

**March 2001**

**Energy Efficiency Standards  
(2000 – 2002)**

**Guidance to gas and electricity  
companies on competition issues**

## Summary

Ofgem has set Energy Efficiency Standards for gas and electricity companies for 2000-2002 (SOP3). The Standards require companies to bring forward projects to improve the efficient use of gas and electricity with a strong emphasis on the needs of disadvantaged customers. SOP3 builds on the previous Standards set for Public Electricity Suppliers, which, the National Audit office concluded, had achieved a net present value saving of €250 million and comfort improvements worth €80 million between 1994 and 1998. Ofgem expects SOP3 to continue to deliver important energy efficiency improvements for customers.

This document contains guidance to companies on competition issues relating to SOP3. This follows and takes account of comments on a consultation paper on this subject which Ofgem issued in October last year. A list of respondents and a summary of their comments are annexed. Ofgem is keen to see the Standards carried out in ways which support the development of competition. The guidance is intended to help companies develop and implement their SOP3 programmes consistent with this objective.

### Rationale:

Companies and **EST** have previously sought reassurance from Ofgem over how they should organise their SOP programmes, and have raised queries about the regulatory position on particular scheme proposals. The rationale for this document is to give companies and other stakeholders guidance on competition issues which may arise in implementing SOP3.

The guidance covers:

- how **SOP3** projects are marketed and offered to customers;
- how far projects may be linked to energy supply contracts;
- how to ensure that projects provide good value for customers and are run competitively.

We are ready to discuss with companies and others the application of this guidance to particular cases, and our reaction to any specific issues raised during the consultation.

Ofgem intends to issue a separate note shortly on the implications for energy services of the licence requirement that customers should be free to change energy supplies on 28 days' notice.

## Table of contents

<b>1. Introduction and background .....</b>	<b>1</b>
<b>2. General approach.....</b>	<b>3</b>
<b>3. Marketing: own-supply and other customers .....</b>	<b>4</b>
<b>4. linking SOP3 offers to energy supply contracts .....</b>	<b>5</b>
<b>5. Customer tie-ins .....</b>	<b>7</b>
<b>6. Methods for targeting customers .....</b>	<b>8</b>
<b>7. Repeat grants etc .....</b>	<b>9</b>
<b>8. Ensuring good value .....</b>	<b>10</b>
<b>9. Approval procedures .....</b>	<b>12</b>
<b>Annex: list of respondents to October 2000 consultation paper</b>	

# 1. Introduction and background

- 1.1 Gas and electricity supply companies are subject to Energy Efficiency Standards of Performance set by Ofgem. The present Standards came into effect on 1 April 2000 and require the companies by 30 March 2002 to carry out projects which will achieve specific improvements in the efficient use of gas and electricity for customers. In order to achieve the Standards, investment of around £110 m is expected to be required. These funds will be raised mainly from gas and electricity customers. Companies are responsible, subject to Ofgem's approval, for decisions regarding the selection of projects, and for how projects are organised and managed.
- 1.2 Ofgem's responsibilities for protecting the interests of customers and promoting competition in gas and electricity supply require us to take appropriate steps to ensure that companies implement the Standards in ways which support competition and protect customers' interests. The present document proposes guidance aimed at achieving these objectives.
- 1.3 In our Decision document on SOP3, issued in March, we indicated that we were concerned to ensure that in delivering the Standards dominant suppliers did not act in ways which adversely affected competition in supply. We also indicated that we were keen to see schemes promoted and offered to customers in ways which widened customer choice and promoted the development of competition. Broadly speaking, the schemes brought forward so far by companies have not raised major competition concerns. However, in the light of our experience so far with SOP3, we believe that it would be helpful to issue further guidance on competition matters for companies developing and carrying out their SOP3 programmes.
- 1.4 This present document therefore sets out, following consultation, guidance on competition issues which are arising in implementing SOP3. This guidance is relevant to gas and electricity companies who have to meet SOP3 targets and will also be of interest to customer and energy efficiency groups and a wide range of energy efficiency service providers.

- 1.5 This guidance relates to SOP3. As regards the Energy Efficiency Standards of Performance (to be known as 'Energy Efficiency Commitment') which the Government proposes to set for 2002-05, Ofgem will in summer 2001 be consulting companies, consumer bodies and others on our proposals for administering and overseeing the operation of the 2002-05 scheme, including competition issues.

## 2. General approach

- 2.1 Broadly, Ofgem is concerned more with the effects on competition of suppliers' actions than with seeking to impose restrictions on defined categories of behaviour. This is consistent with the Competition Act 1998, where it is the effect rather than the form of behaviour that is assessed.
- 2.2 Ofgem's approach to assessing the effect on competition of SOP3 programmes is similar to our approach to considering other new market initiatives and offers. This approach was first set out by Ofgas in the decision document on BGT's Goldfish credit card scheme, and was most recently set out in Ofgem's 2000 review of the development of competition in domestic gas and electricity supply.<sup>1</sup> Such initiatives and offers may also be covered by the Competition Act 1998, and guidance on how they will be assessed can be found on the OFT website at [www.of.gov.uk](http://www.of.gov.uk).
- 2.3 Ofgem would wish to encourage suppliers to pursue innovative ways of delivering energy efficiency in order to increase customer choice and provide direct benefits to customers.

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<sup>1</sup> "A Review of the Development of Competition in Domestic Gas and Electricity Supply", Ofgem, December 2000.

### 3. Marketing: own-supply and other customers

- 3.1 Ofgem indicated in October last year in our initial decisions on SOP3 that we expected that in most cases companies would concentrate SOP3 schemes on their existing supply customers. However, we did not rule out companies providing assistance to gas and electricity users whom they did not supply. In fact, we indicated that it would be inconsistent with the aim of the Standards for a supply company to refuse assistance to a household solely on the grounds that the household did not take a gas or electricity supply from that company.
- 3.2 Whilst accepting that it may not be possible for suppliers to meet all requests for assistance, **Ofgem continues to expect suppliers to make schemes as widely available as possible.**

## 4. Linking SOP3 offers to energy supply contracts

4.1 Ofgem welcomes the fact that, so far, companies are not generally insisting that, to qualify for assistance under SOP3, a customer must enter into an energy supply contract with the company. However, there have been a few schemes where companies have marketed specific SOP3 projects linked to the household remaining or becoming an energy customer. So long as customers willingly; and knowingly, enter into such arrangements, schemes marketed on this basis could well have a role to play in contributing to the achievement of companies' SOP3 targets and in developing experience of Energy Service Companies (ESCOs).

4.2 Ofgem is keen to see suppliers consider the scope for ESCOs, whether these are offered within companies' main supply areas or outside. However, the following safeguards need to apply, particular in the case of schemes offered by dominant suppliers:

- the customer should be made aware of his right to switch supplier on 28 days' notice;
- schemes where energy efficiency assistance is linked to the household remaining or becoming a supply customer of the supplier should not account for an undue proportion of any company's SOP3 programme. The SOP3 targets, based on ESTs model, assume that around 5 per cent of insulation measures are funded through ESCO loans to nondisadvantaged owner-occupiers and social housing providers;
- the household should not be given to understand that assistance under **SOP3** is available only on the condition that it remains or becomes a supply customer of the supplier (ie, should be aware that SOP3 assistance is available through non-ESCO projects);

- in the case of dominant suppliers, the licence conditions on non-discrimination\* and publication of terms of supply apply;
- if a supplier intends to link a **SOP3** scheme to a particular tariff this should be made clear in the SOP submission and that submission should be made along with any necessary tariff notification procedure to Ofgem.

**4.3** With regard to SOP schemes for social housing providers, Ofgem welcomes and encourages partnership between energy companies and social housing providers particularly where this helps to promote competition in energy supply.

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\* Ofgem has proposed to the Secretary of State for Trade and Industry that these licence conditions should be removed from gas and electricity supply licences when the new licences are introduced following the Utilities Act 2000.

## 5. Customer tie-ins

- 5.1 In order to safeguard competition in supply, under the existing licence conditions, suppliers cannot contractually tie-in customers such as to abridge their right to change supplier on 28 days' notice. As indicated above, the terms on which companies offer assistance under SOP3 need to be consistent with this requirement. Ofgem believes that the present regulatory arrangements provide significant opportunities for energy services. However, as previously indicated, where suppliers provide evidence that the 28 day rule proves to be a barrier to the development of energy services, Ofgem is ready to review it.
- 5.2 In addition, dominant suppliers should avoid offering assistance which may have the effect, or risk, of tying in the customer, even though the customer remains contractually free to switch. In particular, a customer who has received assistance under a SOP3 project should be in the same position as any other customer when deciding whether to switch supplier (though in line with the licence conditions the supplier may seek reasonable security in respect of any loans advanced for energy efficiency improvements which may be outstanding).
- 5.3 Under existing licence conditions domestic gas and electricity supply contracts may include reasonable termination charges which customers may be required to pay if they switch supplier during the period of the contract. This provision covers the energy supply element of an ESCO contract. Any such termination fees payable by the customer should be notified to the customer when he enters into the contract and must be made transparent. Termination fees have to be set at a reasonable level and should not exceed the benefits which the customer might have gained from the contract.

## **6. Methods for targeting customers**

- 6.1** It is not possible for all households to be offered assistance or practicable for suppliers simply to respond to customer requests. Ofgem therefore accepts that it is necessary for suppliers proactively to target particular households or customer groups. However, this targeting should be carried out in ways which do not restrict competition.
- 6.2** In their project submissions, dominant suppliers should set out the criteria and methods used for targeting customers to whom assistance is proposed to be offered. For example, if customer names and addresses are extracted from customer databases, what are the criteria used to select those customers? Most suppliers have continued to run schemes where the choice of the households who benefit is effectively made by a third party such as a social housing provider or charity. Such an approach is less likely to have adverse effects for the development of competition.
- 6.3** As indicated above, customers of other suppliers who respond to a company's adverts or enquire about the possibility of assistance should not automatically be turned down, but should be considered on their merits.
- 6.4** In line with the Social Action Plan companies should be proactive in identifying disadvantaged customers, including those in debt, who may stand benefit to benefit most from energy efficiency improvements. Companies should be active in taking referrals from Citizen Advice Bureaux, Local Energy Advice Centres and other agencies.

## 7. Repeat grants etc

- 7.1 There are no fixed restrictions on the same customer, or category of customer, receiving repeated or multiple assistance from a supplier. Indeed, in order to deal effectively with fuel poverty it may be necessary to offer a range of measures to individual households. Equally, it may not be practicable to prevent individual customers taking up offers of assistance on a repeat basis. However, dominant suppliers should give details in their project submissions if they propose to follow a deliberate strategy of offering repeated assistance to particular customers or groups of customers, and provide justification for this.
- 7.2 **As** an alternative to providing further assistance to a customer, it may be appropriate for a company to refer that customer to the appropriate New HEES manager. Ofgem encourages close collaboration between SOP and New HEES programmes.

## 8. Ensuring good value

- 8.1 Under SOP3, companies have an incentive to achieve their energy savings targets at the lowest cost, and have to meet the requirement that at least 65% of their expenditure goes to help disadvantaged customers. **Also** the methodology for accrediting energy savings encourages companies to get customers to take up schemes with the minimum level of grant assistance. Companies should ensure that schemes are designed and managed to ensure good value for customers, not least where customers or their landlords are meeting some of the costs. This has implications for how schemes are run and offered to customers.
- 8.2 In terms of the running of schemes, Ofgem expects that the selection of scheme installers and key product providers should always be subject to competitive tender. Where this is not proposed, this should be indicated in the project submission and a convincing explanation should be provided. In specifying tenders, companies should not introduce requirements which favour affiliated organisations. The use of affiliated companies, eg retail or contracting arms, is not necessarily excluded, but must be justified on value for money grounds, particularly where their exclusive use is involved. Companies should also bear in mind that the leveraging of a company's market dominant position in energy supply into other markets may raise Competition Act issues.
- 8.3 Tender documents issued by companies or the agents should include all relevant information, including the basis on which work will be paid and may be charged. Tenders should be conducted to allow potential bidders to compete on equal terms.
- 8.4 In terms of how assistance is offered to customers, companies should ensure that where customers contribute directly to the cost of a scheme this represents good value for the customer. This should apply to the total package which the customer is acquiring and not just the energy efficiency performance of that package, eg the appliance or heating system as a whole should represent good value for the customer. In designing schemes, companies should consider opportunities for incorporating customer choice, for example in terms of the products, or even installers, used. This is particularly important when decisions

**about the relative priority customers attach to price and quality trade offs are significant.**

## 9. Approval procedures

- 9.1 Ofgem's approval certificates for SOP3 projects indicate that approval is for the purpose of the Standards only. Approval in no way implies exemption or clearance under the Competition Act. The onus is therefore on companies to ensure that their SOP3 arrangements are fully compliant with the Competition Act.
- 9.2 Ofgem reserves the right to investigate the effects on competition in the gas and electricity supply markets of any approved SOP3 project and if necessary to take action under the Competition Act; or to refer cases to OFT. Companies which have concerns or queries on competition issues should raise these with Ofgem, rather than with the Energy Saving Trust.

## **Annex:**

### *List of respondents, summary of main points raised and Ofgem's views*

British Gas Trading

Department of Trade and Industry

Eaga Partnership

Eastern Energy & Norweb Energi

Energy Saving Trust

Federation of Small Businesses

Green Heat Limited

Mr B F Harris

Local Government Association (LGA)

London Electricity & SWEB

NEA

Northern Electric and Gas

npower (Innogy)

Powergen

Scottish Power

Scottish and Southern Energy

SEEBOARD

Strathclyde and Central Energy Efficiency Advice Centre

Yorkshire Electricity

## General

1. A number of respondents, including companies, indicated that the draft guidance was helpful and welcome, and could in general be followed without significant difficulties. One company commented that the draft guidance reflected existing understandings with Ofgem.
2. Arguing against the draft guidance, a company said that it was too late to issue guidance at this stage of ██████. Another company felt that the value of Ofgem's guidance was reduced because it did not remove the obligation on companies to ensure that their **SOP** arrangements complied with the Competition Act. A non-company respondent argued that the guidance should be tighter and more precise. Another respondent said that EEC4 competition issues should be subject to separate consultation.
3. Despite some arguments against, Ofgem believes that it is reasonable to go ahead with final guidance.

## Scheme marketing issues

4. There were a number of different comments on scheme marketing issues, including on whether companies should restrict offers of **SOP3** assistance to their own supply customers. Some companies agreed the general thrust of the draft guidance but pointed out that in practice they could not meet all requests for assistance. One company specifically queried the idea that SOP applications from customers of other suppliers should be treated on their merits.
5. Non-company respondents strongly supported the principle that companies should not restrict **SOP** assistance to households to which they supply gas or electricity. It was also suggested that third parties, including charities, should play a key part in targeting scheme recipients; and that companies should be required to consult local authorities, RSLs, EEACs etc before promoting schemes. Other points were that **SOP** should be completely separated from company marketing; that suppliers should be required to cease branding **SOP** schemes; that companies should not base SOP schemes for social housing providers on the housing provider endorsing the company as a supplier; and that companies should be required to target customers in debt.

6. Ofgem believes that companies' SOP3 programmes should be fully informed by Social Action Plan objectives and meet the target of two thirds expenditure for disadvantaged customers. Otherwise it is not appropriate to place constraints on scheme marketing, provided companies take appropriate steps to make schemes as widely available as possible.

#### ESCOs

7. Companies made few comments on ESCO issues. Comments from other respondents covered a wide range of views. On the one hand, it was suggested that the guidance should incorporate greater encouragement for ESCOs; that alternatives to the 28 day rule should be explored; and that the meaning of "reasonable security" should be explained. On the other hand, it was felt that SOP3 offers should not be allowed to be linked to energy supply tariffs; that ESCOs were not relevant to low income customers; and that ESCOs created a risk of unscrupulous marketing.
8. Ofgem believes that SOP3 specifically and the regulatory regime generally make reasonable provision for ESCOs; and we encourage companies to consider bringing forward ESCO schemes. Ofgem intends to issue a separate note shortly on the implications for energy services of the licence requirement that customers should be free to change energy supplier on 28 days' notice.

#### Dominant and non dominant suppliers

9. Some companies suggested that it was inappropriate in any way for the guidance to distinguish between dominant and nondominant suppliers; and queried the criteria for determining whether a supplier was dominant.
10. Ofgem believes that it is appropriate that the arrangements for delivering SOP should take account of whether a supplier is market dominant. However, the criteria for determining whether a supplier is dominant go wider than guidance for SOP3 and it would not be appropriate to alter the criteria at present.

### Customer choice

11. A number of respondents, not only companies, argued that offering customers a choice of energy efficiency goods and services would prove too costly and raise other difficulties.
12. Ofgem recognises that companies will wish to control the cost of achieving their **SOP3** targets. However this does not rule out companies, when designing schemes, considering the opportunities for incorporating customer choice; for example in terms of the products, or even installers, used.

### Competitive tender

13. On the issue of competitive tender for scheme contractors and installers some companies said that it was not necessary for Ofgem to give guidance on this, because companies already had a financial incentive to seek best value. It was also suggested that guidance on the use of affiliated organisations was not necessary.
14. Whilst recognising the existing financial incentives on companies to seek value for money, Ofgem believes that the use of a competitive tender process is an important safeguard.