepayment meter are able to choose from competing suppliers, obtain discounts against the local ex-PES supplier, while remaining to use this payment method. Increased switching rates among prepayment meter customers suggest that customers are choosing to take advantage of such choices.



## **Barriers to entry and other impediments to development of competition**

- 9.24 Chapter 8 noted that some suppliers expressed a number of concerns about the operation of both the electricity and gas prepayment meter infrastructure services. Ofgem continues to be aware that suppliers' access to these service, and hence the availability of competitive offers for prepayment meter customers, will be enhanced by addressing issues raised. Ofgem is seeking to make progress on these issues and where appropriate encouraging others to do so.

### ***Conclusions***

- 9.25 Those paying by prepayment meter are taking advantage of competitive offers at a rate comparable with customers paying by standard credit methods. Intentions to switch among prepayment customers that have never switched are higher or comparable with other non-switchers. prepayment customers appear as well informed about competition and competitive offers as most other customer groups, such as those paying by direct debit.
- 9.26 Suppliers are increasingly making price offers to PPM customers that produce a discount relative to the former incumbent supplier. Switching rates among PPM customers suggest that these customers are willing and able to take advantage of such competitive offers.

## 10. Competition in electricity supply in Scotland

### *Introduction*

10.1 As noted in Chapter 8 there are a number of regulatory, trading and administrative differences between the electricity industry in England and Wales and in Scotland. These potentially affect the development of competition at the retail level, or affect the extent to which different customer groups in Scotland may have benefited from or had access to the competitive market. This chapter considers evidence of domestic electricity customers' experiences of competition in Scotland.

### **Awareness**

- 10.2 Customers in Scotland were slightly less aware of two or more suppliers (73% or three or more suppliers (47%) as those in England in Wales (79% and 55% respectively), although awareness levels in both regions were high. Awareness levels using this measure in the South of Scotland region were slightly below that of the North of Scotland.
- 10.3 Regarding contact with suppliers, customers in Scotland as a whole were equally as likely as customers in England and Wales to have been visited by a doorstep salesperson (60% and 61% respectively). Compared with England and Wales, customers in the south of Scotland region were slightly more likely to have been visited by a doorstep salesperson (63%), and those in the north of Scotland slightly less likely (54%).
- 10.4 Customers in Scotland as a whole were slightly less likely to say that they had been able to make their own comparisons of prices than those in England and Wales (29% against 34%), but equally as likely to have been approached by suppliers telling the customer about how prices compare (65% for both regions). However, customers in the north of Scotland were both less likely to have made their own price comparisons or been approached by suppliers (24% and 48% respectively). To some degree, this will reflect the large geographical area and largely rural nature of the north of Scotland.
- 10.5 Regarding satisfaction with the overall level of service from the customer's

present electricity supplier, customers in Scotland reported equal satisfaction levels as those in England and Wales (86% and 87% respectively).

### **Switching**

- 10.6 Customers in Scotland have tended to switch at lower levels than customers in England and Wales, and this has been particularly marked in the north of Scotland area. For example, the former incumbent supplier in the north of Scotland area now retains 83% of the market, compared with the average in England and Wales of 70%. The share in the south of Scotland region, at 72%, is comparable with that in England and Wales. These net market shares reflect the slower switching rates of customers in Scotland.
- 10.7 Reported switching by customers is also lower. As chapter 4 noted, around 28% of Scottish electricity customers said that they have switched one or more times, compared with 38% in England and Wales. The rate is particularly low in the north of Scotland region, where only 22% of customers say that they have switched supplier.
- 10.8 Scottish non-switchers are however more likely to intend to change supplier than non-switchers in England and Wales. About 15% of Scottish non-switchers say that they are likely to or certain to change supplier in the next 12 months, against 6% in England and Wales, and 7% for Great Britain as a whole.

### **Market share**

- 10.9 Table 10.1 shows the market shares of the main competitor groups in the electricity supply market in Scotland, by customers supplied, at the end of June 2001 compared to the position at the end of March 2000, September 2000 and March 2001.

**Table 10.1 – Market shares of the main groups in the domestic supply market in Scotland by customers supplied**

Group	Market share at March 2000 (%)	Market share at September 2000 (%)	Market share at March 2001 (%)	Market share at June 2001 (%)
ScottishPower	64	60	56	53
SSE Energy	24	24	23	24
BGT	11	15	18	19
Other suppliers	< 1	2	3	4

10.10 The electricity supply market is more concentrated in Scotland than in Great Britain as a whole. The two ex-PES suppliers have seen their market shares declining, but still retained 77% of the Scottish supply market at the end of June 2001. In Scotland, the only supplier that has gained significant market share has been BGT.

10.11 Furthermore, there is indirect evidence from the customer survey that customers in Scotland display greater brand loyalty to local suppliers than customers in other regions of Great Britain.

#### **Entry and exit of suppliers**

10.12 Chapter 7 on entry and exit of suppliers noted that between October 2000 and October 2001, Ofgem granted 9 supply licences for domestic electricity supply, increasing the number to 29. Other things being equal, this would tend to indicate increased interest in supplying the domestic market.

10.13 However, some companies hold more than one licence, and not all licensees choose to participate in an active way. Ofgem estimates that the number of active suppliers in England and Wales has fallen from 13 to 12, and in Scotland from 13 to 10 over the period October 2000 to October 2001. Atlantic Electric and Gas has however begun actively to market in both the England and Wales and Scottish markets over this period.

10.14 Chapter 6 noted the pricing offers by region and by payment method. In

general, customers in Scotland appear to have access to a similar range of offers and discounts as those in England and Wales, across all payment types. The median discount available in the two Scottish areas for payment by standard credit or direct debit for example are comparable with most other regions of Great Britain, even though there are slightly fewer competitors offering discounts.

### **Barriers to entry**

10.15 Chapter 8 noted a number of issues specific to Scotland that might impede entry to the market and / or the development of competition. These were :

- ◆ the lack of consistent GB wide electricity trading arrangements;
- ◆ the issue of Shared Unmetered Supplies;
- ◆ the issue of dynamic teleswitched heating loads; and
- ◆ the introduction of the Renewables Order in Scotland and access to renewable generation.

10.16 It is clear that these issues have contributed to restricting entry in Scotland and / or reduced some customers' ability to transfer supplier. In view of the indicators of competition development for Scotland as discussed in this chapter however, it appears that these issues have not yet seriously impeded the development of domestic retail competition.

### ***Conclusions***

10.17 Customer awareness of competition and the extent of contact with suppliers in Scotland are comparable with levels in England and Wales, and Scottish customers appear equally as satisfied with their suppliers' overall service as their English and Welsh counterparts.

10.18 Electricity switching rates have been lower among Scottish customers, with 28% of customers having switched compared with the overall average for Great Britain of 38%. Electricity switching rates are particularly low in the north of Scotland region. Gas switching rates are comparable between Scotland and England and Wales. To an extent, lower electricity switching rates in Scotland

may reflect the particular issues of Shared Unmetered Supplies and Teleswitching tariffs, which are discussed in chapter 8.

- 10.19 The lower electricity switching rate has been translated into the two Scottish ex-PES suppliers losing market share slightly more slowly than ex-PES supplier in England and Wales. It is notable that the market in Scotland is mainly served by just three suppliers, the two ex-PES suppliers and BGT, whereas in general supply in England and Wales is less concentrated. However, there are around 10 active electricity suppliers in Scotland, and customers are able to obtain a range of offers comparable with those in England and Wales, over the range of the three main payment methods.
- 10.20 The concentration levels in Scotland may reflect the relative difficulty of suppliers accessing generation and other arrangements in Scotland. Chapter 8 discussed these issues in more detail and noted that it will be important for example to continue to address imperfections in the competitive process in the wholesale generation market there.
- 10.21 Overall, electricity customers in Scotland appear to be well informed about competition and able and willing to switch. Customers are able to access a range of offers, comparable with those in England and Wales. There remain specific structural issues in Scotland, particularly regarding the operation of the wholesale generation market.

## 11. Summary of findings

### *Introduction*

- 11.1 Overall, the findings from the review of domestic competition given in chapters 3 to 10 indicate that competition is now well established, effectively protecting customers' interests, and continuing to develop well.

### **Customer awareness**

- 11.2 Customer awareness levels remain high. Many customers have had some form of contact with suppliers, and this has been broadly true across the whole of Great Britain. The overwhelming majority of customers express satisfaction with the overall service that they are receiving from their supplier. Most of these indicators do not differ significantly between major customer groups such as payment method or those in England and Wales compared with those in Scotland.

### **Switching**

- 11.3 Around 38% of domestic electricity customers and 37% of domestic gas customers have now switched supplier at least once.
- 11.4 The momentum of switching has been maintained, albeit with some tailing off of net switching from BGT. Around 100,000 electricity customers switch supplier each week, of whom 56,000 leave ex-PES suppliers in net terms, thus leaving them on average with 70% of the domestic electricity market in September 2001. Equivalent rates in gas are around 70,000 a week gross, and 14,000 a week net, leaving BGT with 67% of domestic gas customers in September 2001.
- 11.5 Switching rates are much more evenly distributed across customer groups than in previous years. In electricity, 44% of direct debit customers have switched at least once, 32% of quarterly credit customers and 31% of prepayment customers, making an average of 38%. In gas the figures are 43% direct debit, 32% quarterly credit and 28% prepayment, making an average of 37%. According to the customer survey, this evidence suggests that there is no statistically significant difference in the level of switching between customers on

PPM meters and those paying quarterly by cash or cheque (i.e. standard customers). Indeed, 23% of electricity PPM customers switched supplier last year, compared to 18% of standard customers. There are also no significant differences in switching rates across socio-economic groups or income levels. However, pensioners continue to switch less frequently than others, and competition is still somewhat less advanced in rural areas.

- 11.6 The proportion of electricity customers who have not yet switched but say they intend to switch in the forthcoming year remains at the same level as last year (i.e. 7%). The proportion of PPM non-switchers who intend to switch is 9%, compared to 4% of standard domestic customers.
- 11.7 There are also a number of specific indicators showing that competition is just as effective for electricity PPM customers as it is for those on standard terms. These include: how informed each group feels about prices (PPM: 50%; standard 51%); the degree of satisfaction with current suppliers (PPM: 86% fairly/very satisfied; standard: 86%); and the proportion of customers in debt (PPM: 7%; standard: 8%).
- 11.8 The market is increasingly characterised by the sale of dual fuel supplies: 4 out of 5 electricity switchers now buy gas and electricity from the same company; and the offer of a dual fuel discount is now given as the second most important reason for switching after 'cheaper prices'.

### **Market shares**

- 11.9 BGT continues to lose market share. Between September 2000 and September 2001 its market share as measured by customer number fell by 4 percentage points to 67%. Its market share loss has been most pronounced for direct debit customers, where it retains 63% of the market. However, BGT's share of the prepayment market has now fallen to 79%, compared with 83% a year ago.
- 11.10 In electricity, the ex-PES suppliers' GB aggregate share of the 'in area' market (measured by customer number) continues to fall, by 10 percentage points between September 2000 to September 2001. There is considerable variation between regions, with the ex-PES supplier in the north of Scotland, SSE, retaining 83% of the market there.



- 11.11 Merger and acquisition activity has resulted in a consolidation of the domestic electricity supply market over the last year. The acquisition by Innogy of Yorkshire Electricity and Northern Electric and Gas has made it the largest domestic electricity supplier in Great Britain, with around one fifth of the market. BGT and TXU Energi closely follow Innogy.
- 11.12 Electricity market share by payment method reflects the recent increase in the switching rate among prepayment meter customers, with the ex-PES suppliers 'in area' seeing the proportion of these customer retained falling by 10 percentage points to 80% between September 2000 and June 2001. This reduction is greater than equivalent reductions for direct debit and standard credit customers.
- 11.13 The extent of customers taking both gas and electricity from the same supplier, 'dual fuel' deals, continues to grow. Ofgem estimates that around 7.5 million customers are now on dual fuel deals, compared with an estimated 6.8 million in October 2000.

#### **Price and non-price offers**

- 11.14 BGT's prices at August 2001 for its LatePay / Prepayment meter tariff are at about the level allowed for relative to its Direct Debit tariff, and around 1% less than the level allowed for relative to its PromptPay tariff. Nationally, at October 2001, domestic gas customers could choose from around 14 active gas suppliers and achieve median savings relative to BGT of 14% and 9% for standard credit and direct debit payment methods respectively.
- 11.15 Recent consolidation in the industry has reduced the number of active gas suppliers over the last year, but customers are still able to obtain a range of savings. This is also true for those paying by prepayment meter.
- 11.16 In electricity, ex-PES suppliers are in some cases pricing up to 2% below the level allowed for under the present price control. Often, these suppliers have chosen in 2001 to freeze prices in nominal terms, resulting in a real terms fall in prices.
- 11.17 Customers are able to obtain significant savings by switching. Median savings compared with the incumbent at October 2001 range from 5%-13% for standard credit tariffs, and 6%-14% for direct debit tariffs. The number of suppliers

offering discounts against the incumbent for prepayment meter customers has in general increased over the period October 2000 to October 2001.

- 11.18 Both gas and electricity suppliers are expanding the range of types of tariff they offer, and often bundling these together with other offers. In electricity for example, customers now have an increased choice of 'green' tariffs. Some suppliers are also for example choosing to provide some form of packaged utility services including gas, electricity and telecoms.

### **Entry and exit of suppliers**

- 11.19 The number of active domestic suppliers has fallen slightly over the last year. Merger and acquisition activity accounts for some of this reduction. There has also been some entry, with Atlantic Electric and Gas for example becoming an active domestic electricity and gas supplier. This activity has resulted in consolidation in the domestic electricity sector, with Innogy now the largest domestic electricity supplier, supplying around one fifth of all GB electricity customers.

### **Barriers to entry**

- 11.20 There continue to remain a number of barriers to entry and other impediments to market development. Principal among these are the reform of trading arrangements in Scotland, and the desire to address problems associated with suppliers' access to arrangements for providing customers with prepayment meter facilities.

### **Prepayment meter customers**

- 11.21 There are few significant differences between the experiences of customers paying by prepayment meter compared to those paying by standard credit, or to a large extent, all customers. Awareness levels are high, and PPM customers appear to be able to, and have switched supplier. The range of offers available to PPM customers, although narrower than for customers using other payment types, has nevertheless broadly remained constant or expanded over the last year. There are suppliers in the market who are actively interested in PPM customers' business, and are prepared to offer discounts against the incumbent to get this business.

## Scotland

- 11.22 Customers in Scotland appear as aware of the competitive market as customers in England and Wales, and were broadly equally likely to have had some form of contact with suppliers. Satisfaction levels with gas and electricity suppliers in both Scotland, and England and Wales are also high.
- 11.23 Electricity switching rates in Scotland, at 28%, are lower than the average for GB of 38%. However, Scottish non-switchers say that they are more likely to switch over the next 12 months (15%) than those in England and Wales (6%). Gas switching rates, at 37% in England and Wales and 39% in Scotland, are equivalent.
- 11.24 The electricity market in Scotland continues to be mainly supplied by the two Scottish ex-PES suppliers and BGT. BGT now holds around one fifth of the Scottish electricity market. However, there are around 10 active suppliers in the Scottish electricity market. These suppliers are offering a range of discounts relative to the ex-PES supplier that are equivalent to or greater than those available in England and Wales.
- 11.25 There continue to be structural issues in the Scottish electricity market that require addressing. The lack of a fully competitive wholesale generation market is for example an impediment to existing and new suppliers. The issues of shared unmetered supplies and dynamic teleswitched heating loads also tend to impede the ability of some suppliers to make competitive offers to customers on these tariffs. The differential operation of the Renewables Obligation in Scotland may also help to fetter the ability of some suppliers to secure appropriate generation sources in Scotland.

## 12. Ofgem's initial proposals for price regulation

### *Introduction*

12.1 Against the background of the review of competition in gas and electricity supply, Part III considers three options for regulation of domestic gas and electricity prices beyond April 2002, and sets out Ofgem's initial proposals.

### *Approach*

12.2 Ofgem's principal objective is to protect the interests of consumers, wherever appropriate through promoting effective competition. In this context, it is important to select a form of regulation that will protect consumers' interests, and allow innovation and the offering of a range of prices and services. A key consideration in deciding upon the approach to be adopted is the development of competition, and its future prospects, in gas and electricity supply.

12.3 In practice, Ofgem has identified three options for future price regulation:-

- ◆ option one - retaining existing relative price caps for BGT, and revising the ex-PES suppliers' price restraints;
- ◆ option two - retaining existing relative price caps for BGT, and introducing relative price caps for ex-PES suppliers; or
- ◆ option three – replacing regulation via price controls with the use of powers of investigation and enforcement under competition law, including the Competition Act 1998.

12.4 This chapter describes, discusses and makes an assessment of all three options for price regulation from April 2002.

12.5 Following separate consultations<sup>33</sup>, Ofgem concluded that, when competition had developed sufficiently to protect the interest of consumers, and price controls could be lifted, then prescribed standards of service in supply<sup>34</sup>, and the

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<sup>33</sup> "Guaranteed and overall standards of performance – final proposals." Ofgem, January 2001. "The role of regulatory accounts in regulated industries – a final proposals paper." Ofgem, *et al* April 2001.

<sup>34</sup> See appendix 4 for more details.

requirement for regulatory accounts, would also be removed. This policy is applied in assessing the options set out in paragraph 12.3.

***Option one: continued price caps for ex-PES suppliers***

**Description**

*Gas*

- 12.6 Under options one and two the regulation of BGT's retail prices is the same. Therefore the continued relative price regulation in gas is discussed under option two.

*Electricity*

- 12.7 This option involves extending, for a further year, the price restraints that currently apply to ex-PES suppliers<sup>35</sup>. Revised caps would continue to apply to Standard Domestic and Domestic Economy 7 customers paying by credit. A further control would provide a cap on the premium paid by prepayment customers. Moreover, where applicable, standing and unit charges would continue to be capped separately through side constraints. Direct Debit customers would remain outside the control.
- 12.8 Consistent with Ofgem's standing commitments, option one would result in:
- ◆ retaining the two remaining prescribed standards of performance in electricity supply;
  - ◆ retaining the voluntary standards of performance in gas supply; and
  - ◆ maintaining the requirement for BGT and ex-PES suppliers to submit regulatory accounts to Ofgem.

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<sup>35</sup> The present price control is set out in Appendix 2.

## Discussion

- 12.9 When competition was first introduced into the designated electricity supply markets, it was accompanied by price controls on designated tariffs<sup>36</sup>. Where competition still falls short of providing adequate safeguards, a maximum price, guaranteed through a revised cap, could protect customers' interests.
- 12.10 By the historical standards established for Direct Debit customers, the conditions for removing all price caps and regulating under competition law have been met. The customer survey shows that 28% of gas prepayment customers and 31% of electricity prepayment customers have switched supplier at least once since the market was liberalised. This compares with figures of 28% and 15% for gas and electricity Direct Debit customers when both were removed from the scope of price caps, in April 2000.
- 12.11 Current switching levels in gas and electricity supply are also higher than some products without price regulation (for example, home insurance, mortgages, and retail banking services)<sup>37</sup>.
- 12.12 Setting price caps carries the risk of distorting competition. Where caps are too low, relative to costs, profits can fall below a commercially sustainable level, thereby deterring investment and risking the regulated company's financial viability. Moreover, caps may restrict headroom and limit the ability of other suppliers to compete effectively, which would act against customers' longer term interests. For example, BGT incurred substantial increases in wholesale gas costs in 2000/01, which raised BGT's costs of supply. Had price caps continued beyond April 2001, BGT may have been unable to pass through any of this cost increase, potentially jeopardising the development of competition. If the cap is too high and there is competition, these competitive conditions will push prices below these caps, leaving the caps superfluous.
- 12.13 Analysis of ex-PES suppliers' responses to Ofgem's information request revealed wide variations in costs across suppliers. This emphasises the difficulties in

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<sup>36</sup> Price caps set the maximum price a supplier can charge. Currently, they apply to regulated electricity tariffs offered to in-area customers by ex-PES suppliers. The cap is set as a maximum average unit price, expressed in pence per kilowatt-hours, for a customer at average consumption.

<sup>37</sup> 'Research on switching suppliers report', DTI, July 2000.

assessing efficient level of costs across ex-PES suppliers, necessary for determining the price caps.

- 12.14 Moreover, there are inherent difficulties associated with forecasting generation costs which could lead to mismatches between forecast and outturn generation costs. One way to limit this problem is for the price cap to allow the pass-through of efficient generation costs, through an economic purchasing requirement<sup>38</sup>. Inherent in such pass-through regimes is the time lag between the time when companies are required to set prices and the time when the actual costs are determined to the satisfaction of the regulator. Such time lags may extend for a period of 12 to 18 months. This creates uncertainty over appropriate price caps, making difficult the evaluation of an ex-PES supplier's performance against its price control. This raises a question as to whether such a mechanism would satisfactorily protect consumers' interests in the event that competition was not effective.
- 12.15 Price caps with side-constraints that restrict rebalancing between charge components may inhibit innovative tariff restructuring. This could act to restrict the introduction of competitive offers, to the potential detriment of customers' interests.
- 12.16 The review of competition highlighted that gas and electricity supply was increasingly supplied to domestic customers on a dual fuel basis. This makes consistent treatment of gas and electricity a desirable objective. This option implies different regimes in gas (relative price regulation) from electricity (price caps) and therefore does not meet this objective.

### **Assessment**

- 12.17 The competitive market review has revealed that competition in domestic electricity supply is now well established. Evidence suggests high consumer awareness of competition<sup>39</sup>, with high levels of customer satisfaction. Around 100,000 electricity consumers switch supplier each week, leaving ex-PES suppliers with 72%, on average, of the domestic electricity market in July 2001. Competition has also advanced across all payment methods and socio-economic

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<sup>38</sup> An economic purchasing requirement requires the ex-PES supplier to demonstrate to Ofgem it has done its utmost to minimise these costs.

groups and income groups over the last 12-months. This suggests that the continuation of price caps is no longer justified.

12.18 Furthermore, by retaining price caps of the current form there is a risk that competition could be distorted to the detriment of existing and future customers' interests. In particular, the continuance of price caps risks discouraging innovation in price and service offerings.

12.19 On the basis of the competition review and the drawbacks highlighted above, Ofgem proposes not to pursue option one.

### ***Option two: relative price caps***

#### **Description**

12.20 Relative price regulation links the prices for customers whose interests are not sufficiently protected by competition (the 'target' group) to the prices for customers where competition is sufficiently developed (the 'marker' group).

#### *Gas*

12.21 The proposal would extend BGT's existing form and level of relative price caps for a further year, i.e. until March 2003. This means that the maximum differential between the combined PrePayment/LatePay and PromptPay groups and between the combined PrePayment/LatePay with Direct Debit groups would be maintained. BGT would have to continue complying with prescribed supply standards and submitting regulatory accounts.

#### *Electricity*

12.22 For electricity, caps on the differentials between ex-PES suppliers' prepayment and credit prices would be applied. Specifically, the caps would apply to the differences between the ex-PES suppliers' prepayment prices and its standard credit prices or between its prepayment prices and the weighted average of standard credit (where an early payment discount is offered). The caps on differentials would apply to both standard domestic and economy 7 types of tariff.

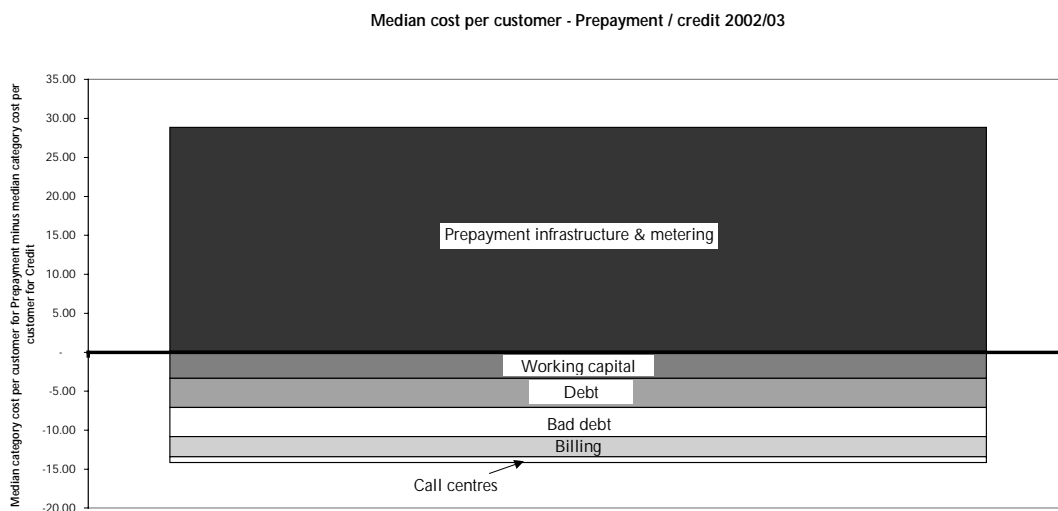
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<sup>39</sup> 77% of electricity customers were aware of two or more suppliers.



12.23 The differentials would be set at £15 per customer per year. Where no standing charge was levied, a cap on the p/kWh differentials would be applied, calculated by reference to average volumes consumed. This differential broadly reflects the median differential in costs between serving prepayment and standard credit customers. Based on cost data provided by ex-PES suppliers in response to Ofgem’s information request, figure 12.1 shows estimates of the median cost differential between prepayment and stand credit customers.

**Figure 12.1 – Median cost differential between prepayment and credit**



12.24 Figure 12 shows that typically prepayment infrastructure and metering costs outweigh savings associated with serving prepayment customers from working capital, debt management, bad debt, billing and call centre costs.

12.25 Under this option, ex-PES suppliers would have to continue to comply with the prescribed supply standards of service, and submit regulatory accounts.

**Discussion**

12.26 Relative price regulation is intended to share the benefits generated by competition in the market group with the target customers. Thus it is a useful tool in translating the benefits of competition from one group of customers (for whom competition is relatively advanced) to another group (for whom competition is less well developed).

- 12.27 There are two principal advantages associated with adopting relative price regulation in the form proposed above. First, it could address perceptions that competition for prepayment customers remains less effective than competition for other customer groups. Second, in relation to gas supply, it could provide added protection to customers in debt, whose ability to switch supplier is limited.
- 12.28 On the other hand, most recent evidence on the development of competition, as set out in Part II, suggests that competition for both gas and electricity prepayment customers over the last twelve months has been equally vigorous as competition for customers on standard credit payment methods. This finding is supported by recently published research carried out for Ofgem by Scottish & Southern Energy plc<sup>40</sup> which reports evidence suggesting that prepayment customers are no longer 'missing out'. It suggests that many suppliers, while initially focussing on the more straightforward task of gaining customers on credit meters have now turned their attention to attracting prepayment customers.
- 12.29 If indeed it is the case that competition for prepayment customers has become as effective as competition for customers on standard credit, it is questionable whether the application of relative price caps would achieve the purpose for which it was originally intended, that is, to translate the benefits of effective competition in one part of the market to another where competition is less effective.
- 12.30 The most recent evidence collected from the customer survey suggests that the extent to which customers in debt are deprived the benefits of the competitive market may not be as widespread as originally thought. Thus, although it will be important to progress the trial leading to the removal, or replacement, of current debt-blocking rules, it is unclear on the evidence currently available that the existence of the suppliers' right to block the transfer of customers in debt justifies retaining (in gas) or introducing (in electricity) some form of relative price regulation.

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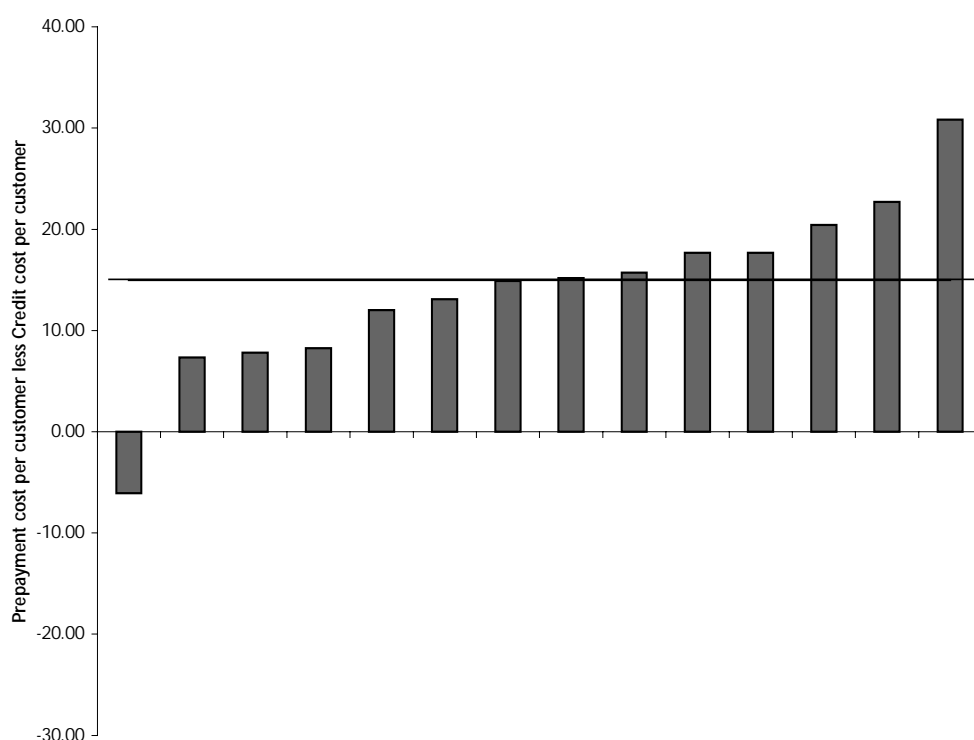
<sup>40</sup> "Ofgem's Social Action Plan Research Project: Prepayment Meter Customer Switching, a report by Scottish & Southern Energy plc", SSE plc, November 2001

12.31 Notwithstanding the limited evidence for retaining or introducing relative price caps discussed above, there are a number of other potential disadvantages associated with this option:-

- ◆ set incorrectly relative price caps risk distorting competition, including restricting innovation, which would harm consumers' longer-term interests. This could occur through movements in relative costs during the period of the control. Moreover, differences in the efficient level of costs between the ex-PES suppliers may mean that a one-size-fits-all control may provide insufficient headroom for some companies, in return for limited protection for the customers of other ex-PES suppliers;
- ◆ relative price regulation risks distorting prices for the marker group by changing suppliers' incentives. This distortion is likely to be greater the higher the ratio of target group customers to market group customers. Too small a marker group would have insufficient weight to create the appropriate incentives. Suppliers could raise prices for these customers, in order to increase prices for the target customers. Although marker customers will move to other suppliers, this revenue loss is more than offset by the increase in revenue from the target customers;
- ◆ when setting the current relative price regulation for gas Ofgem's intention was to protect customers in debt, as they arguably had less access to a competitive market. This was relatively practicable as PrePayment/LatePay functioned as a debt tariff, with a high proportion of customers in debt. However, in electricity, prepayment is not a 'debt tariff' as only 9% of its customers are in debt. Such an inconsistency between gas and electricity is of greater concern, the greater the degree of dual fuel sales; and
- ◆ data limitations and differences in the accounting practices of the ex-PES suppliers highlighted during the price control review have emphasised the inherent difficulties in attributing avoidable costs to ex-PES suppliers payment types, and therefore the accuracy with which the relative price caps can be determined. Figure 12.2 sets out the additional annual costs of serving prepayment customers over and above the costs of serving

credit customers as submitted by the ex-PES suppliers, with a number of modifications to ensure comparability between suppliers. Some of the variation is accounted for by differences in metering cost differentials. However, much of the remainder of the variation results from significant differences in the attribution of bad debt and call centre costs.

**Figure 12.2 – Additional annual costs of serving electricity prepayment over credit (2002/03, nominal)**



### Assessment

12.32 In the light of the evidence from the customer survey, together with the analysis presented above, adopting option two in either gas or electricity does not appear to be justified.

### *Option three: moving to regulation under competition law*

#### Description

12.33 This option involves replacing regulation via price controls with the use of powers of investigation and enforcement under competition law, including the Competition Act 1998. Ofgem would continue monitoring the behaviour of all suppliers and, in particular, dominant suppliers, and could take action should that behaviour be prohibited by competition law. Under its concurrent powers under the Competition Act 1998, Ofgem could bring action for anti-competitive practices such as excessive pricing<sup>41</sup>, and discriminatory or predatory pricing<sup>42</sup>.

12.34 Under option three requirements on gas and electricity supply businesses to comply with prescribed supply standards and prepare regulatory accounts would be removed from April 2002.

### **Discussion**

12.35 As noted in Part II, competition has become well established across domestic gas and electricity supply, albeit with a number of gas and electricity suppliers in potentially dominant positions. In these circumstances, the Competition Act 1998 is arguably the best tool for protecting the interests of customers. This is because it allows customers to benefit from vigorous competition between suppliers, unrestricted by regulatory price caps, while provided the reassurance for all customers that action will be taken to address abusive behaviour by a dominant supplier, e.g. excessive pricing. The Competition Act 1998 provides particularly strong incentives on dominant suppliers at the retail level, given that this is the part of the supply chain where powers to penalise are at their greatest.<sup>43</sup>

12.36 Other factors arguing in favour of adopting this approach are:-

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<sup>41</sup> Excessive pricing has been examined in European case law, where, for example, the European Court has held that, "charging a price which is excessive because it has no reasonable relation to the economic value of the product supplied is ... an abuse", *United Brands Co. v Commission Case 27/76 [1978] ECR 207 [1978] 1 CMLR 429*. Further a guideline issued by the Office of Fair Trading on the Competition Act's Chapter II prohibition indicates some of the circumstances in which behaviour will, or may be, regarded as abusive. In relation to excessively high prices, the guideline states that: "...in general to be excessively high the price must be higher than it would normally be in a competitive market". The Chapter II Prohibition, OFT402, March 1999.

<sup>42</sup> There is considerable case law on discriminatory and predatory behaviour. To address such behaviour, Ofgem would need to consider the degree to which the company's prices deviated from the costs of serving particular customer groups and whether the company intended to behave anti-competitively. If there was strong evidence of an anti-competitive intent, then the cost test might be less important.

<sup>43</sup> This is because maximum penalties are calculated by reference to turnover.

- consistency with Ofgem's objective of withdrawal from the regulation of competitive markets; and
- unifying the regulation of gas and electricity under competition law would reduce distortions to the development of dual-fuel offers.

### Assessment

12.37 The principal argument for removing price controls in favour of regulation via competition resides in the evidence of the degree to which competition in retail gas and electricity supply continues to serve customers' best interests, across all groups of customers. This evidence is strong.

12.38 In particular, the evidence shows that competition for prepayment and standard credit customers is similar, although it is recognised that the benefits from competition for these groups are not, to date, as great as those which have accrued to Direct Debit customers. Ofgem continues working on and undertaking a programme for prepayment customers, and considering studies and work from other organisations and individuals. These initiatives include:

- ◆ supporting the debt-blocking trial to assist gas and electricity customers in debt wanting to switch supplier (see Chapter 9);
- ◆ a joint working group, with energywatch, to examine best practice in debt management and prevention;
- ◆ following up existing research, including Catherine Waddams' study for the Electricity Association of prepayment customers and self-disconnection, and SSE Supply Ltd survey of alternative payment options for prepayment customers;
- ◆ pursuing, within the metering strategy, options for competition and innovation in prepayment metering; and
- ◆ further research, including work currently being undertaken by energywatch.

12.39 In Scotland, electricity switching rates are lower than in England and Wales with 28% of electricity customers having switched compared to the national average

of 38% for electricity. This is partly because many customers living in rural areas are not on mains gas, so they cannot benefit from dual fuel deals which account for around 80% of the offers taken up by those who have switched supplier.

12.40 As noted in chapters 8 and 10, Ofgem has serious concerns about the degree of competition in the Scottish wholesale electricity market. Ofgem is therefore working on reforms to the wholesale market to bring more competitive arrangements like those which now exist in England and Wales. The lack of competition in the Scottish wholesale market prevents Scottish customers from getting the full benefits to be derived from rivalry between suppliers in the purchase of wholesale electricity. Nonetheless, this does not mean that retail supply competition is insufficiently strong to allow price controls to be lifted.

12.41 Having carefully considered the particular circumstances that apply in relation to gas and electricity prepayment customers and electricity customers in Scotland, as well as the arguments for and against alternative forms of regulation, Ofgem proposes, from 1 April 2002, to replace regulation of gas and electricity supply via price controls with the use of powers of investigation and enforcement under competition law, including the Competition Act 1998.

12.42 Consistent with Ofgem's commitments, this will also result in:

- ◆ removal of the two remaining prescribed standards of performance in electricity supply;
- ◆ removal of voluntary standard of performance in gas supply; and
- ◆ lifting the requirement for BGT and ex-PES suppliers to submit regulatory accounts to Ofgem.

### ***Views invited***

12.43 **Ofgem would welcome views on this proposal, and any other aspect of this document, by Friday, 18 January 2002.**

## Appendix 1 Regulatory Framework

1.1 This chapter sets out a summary of the regulatory framework.

### *Regulatory framework*

1.2 The Utilities Act 2000 was granted Royal Assent in July 2000. It had the effect of amending the gas and electricity regulatory framework in key respects. This section discusses the new regulatory framework, relevant to this review, including:

- ◆ the Gas Act 1986 (as amended) and the Electricity Act 1989 (as amended);
- ◆ the gas suppliers' licences and the electricity suppliers' licences; and
- ◆ competition law.

1.3 These powers are discussed in turn.

### **Ofgem's duties under the Gas and Electricity Acts**

1.4 The functions of the Gas and Electricity Markets Authority ('the Authority') are set out in the Gas and Electricity Acts, as amended by the Utilities Act 2000 and must be carried out in accordance with the principal objective and general duties set out in those Acts.

1.5 In relation to the Gas Act 1986 (as amended) and Electricity Act 1989 (as amended), the Authority has a principal objective to protect the interests of all consumers, both existing and potential. This is to be achieved, wherever appropriate by promoting effective competition between individuals and companies involved in, or in commercial activities connected with the gas and electricity markets. These activities relate to the shipping, transportation and supply of gas to end-consumers, and to the generation, transmission, distribution and supply of electricity to end-consumers.

1.6 The Authority must carry out its functions in the manner it considers best calculated to further that objective having regard to the need to ensure that all reasonable requests from consumers for the supply of gas and electricity are met,



and to secure that licensees are able to finance the activities in respect of which obligations are imposed by or under the Acts. In complying with these duties the Authority needs to have regard, amongst other matters, to the interests of customers who are disabled or chronically sick, of pensionable age, of low income or those living in rural areas.

- 1.7 Where a licensee has breached its licence obligations and certain statutory requirements, Ofgem has the power under the respective acts and after complying with the statutory procedures, to impose a financial penalty on the licensee. The penalty imposed must be reasonable, taking into account the breach that occurred, and other relevant circumstances, and cannot be any more than 10% of the company's turnover calculated in accordance with an order to be made by the Secretary of State. Ofgem must publish a statement of policy regarding the imposition of penalties and determining the amount.

#### **The Gas Suppliers' licence**

- 1.8 The Gas Act 1986 (as amended) provides for the licensing of gas suppliers. The licence consists of Standard Conditions that are included in the licences of all suppliers, and may also include Special Conditions, which only apply to the individual licensee. BGT's licence contains such Special Conditions relating to domestic customers.

#### *Standard Conditions*

- 1.9 Suppliers who are authorised to supply domestic customers must meet all reasonable demands for the supply of gas made by domestic customers connected to the gas pipeline within the areas in which they operate. Each supplier must also make available its terms of supply on request from customers.
- 1.10 Suppliers are required to make available a range of payment options. This involves the facility to settle bills using various payment methods, including the options of a prepayment meter, or payment by cash or cheque. It also relates to the different intervals of payment, for example, twice-monthly, a pre-determined monthly sum, or quarterly in arrears.
- 1.11 Social obligations bind suppliers to offer additional services for customers including those in difficult circumstances. These services include:

- ◆ energy efficiency advice on request;
- ◆ special controls, adapters, advice on gas use, appliances and fittings to customers who are of pensionable age, disabled persons and chronically sick persons on request, and facilities for blind and deaf people, and to keep a register of such customers; and
- ◆ credit terms for supplying gas to customers in debt through misfortune or inability to meet bills for gas supplied on credit. This includes offering the facility to discharge their debt by instalments, or a prepayment meter, and general advice on reducing future bills through the efficient use of gas.

1.12 Suppliers are able to block the transfer of existing customers to other suppliers under Standard Condition 30, of the customers have had debt outstanding for more than 28-days.

*Special Conditions*

1.13 Special Condition 3 of BGT's gas supplier licence relates to the current price regulation of BGT's supply business. From April 2001, Ofgem removed the existing caps on BGT's PromptPay, LatePay and PrePayment tariffs, and opted for a system of relative price regulation. This modification caps the differentials between BGT's various tariffs, at their April 2001 levels<sup>44</sup>. The modification sets out clear guidelines relating to the tariffs that BGT is permitted to market to consumers, and the relevant provisions that are required, following an amendment approved.

1.14 Special Condition 13A requires that BGT takes all reasonable steps to ensure that certain standards of performance, relating to the supply services offered to domestic customers, are achieved. Specifically, this relates to the supply of gas, the accuracy of meter readings and the recovery of gas charges. The Condition requires that if these standards of performance are not achieved, domestic customers should received specified amounts by way of compensation.

## The Electricity Suppliers' Licence

- 1.15 The Electricity Act 1989 (as amended) provides for the licensing of electricity suppliers. The licence consists of Standard Conditions that are included in the licence of all suppliers. The ex-PES supply licences also include special conditions that are not in other suppliers' licences, and were introduced because of the dominance of the ex-PESs in their incumbent supply services areas.
- 1.16 A key development arising from the implementation of the Utilities Act 2000, has been the transition from the use of first and second tier supply licences to the use of a Great Britain-wide supply licence. This licence can be used in England, Wales and Scotland. One exception to this modification is SSE who requested that they would not have a Great Britain-wide licence.

### *Standard Conditions*

- 1.17 Suppliers who are authorised to supply domestic customers must meet all reasonable demands for the supply of electricity made by domestic customers within the areas they operate. Each must make available its terms of supply on request from customers.
- 1.18 Suppliers are required to make available a range of payment options. This involves the facility to settle bills using various payment methods, including the options of a prepayment meter, or payment by cash or cheque. It also relates to the different intervals of payment, for example, twice-monthly, a pre-determined monthly sum, or quarterly in arrears.
- 1.19 Licence holders are required to prepare a code of practice relating to the treatment of customers who, through misfortune or inability to cope with electricity supplied on credit terms, may have difficulty in paying bills. Suppliers should endeavour to identify such customers and:
- ◆ provide information to customers regarding the efficient use of electricity;

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<sup>44</sup> It specifies that the differentials between BGT's direct debit and Latepay/Prepayment tariffs; and between its PromptPay and LatePay/Prepayment tariffs should not exceed their April 2001 level.

- ◆ make special arrangements to enable the customer to comply with the payment of bills; and
- ◆ where the customer fails to comply with such arrangements, offer them the provision of a prepayment meter.

1.20 The licensee should avoid, as far as is practicable, the disconnection of premises where customers are having payment difficulties.

*Special conditions*

1.21 Special Conditions<sup>45</sup> relate to the current price regulation with which each ex-PES supply business must comply. Since April 2000, ex-PES supply businesses are restricted on the weighted-average unit-price chargeable to non-Direct Debit customers on Standard Domestic and Domestic Economy 7, within their supply services area.<sup>46</sup>

1.22 For non-Direct Debit customers on all domestic tariffs neither the unit-rate nor the standing-charge can increase in real terms. These modifications set out clear guidelines relating to each ex-PES suppliers' permitted tariffs, and the relevant provisions that are required to be made, following the an approved amendment.

1.23 The special conditions relating to price controls, applicable to all ex-PES suppliers, will remain in force unless the licensee issues a disapplication request to the Authority. The Authority may agree, in writing, to this request, or make a reference to the Competition Commission. If a recommendation is made by the Competition Commission that the charge restriction conditions are no longer necessary, the licensee can, by notice to the Authority, cause them to cease to have effect.

1.24 Prior to 1 October 2001, Scottish Power UK plc and SSE plc were vertically integrated companies with Scottish generation, transmission, distribution and supply activities held together under a single composite licence ("the composite licence"). By virtue of the licensing and transfer schemes, from 1 October 2001,

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<sup>45</sup> Special Condition B except for SSE Energy Supply Ltd (Condition D in the Southern area, Condition I in the Scottish Hydro Area), South Wales Electricity Ltd (Condition O) and Scottish Power Energy Retail Ltd (Condition C in the Manweb area, Condition H in the Scottish Power area).

<sup>46</sup>The cap applies to the weighted average unit price of the Standard Domestic and E7 tariffs (in pence/kWh) and covers generation, transmission, distribution, supply costs, Fossil Fuel Levy, and a margin for profit.

these companies demerged into separately licensed legal entities, responsible for supply, generation, transmission and distribution activities.

### **Competition law**

- 1.25 The Authority has concurrent powers with the Director General of Fair Trading to enforce the Competition Act 1998 and the Fair Trading Act 1973 in the gas and electricity sectors.
- 1.26 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 can be required to take remedial action and may face a fine of up to 10% of UK group turnover for each year of the infringement, up to a maximum of 3 years.
- 1.27 The Office of Fair Trading ('OFT') and the sector regulators have developed guidelines to explain how they will apply the Act<sup>47</sup>. In March 2001, Ofgem and the OFT formally issued a guideline explaining how they will apply the Act to the gas and electricity sectors<sup>48</sup>.
- 1.28 Ofgem believes that with the development of the gas and electricity markets, the powers available under the Competition Act will provide customers sufficient protection in relation to prices charged to customers through the prohibition, the restriction or distortion of competition and the abuse of a dominant position. Chapter 5 sets out how Ofgem would regulate using Competition law.
- 1.29 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.

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<sup>47</sup> Copies of these guidelines can be found on the OFT website at [www.ofg.gov.uk](http://www.ofg.gov.uk)

<sup>48</sup> "Competition Act 1998, Application in the Energy Sector" Ofgem and OFT, March 2001

## Appendix 2 Current retail price regulation

- 2.1 This appendix considers the current retail price regulation on the ex-PES suppliers and BGT. It summarises the form, scope, duration and level of the controls.
- 2.2 If more detail is required, copies of licences (which contain existing price control conditions) are available in Ofgem's library (library@ofgem.gov.uk) and can be viewed by appointment.

### *Electricity*

- 2.3 Electricity price controls are set out in Special Conditions<sup>49</sup> of the supply licences of the ex-PES suppliers.

### **Form of Control**

- 2.4 Ex-PES suppliers are obliged to offer Standard Domestic and Domestic Economy 7 supply to any domestic<sup>50</sup> consumer that wants it. The company cannot vary the terms and conditions of these contracts without the consent of the Authority.
- 2.5 Current price controls on the ex-PES suppliers take the form of a restriction on the weighted average unit price they can charge to Standard Domestic customers and the weighted average unit price they can charge to Domestic Economy 7 customers within their supply services area.
- 2.6 Supplementary restrictions require that the individual components of the charge cannot increase faster than the retail price index.
- 2.7 An additional restriction limits the amount by which charges for in-area customers supplied on a PrePayment contract can exceed the corresponding charges to customers supplied on a credit contract. This restriction is a £15 maximum surcharge, except in the Eastern and Scottish Hydro regions where the surcharges are £11.22 and £0 respectively.

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<sup>49</sup> Special Condition B except for SSE Energy Supply Ltd (Condition D in the Southern area, Condition I in the Scottish Hydro Area), South Wales Electricity Ltd (Condition O) and Scottish Power Energy Retail Ltd (Condition C in the Manweb area, Condition H in the Scottish Power area).

<sup>50</sup> A domestic customer is a customer taking supply at a premise where such supply is to be used wholly or mainly for domestic purposes.

## Scope

- 2.8 Price controls apply to all ex-PES suppliers who have supply services obligation, for particular areas, regardless of the name the company uses when supplying the domestic customer<sup>51</sup>.

## Duration

- 2.9 Ofgem introduced the current electricity retail price controls from April 2000. The price controls run indefinitely, until a modification of the licence condition changes or removes the restrictions.

## Level

- 2.10 For an average-consumption domestic consumer<sup>52</sup> the main restrictions for the financial year 2001/02 are set out in Table A2.1.

Table A2.1

Company	Region	Restriction £ <i>per annum</i>	
		Standard Domestic	Economy 7
London Electricity	London	239	347
	SWEB	257	370
Npower	Midlands	236	342
	Northern	243	343
	Yorkshire	232	342
Powergen	East Midlands	230	338
Scottish Power Energy Retail	Manweb	251	371
	Scottish Power	265	387
Seeboard	Seeboard	229	337
SSE Supply	Scottish Hydro	261	383
	Southern	243	347
	Swalec	271	380
TXU Energi	Eastern	224	330
	Norweb	232	335

<sup>51</sup> For instance if a company that owns two ex-PES supply businesses (ex-PES A and ex-PES B) has a customer in ex-PES area A in the name of ex-PES B the price control of ex-PES A would bind.

<sup>52</sup> Assumed to be 3,300kWh *per annum* for Standard Domestic and 6,600kWh *per annum* for Domestic Economy 7 (with 55% of Domestic Economy 7 consumption at night).

- 2.11 If costs relating to Generation, Supply or Transmission “increase substantially in the aggregate because of factors outside the licensee’s control” the Authority can issue a direction increasing the price caps.

### ***Gas***

- 2.12 Gas price controls are set out in Special Condition 3 of BGT’s gas supply licence.

### **Form**

- 2.13 BGT is subject to relative price regulation. This is a restriction on the amount that the PrePayment Late Pay tariff can exceed the PromptPay and Direct Debit tariffs.

- 2.14 BGT’s relative price regulation implies an additional restriction that the charges for supply on PrePayment terms and on Late Payment terms must be equal.

- 2.15 If BGT wishes to introduce new types of tariff it must obtain the consent of the authority.

### **Scope**

- 2.16 Price controls apply nationally and apply to all domestic consumers although the price control only prevents relative increases in prices for those supplied on PrePayment and late payment terms.

### **Duration**

- 2.17 Ofgem introduced the current price regulation on BGT from April 2001.
- 2.18 The price regulation runs indefinitely, however from January 2002 BGT can ask the Authority to ‘disapply’ the price control. Price controls will cease to apply four-months after BGT’s request unless, within two-months<sup>53</sup> of the request, the Authority informs BGT that it will not allow the disapplication and explains its reasons.

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<sup>53</sup> If, within one-month of the disapplication request, the authority asks BGT for further information to allow it to determine whether to permit the disapplication, this two-month period is extended by the time it takes BGT to provide the information.



## Level

2.19 Table A2.2 summarises the restrictions on BGT's charges.

**Table A2.2**

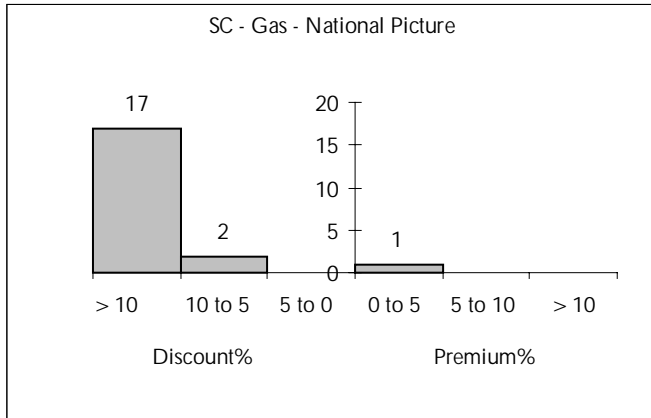
	p/kWh	
	Direct Debit	Prompt Pay
Up to 1143 kWh per quarter	0.556	0.719
Over 1143 kWh per quarter	0.046	0.000

## **Appendix 3 Number of gas and electricity suppliers offering discounts**

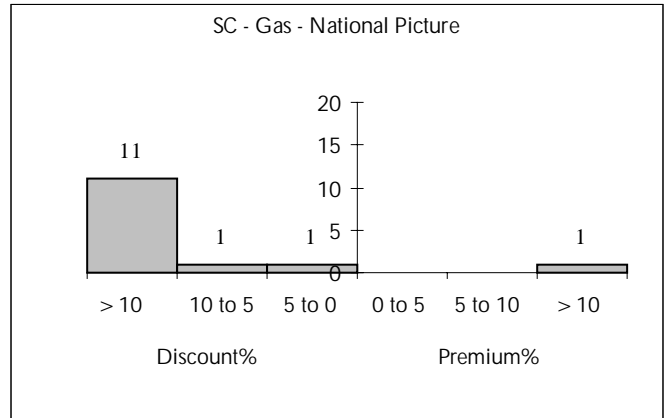
3.1 Appendix 3 contains a number of histograms that summarise, over ranges of discounts, the number of suppliers offering discounts or premiums compared with BGT or ex-PES suppliers. The histograms show discounts by payment method, and, for electricity, by region. They compare the position in October 2000 with the position in October 2001.

Number of suppliers offering discounts to gas standard credit (SC) customers

October 2000

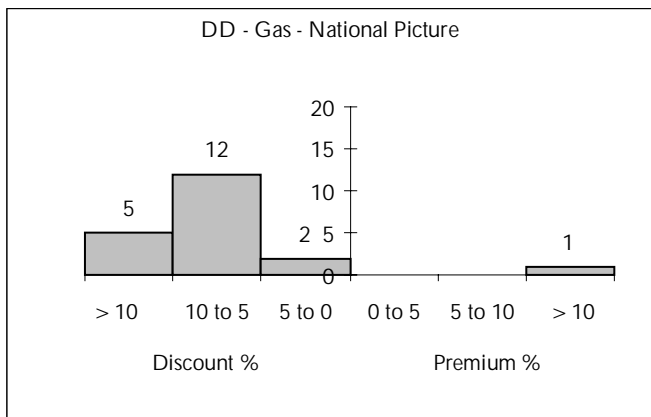


October 2001

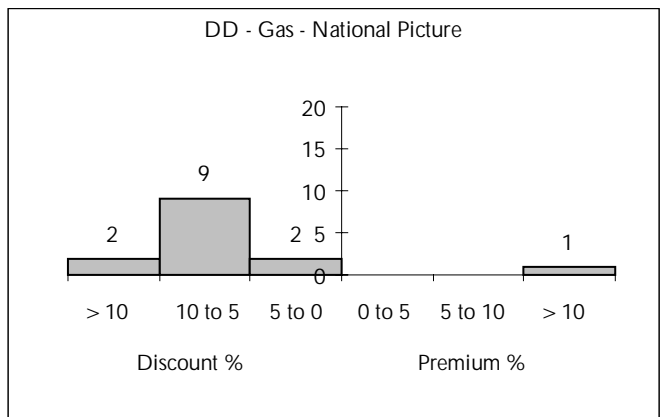


Number of suppliers offering discounts to gas direct debit (DD) customers

October 2000

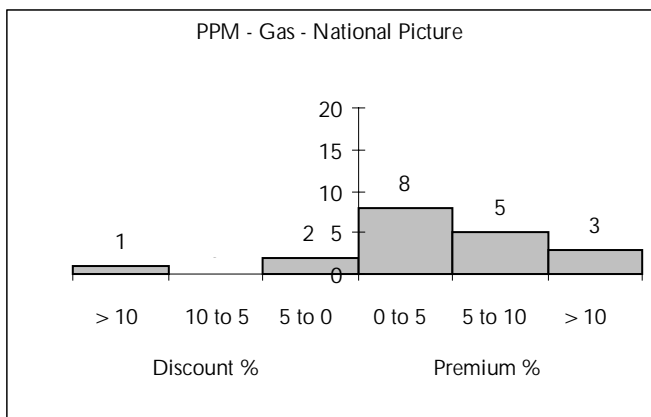


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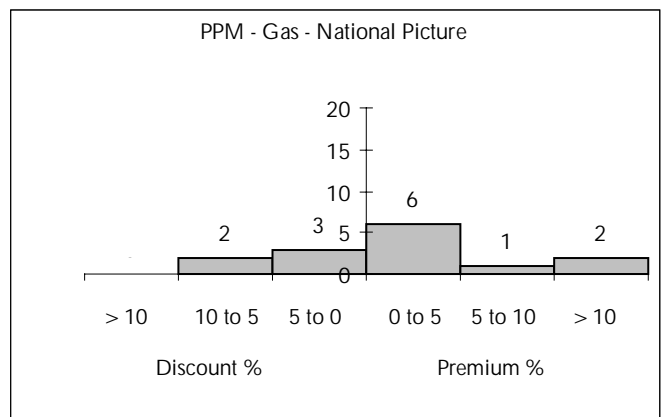


Number of suppliers offering discounts to gas prepayment (PPM) customers

October 2000



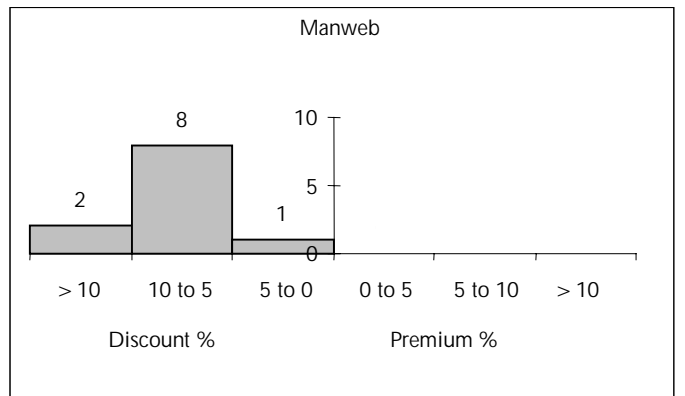
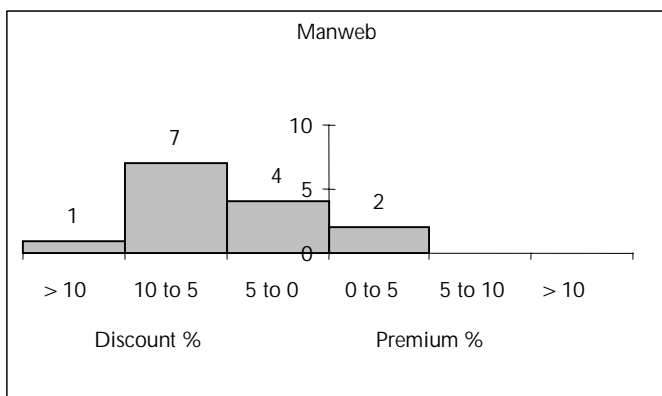
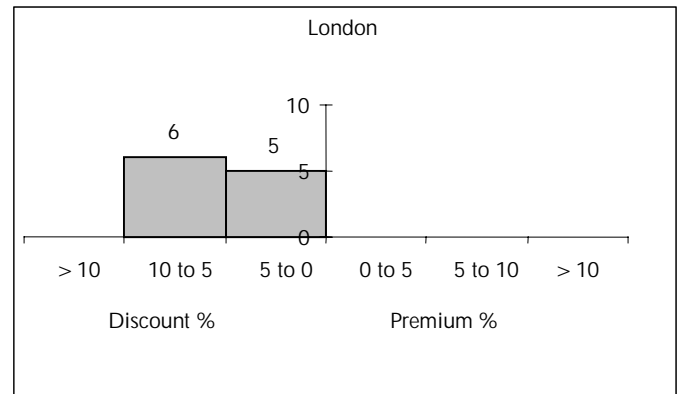
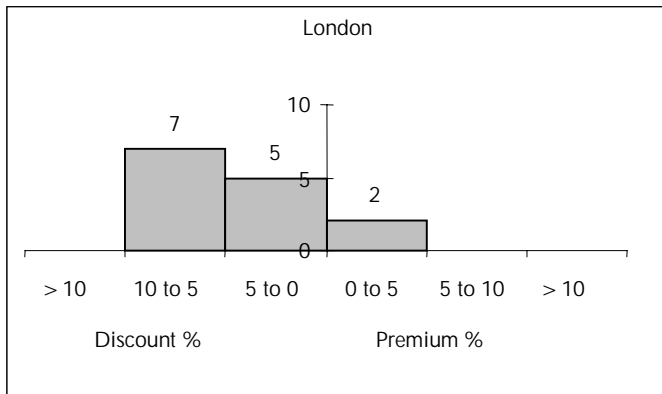
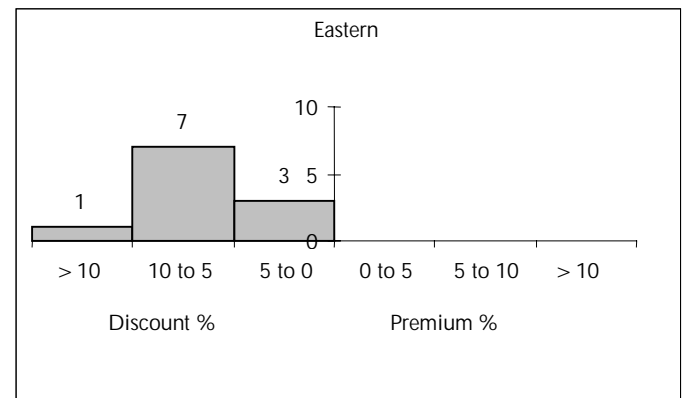
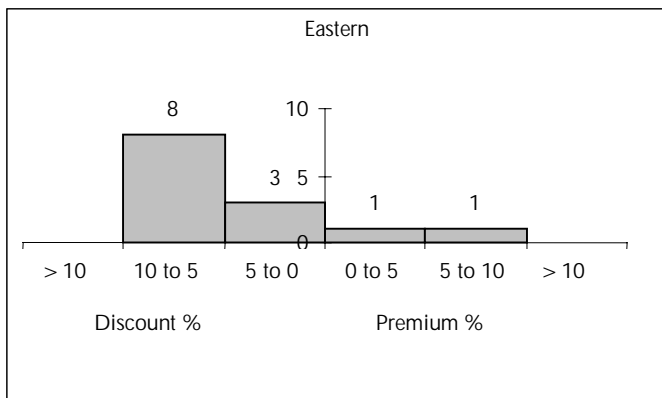
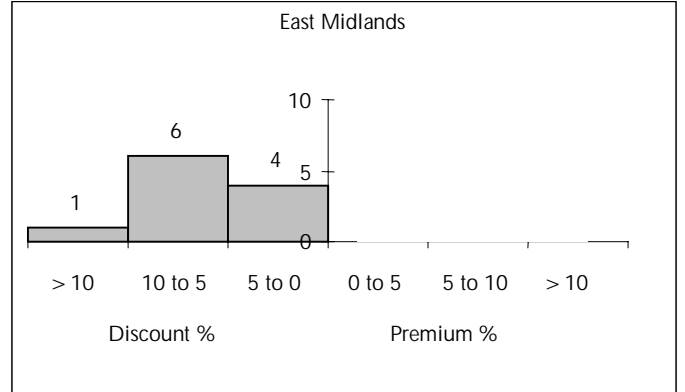
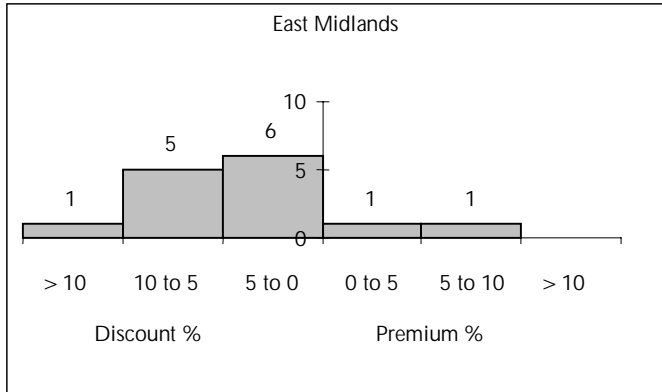
October 2001



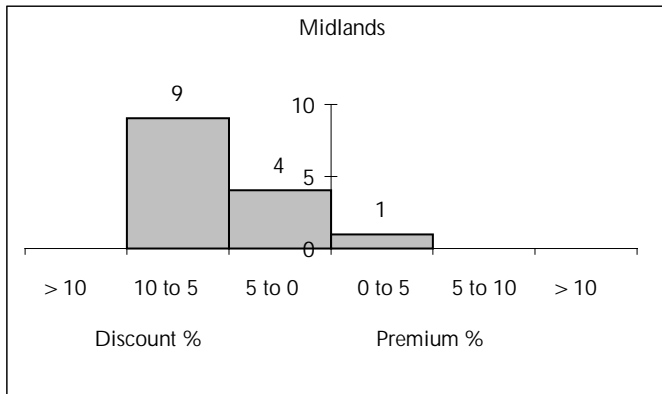
Number of suppliers offering discounts to standard credit (SC) customers

SC October 2000

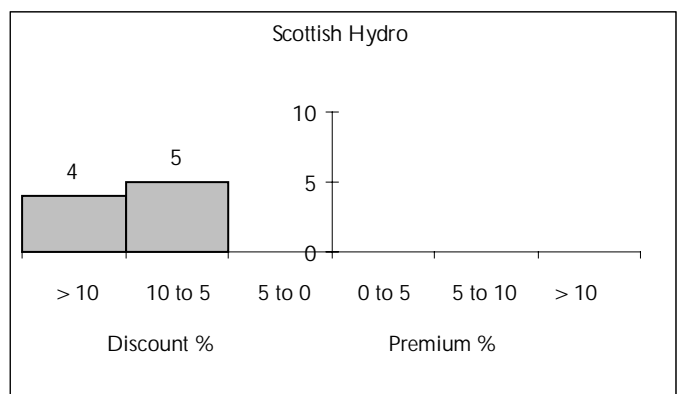
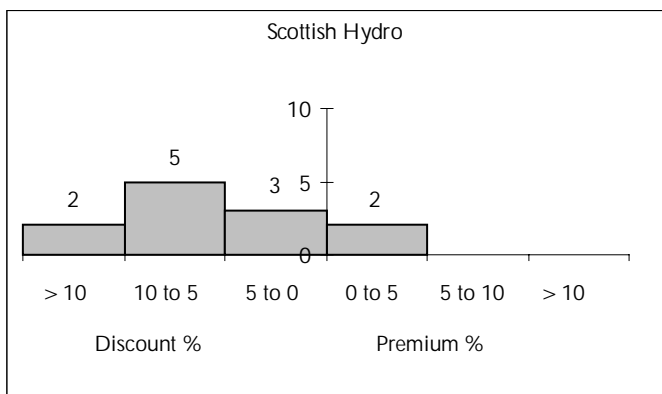
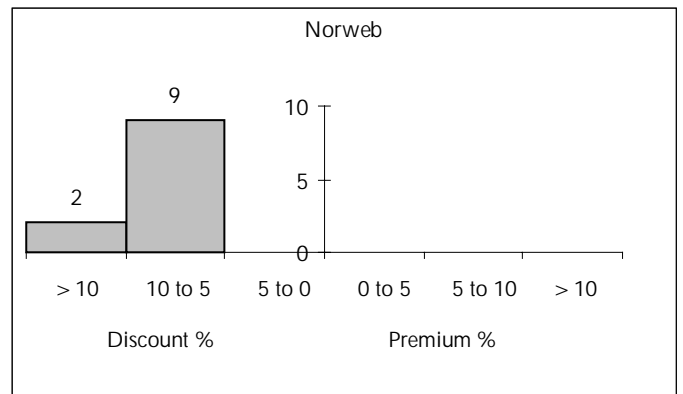
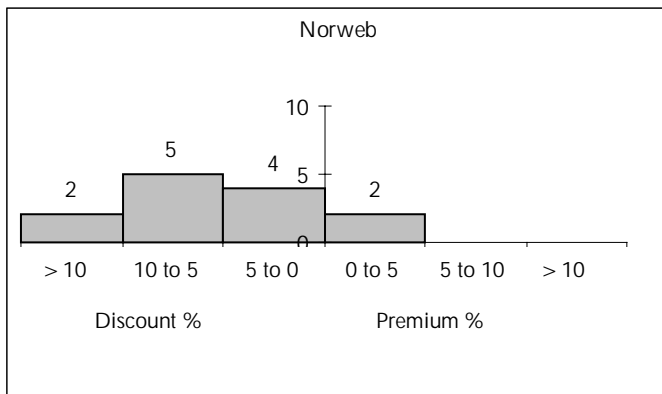
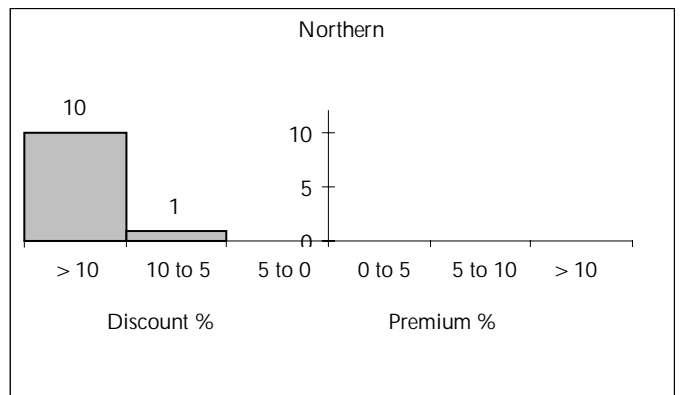
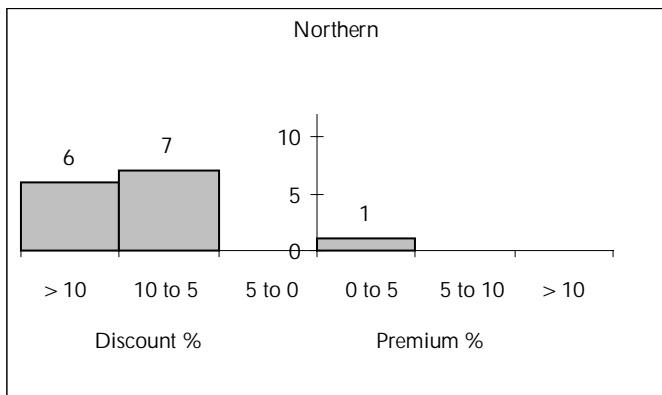
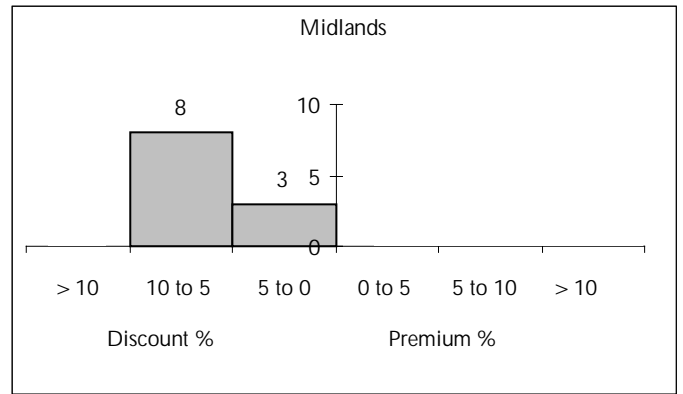
SC October 2001



SC October 2000



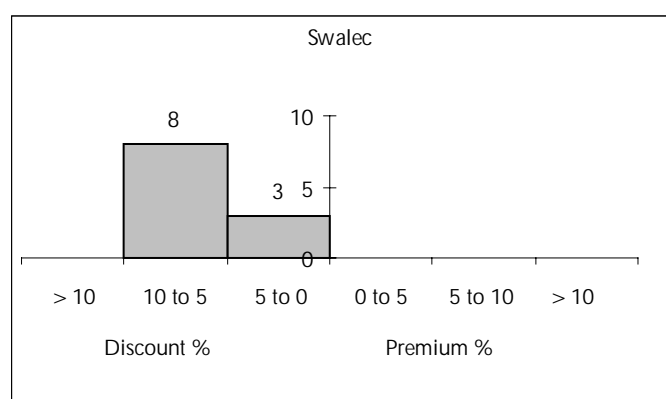
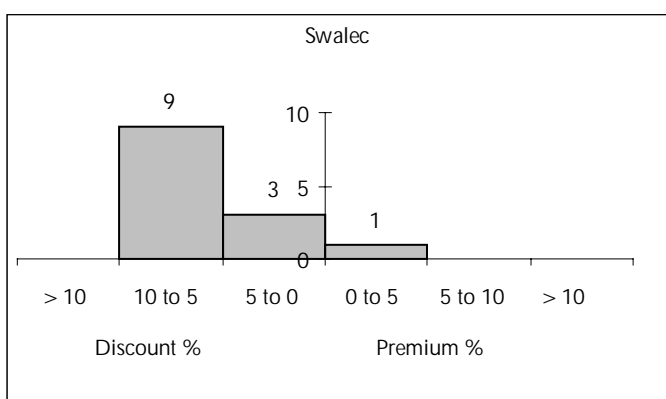
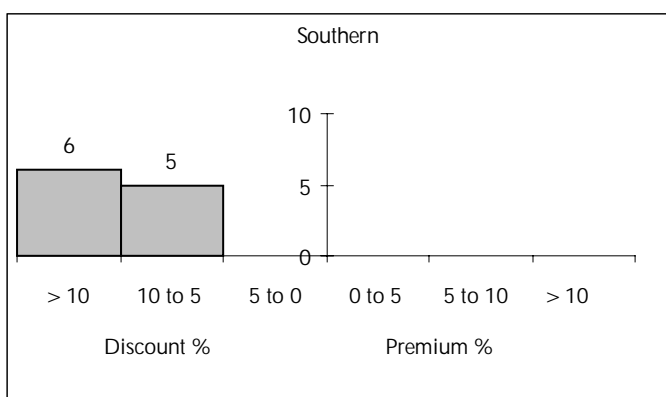
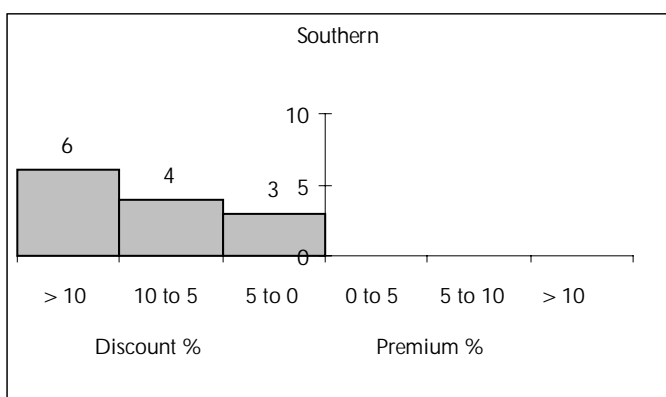
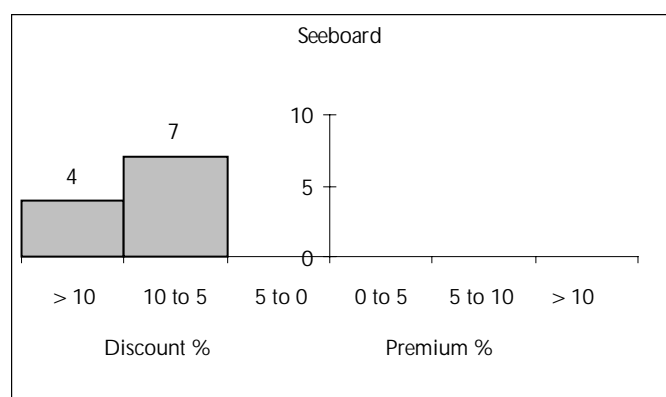
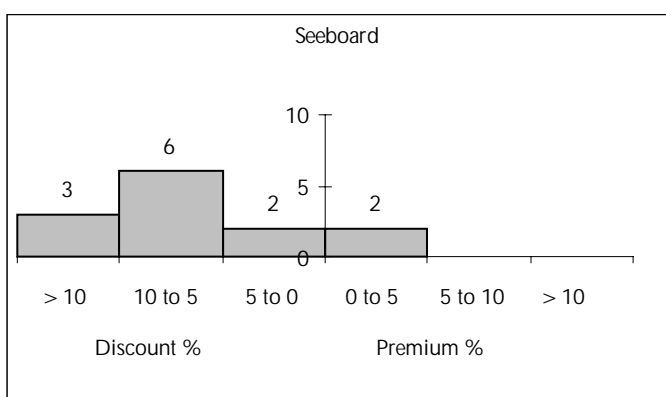
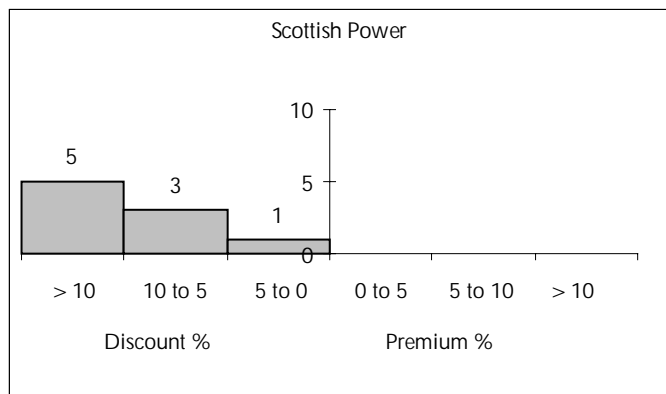
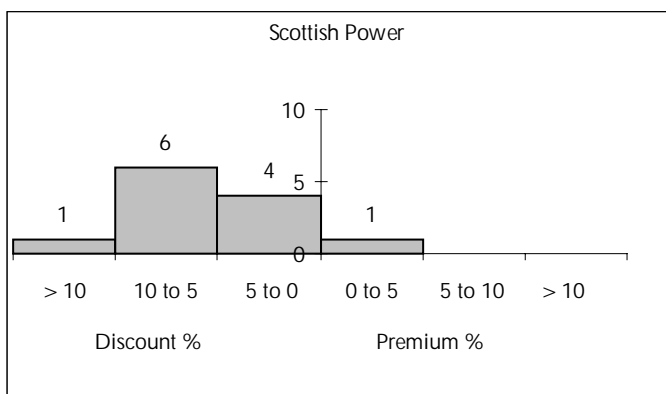
SC October 2001



Number of suppliers offering discounts to standard credit (SC) customers (continued)

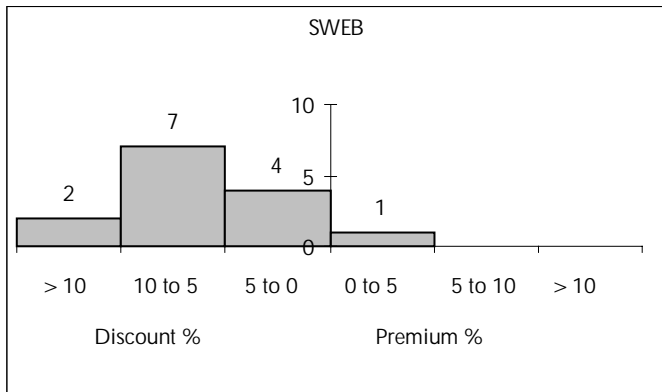
SC October 2000

SC October 2001

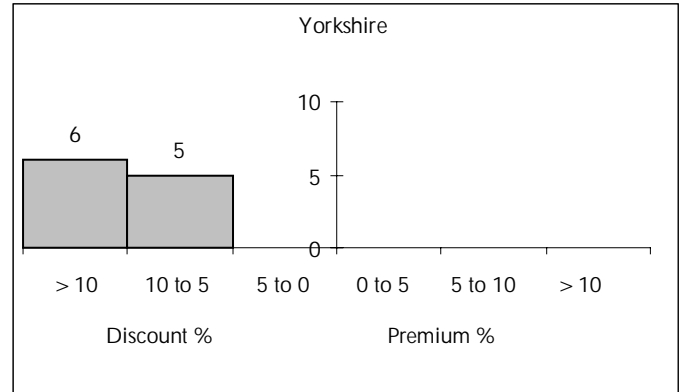
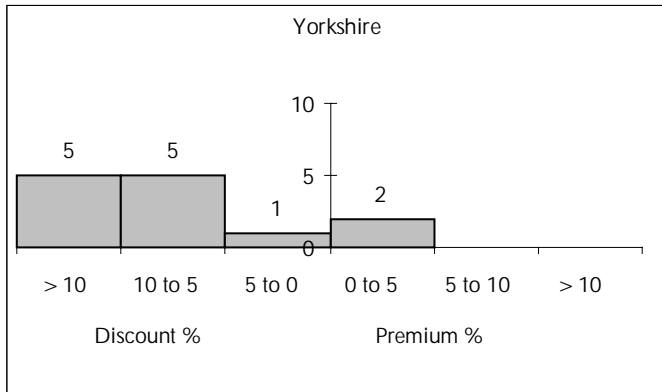
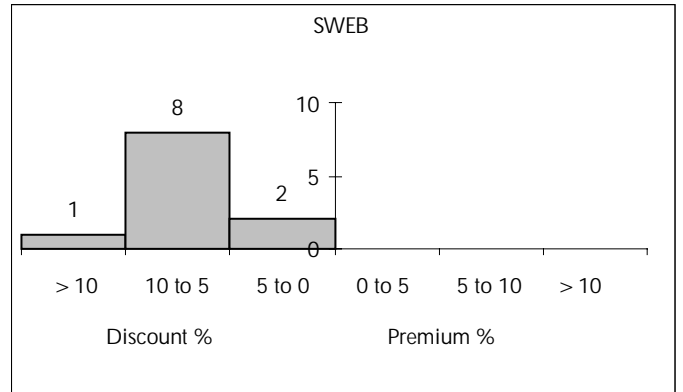


Number of suppliers offering discounts to standard credit (SC) customers (continued)

SC October 2000

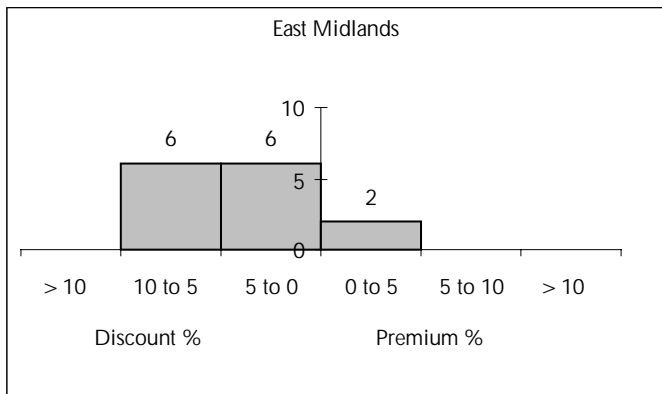


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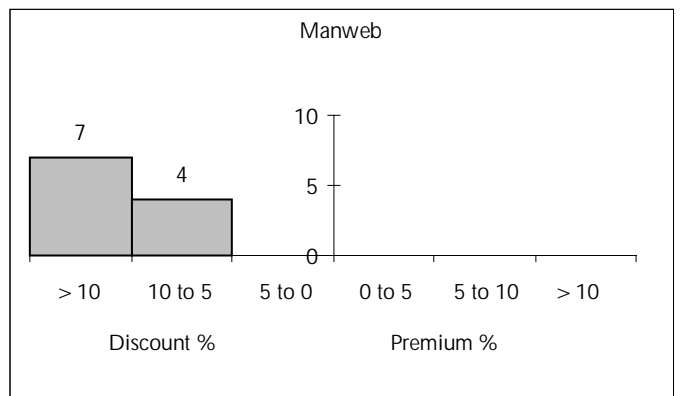
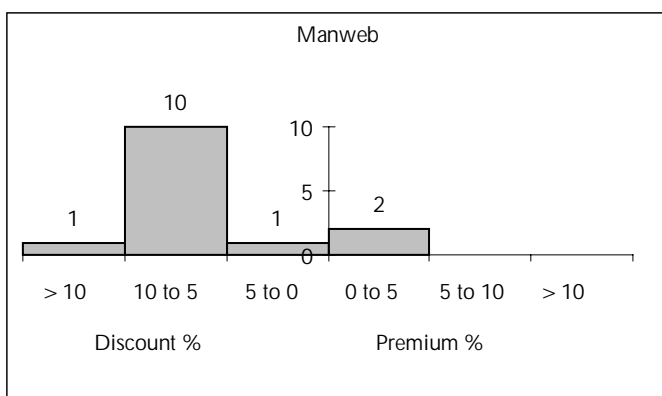
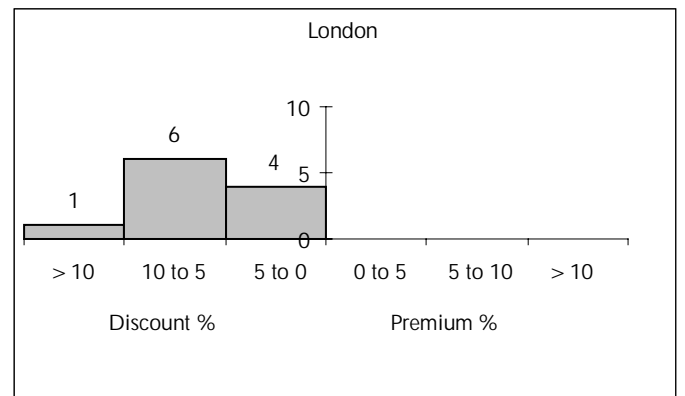
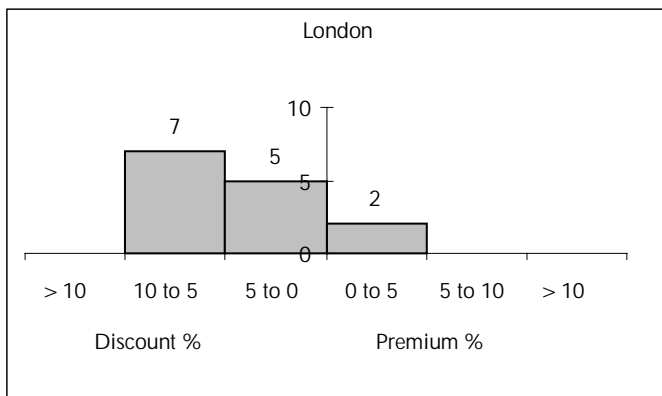
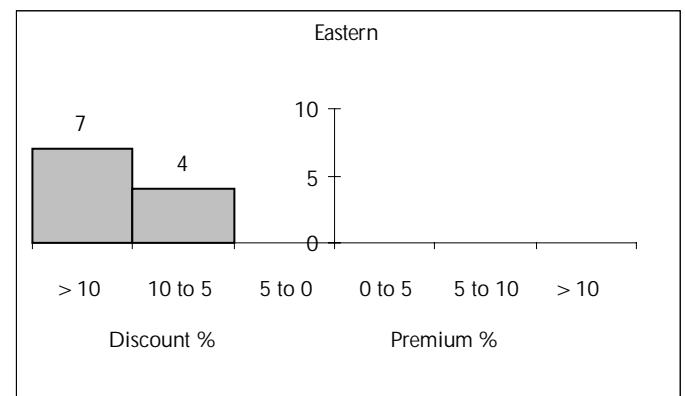
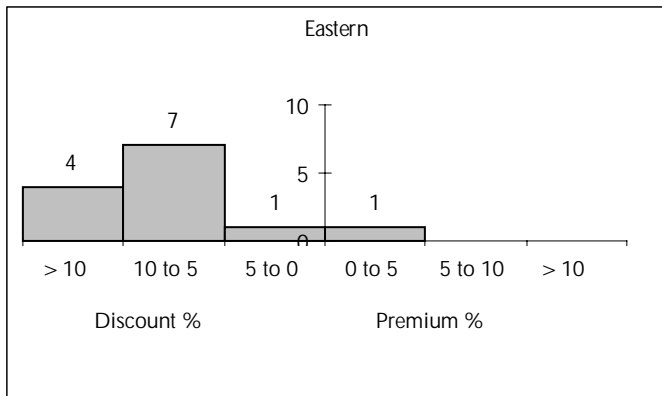
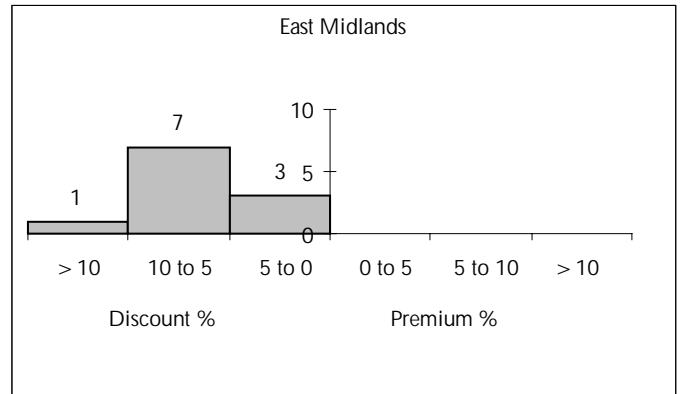


Number of suppliers offering discounts to direct debit (DD) customers

DD October 2000



DD October 2001

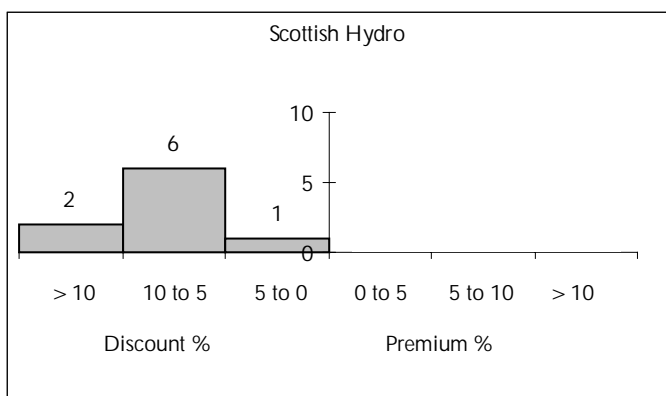
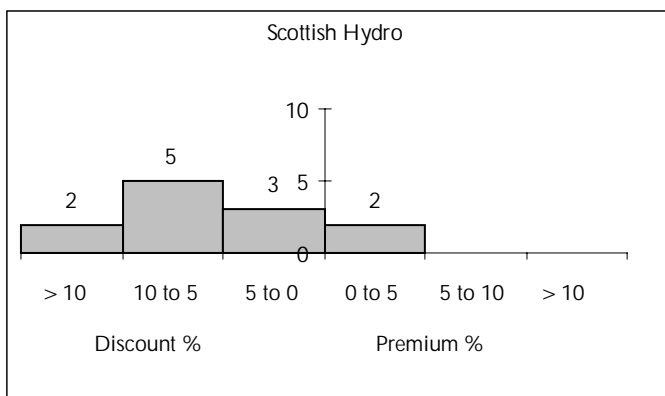
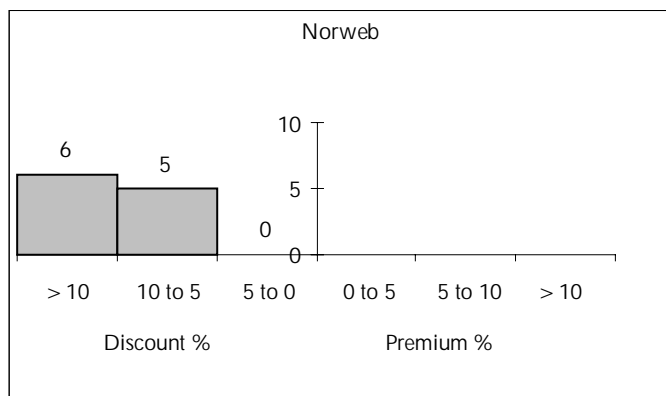
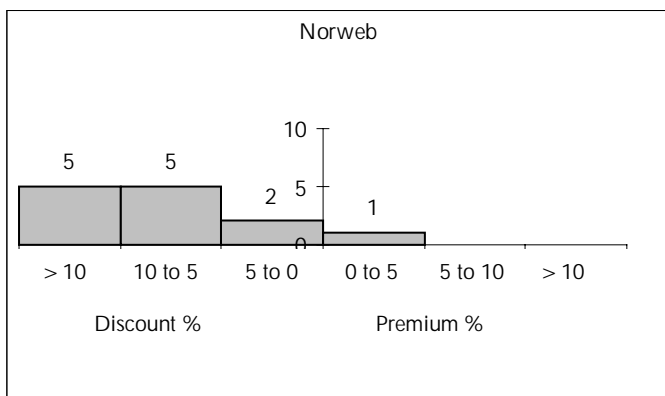
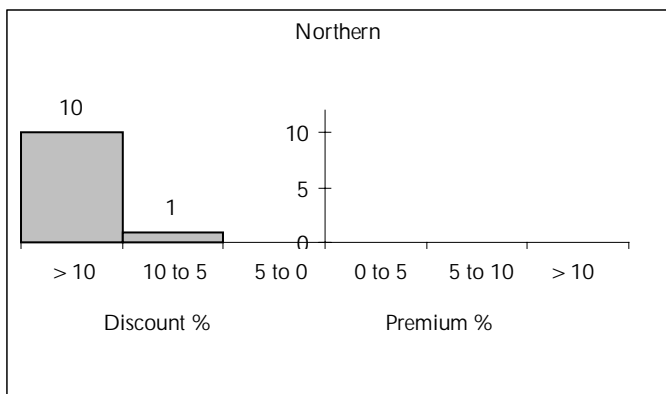
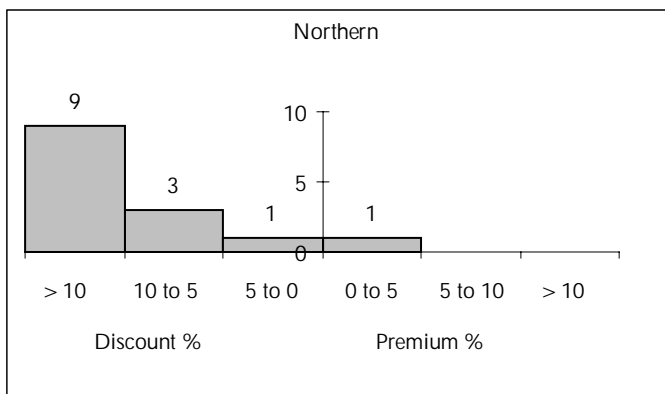
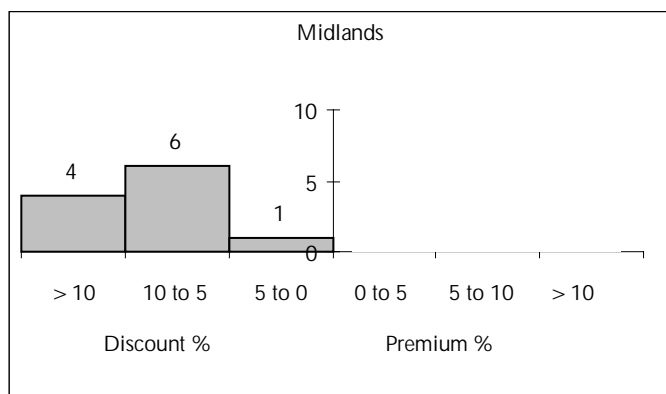
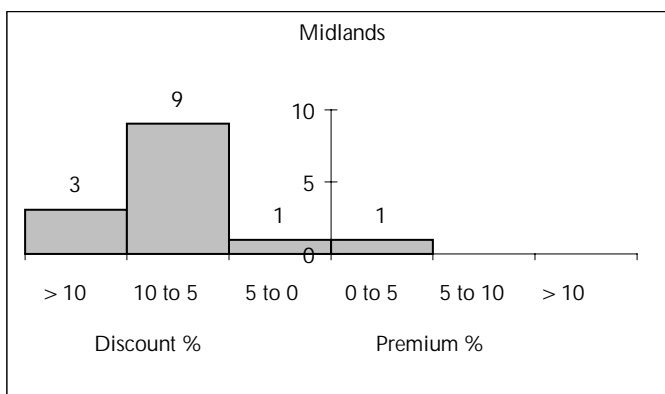




Number of suppliers offering discounts to direct debit (DD) customers (continued)

DD October 2000

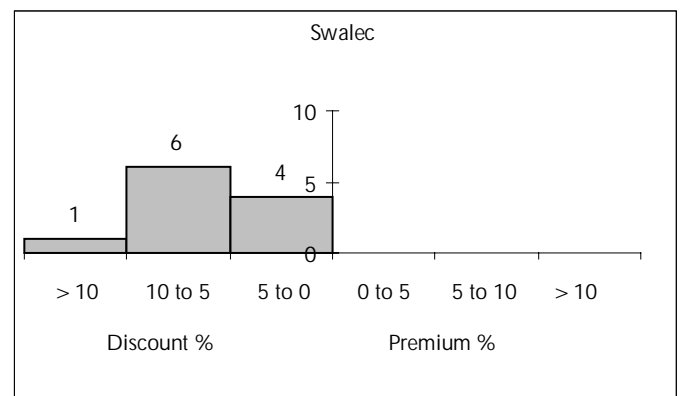
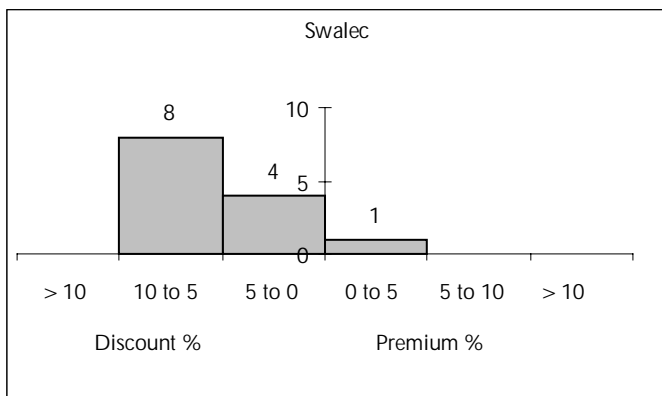
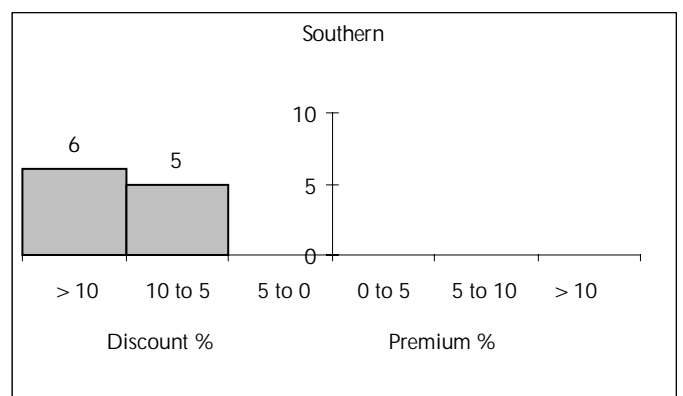
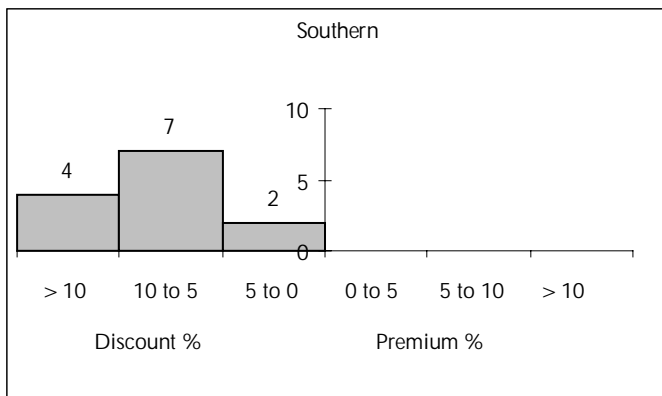
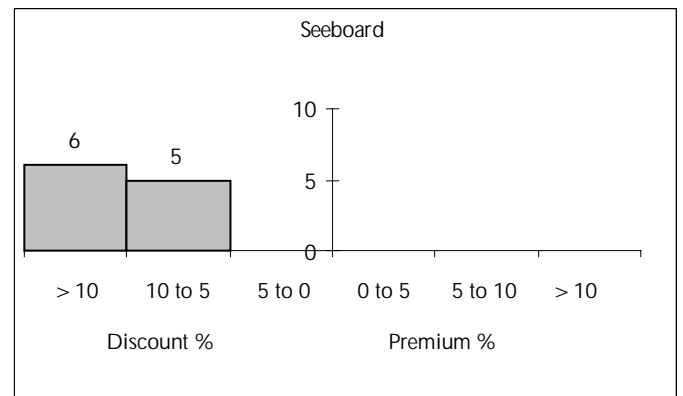
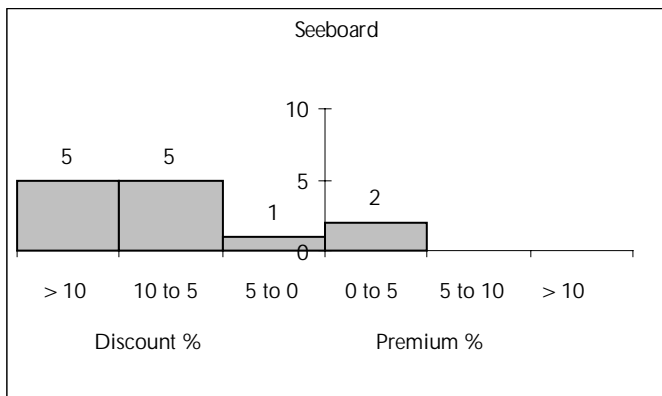
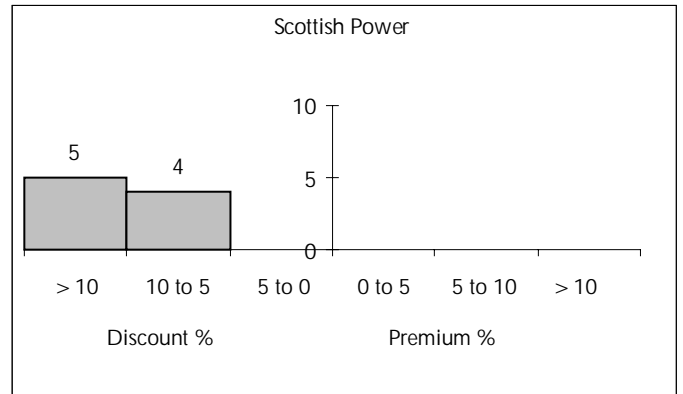
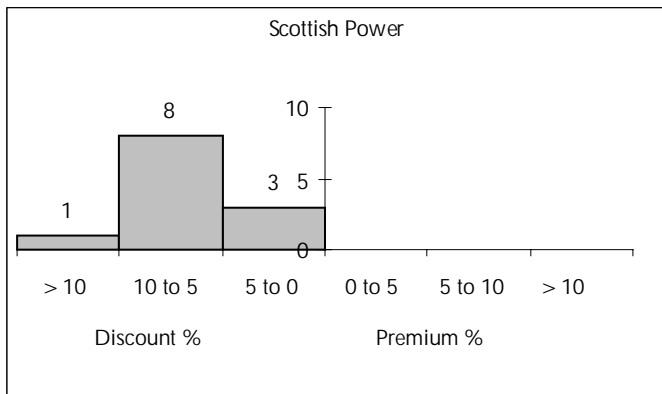
DD October 2001



Number of suppliers offering discounts to direct debit (DD) customers (continued)

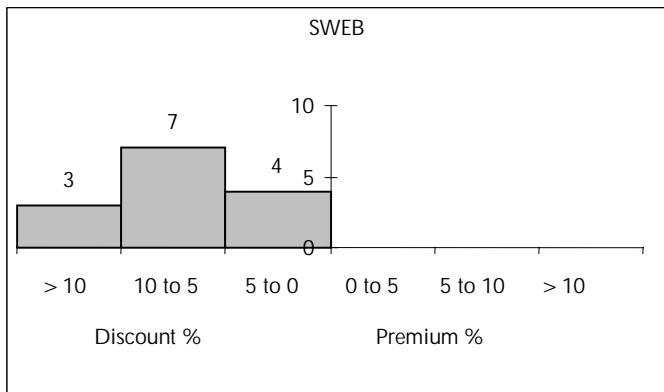
DD October 2000

DD October 2001

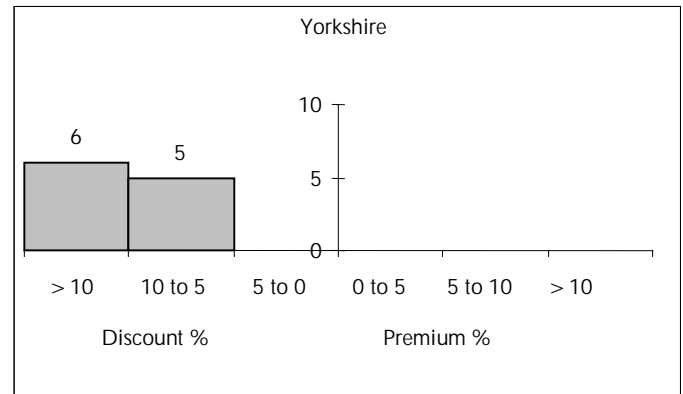
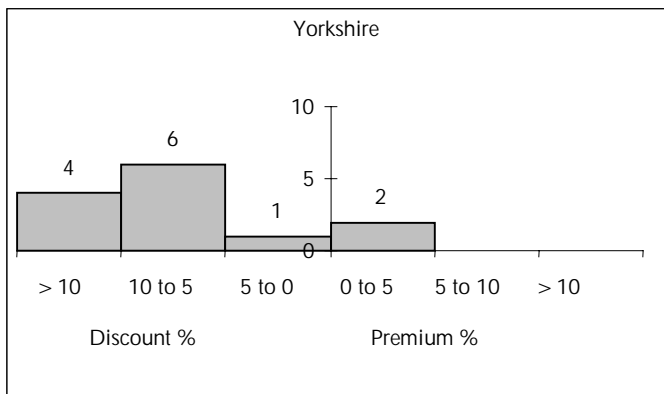
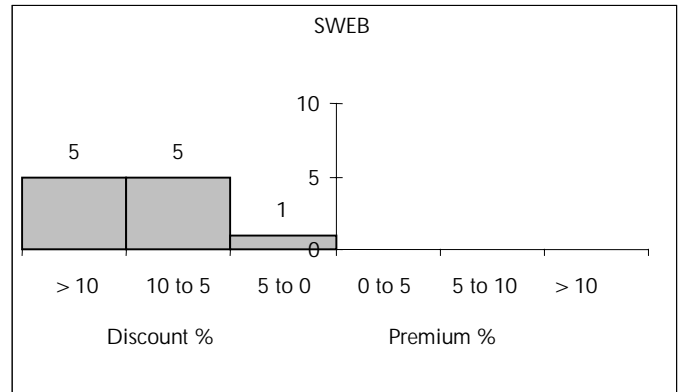


Number of suppliers offering discounts to direct debit (DD) customers (continued)

DD October 2000

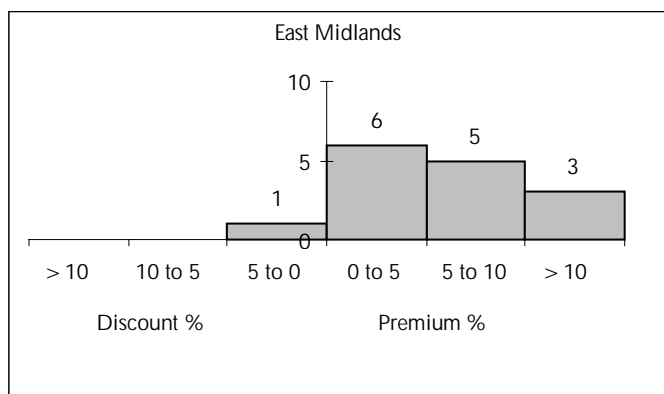


DD October 2001

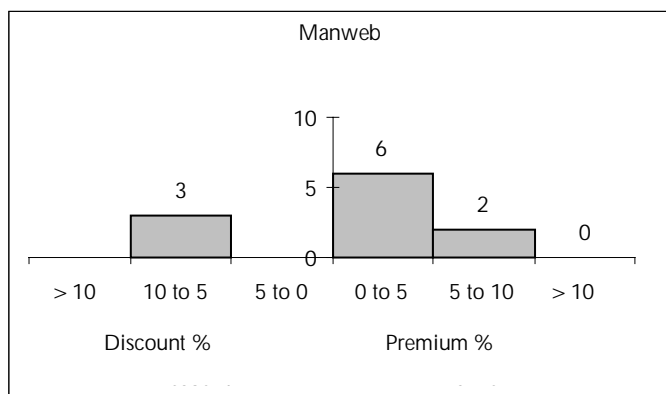
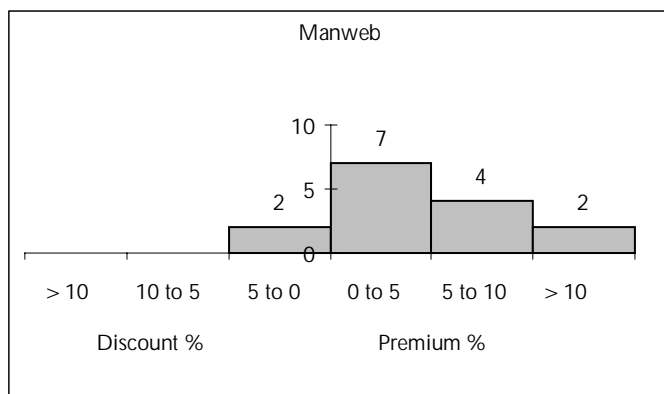
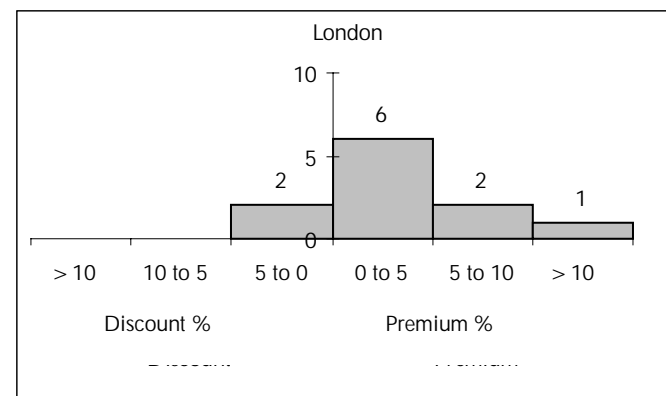
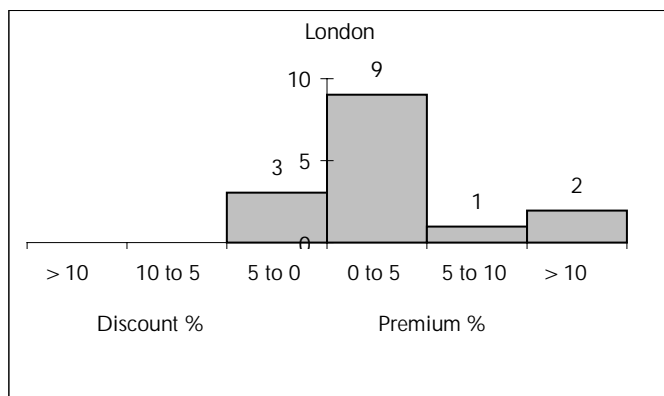
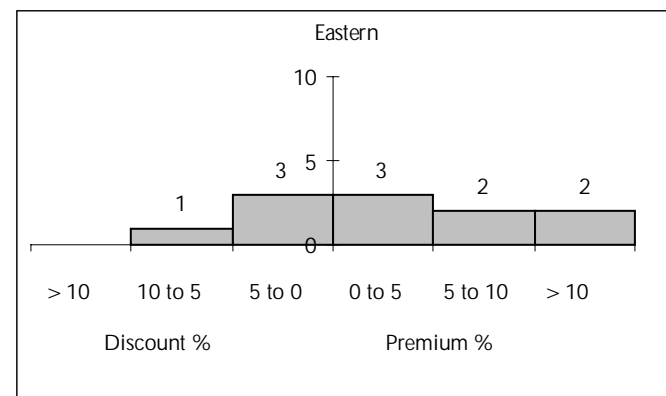
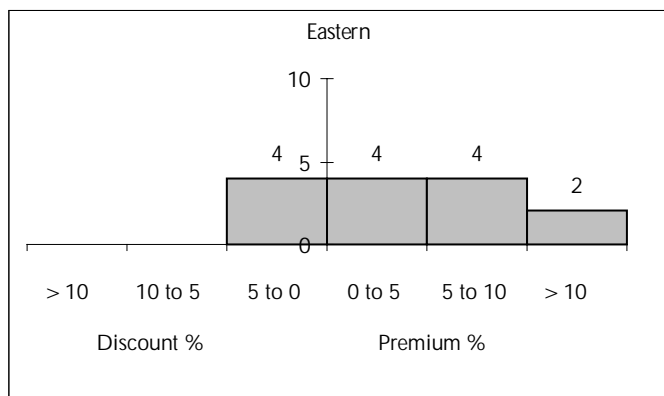
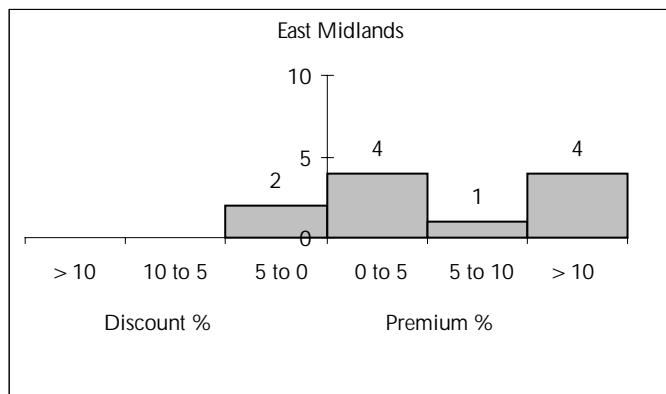


Number of suppliers offering discounts to prepayment (PPM) customers

PPM October 2000



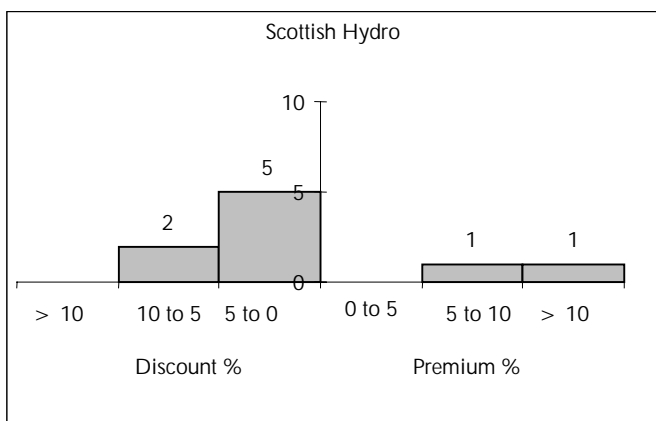
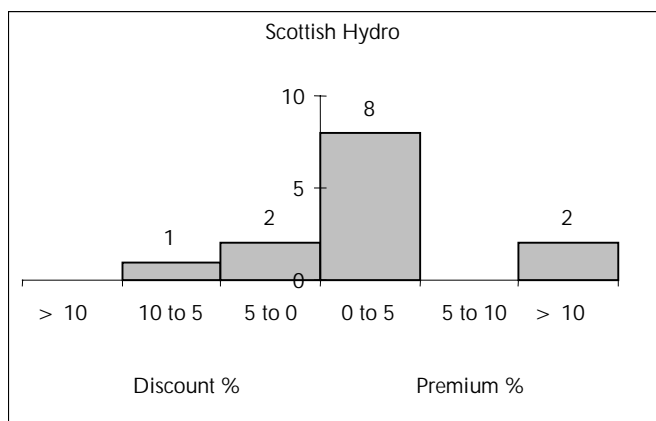
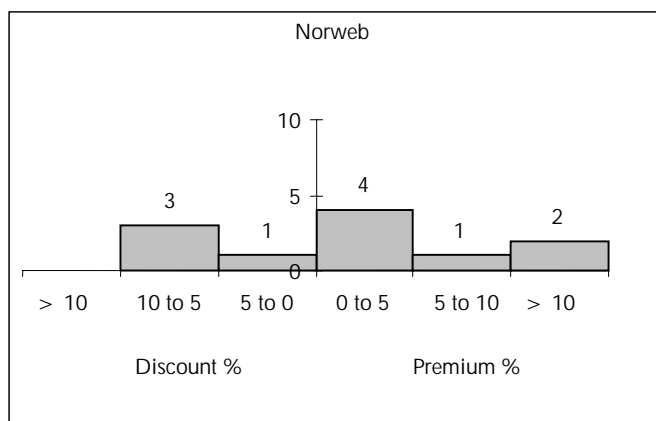
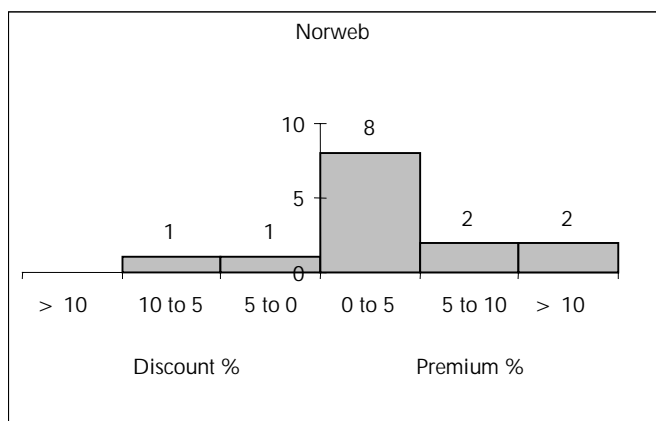
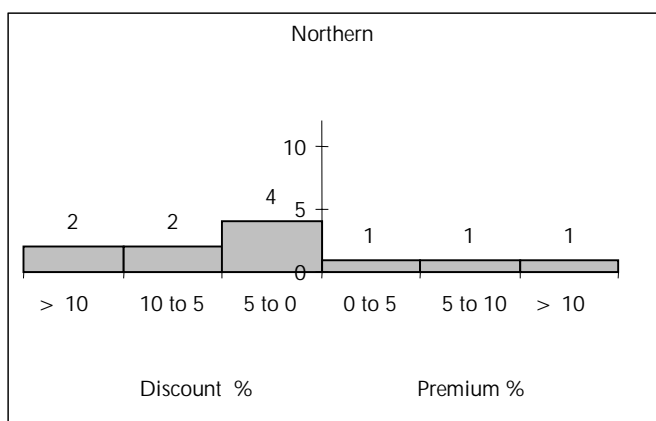
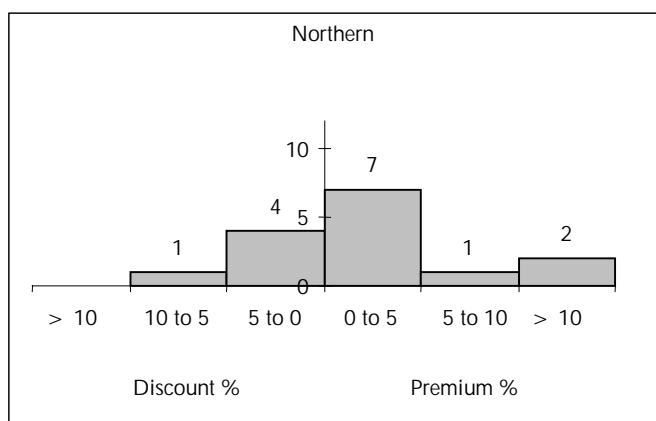
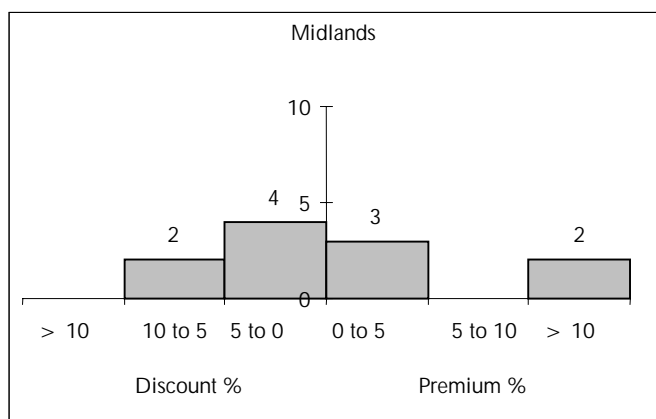
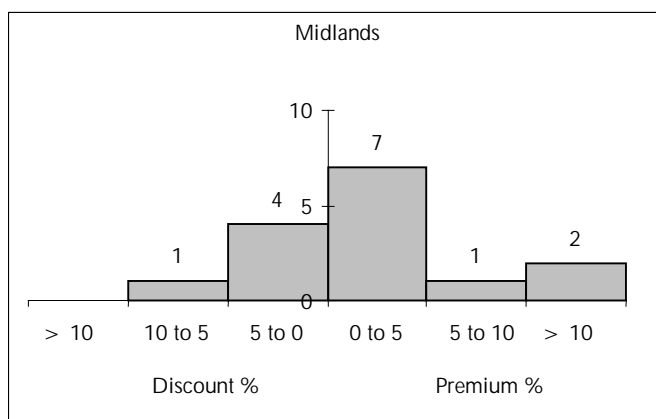
PPM October 2001



Number of suppliers offering discounts to prepayment (PPM) customers (continued)

PPM October 2000

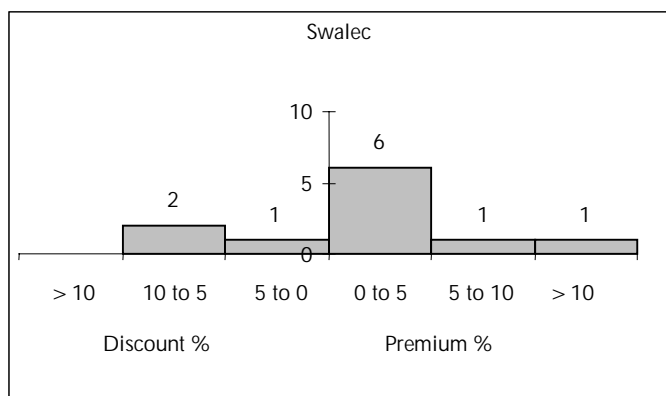
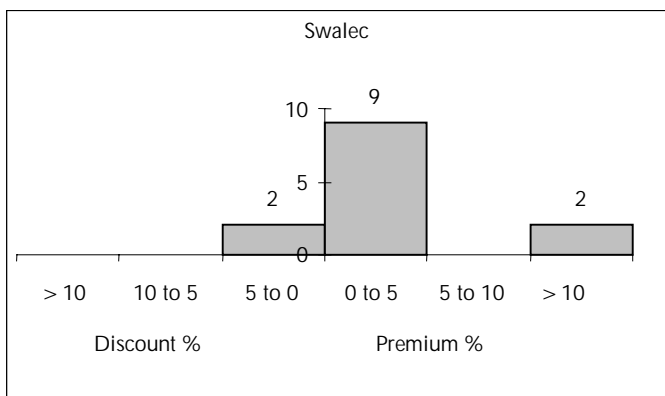
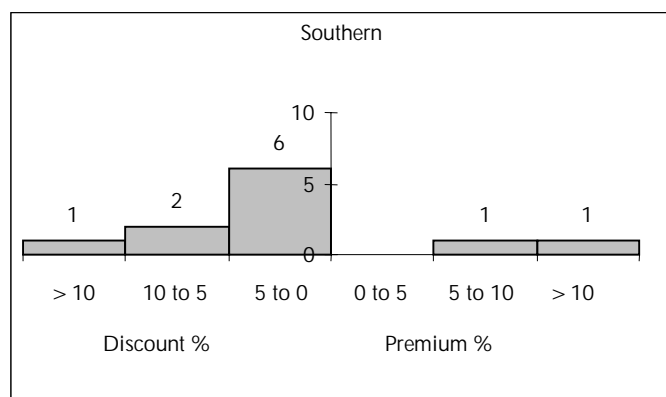
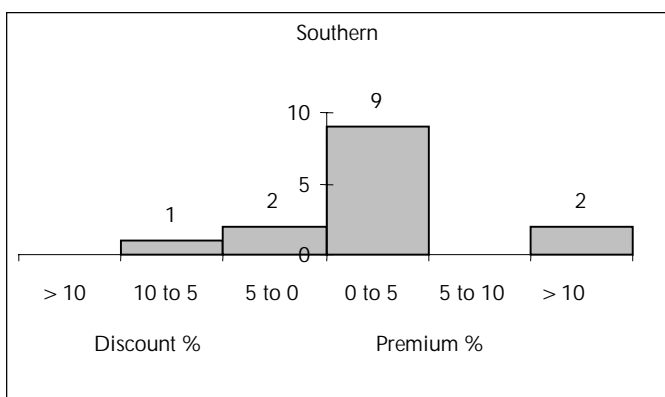
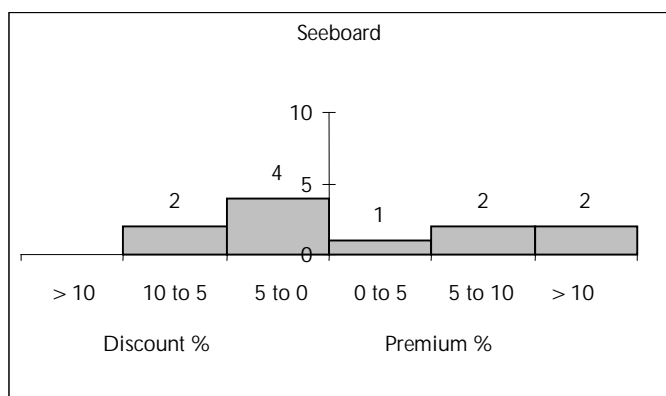
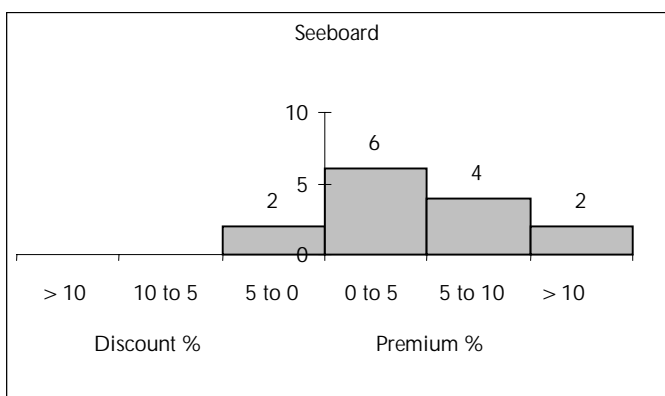
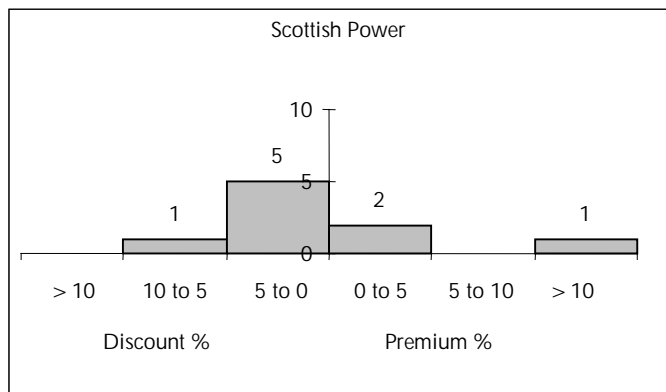
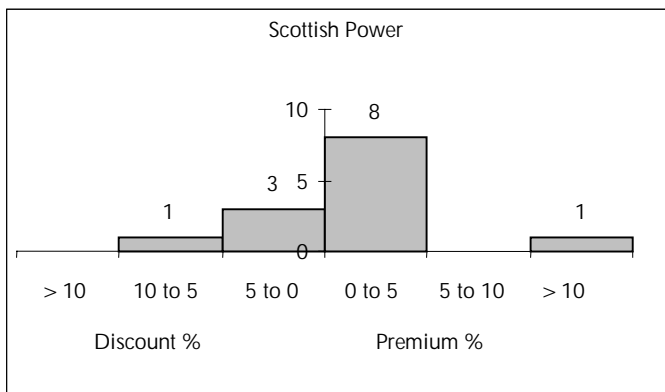
PPM October 2001



Number of suppliers offering discounts to prepayment (PPM) customers (continued)

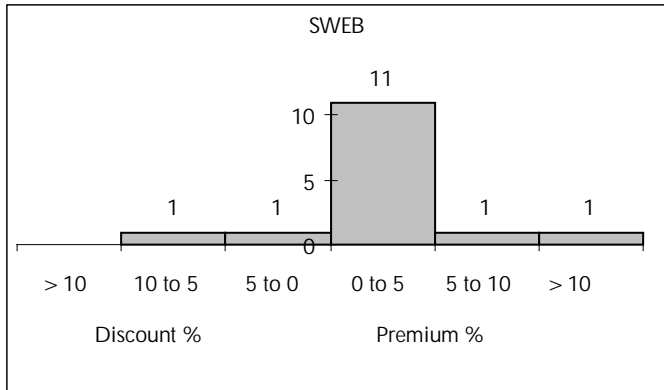
PPM October 2000

PPM October 2001

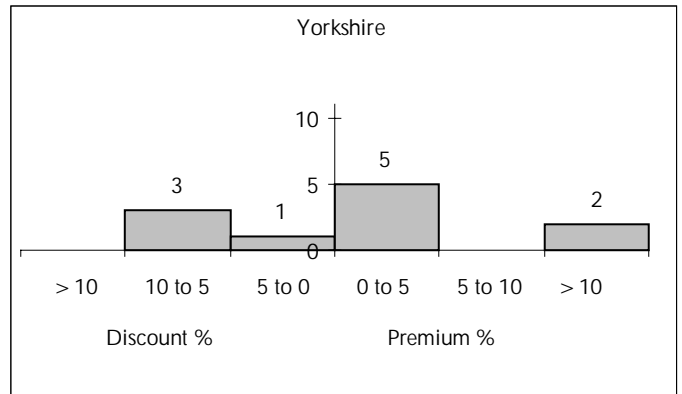
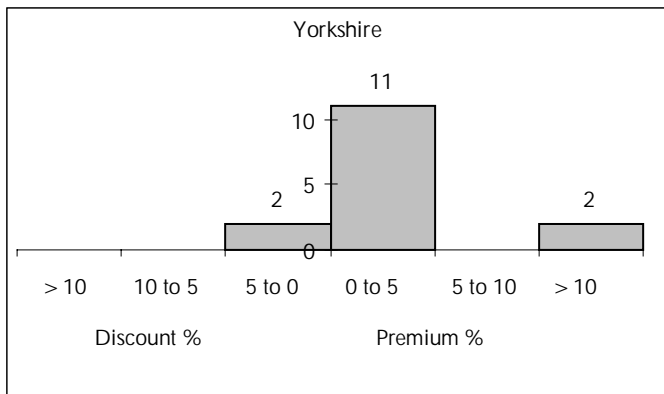
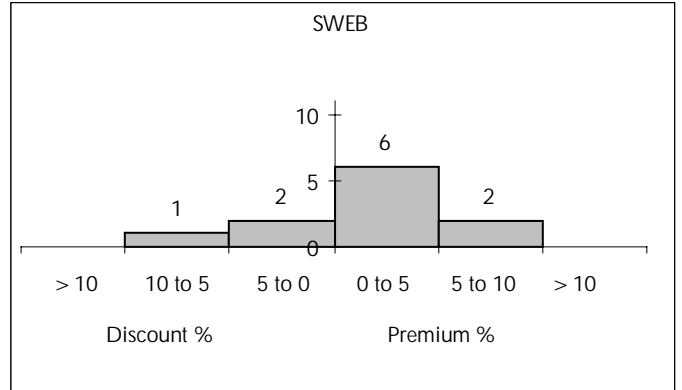


Number of suppliers offering discounts to prepayment (PPM) customers (continued)

PPM October 2000



PPM October 2001



## Appendix 4 Standards of Performance in gas and electricity supply

4.1 Prescribed standards of service were incorporated into BGT's and the ex-PES supply companies' licences to protect the interests of consumers in the absence of competition. In October 2000, Ofgem reviewed the guaranteed and overall standards of performance that were contained in gas and electricity supply licences. The document outlined proposals for the removal of a number of standards in gas and electricity, including proposals for standards in supply<sup>54</sup>. After consultation, Ofgem concluded in January 2000 that in a market where competition is firmly established there is a strong argument for discontinuation of prescribed standards of service<sup>55</sup>.

### *Gas*

4.2 BGT's voluntary standards of performance relate to the supply of gas, the accuracy of meter readings and the recovery of gas charges. In particular, BGT is required to establish standard of performance in regards to the making of visits to customers' premises and responses to complaints and enquiries made in person, by telephone, in writing or otherwise in respect of gas supply services.

4.3 As in electricity, the gas standards are split into those that attract fixed compensation and those that do not.

### *Electricity*

4.4 There are two remaining electricity supply standards which would face removal when supply price controls are discontinued. Both standards are related to the response time of suppliers to customer enquiries as opposed to the quality of service provided.

4.5 The first is a guaranteed standard of performance related to the time that it takes suppliers to respond to consumers' queries about charges and payments. Currently suppliers are required to provide a substantive reply and agreed

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<sup>54</sup> "Guaranteed and overall standards of performance, A consultation paper", Ofgem, October 2000

<sup>55</sup> "Guaranteed and overall standards of performance, Final proposals", Ofgem, January 2001



refunds within five working days. If these standards are not met, the supplier is obliged to compensate the affected consumer to the sum of £20.

- 4.6 The second is an overall standard of performance. This relates more generally to the services that suppliers provide and operates to ensure that all letters received by the company receive a response within 10 working days.