

Addressing undue discrimination - final proposals

Document type: Consultation

Ref: 42/09

Date of publication: 15 April 2009

Deadline for response: 13 May 2009

Target audience: Energy suppliers, consumers, consumer organisations and representatives, academics and other interested parties

Overview:

The Gas and Electricity Markets Authority is minded to introduce two new supply licence conditions to address undue discrimination in the domestic energy supply market. This document sets out draft licence conditions and accompanying guidelines, building on responses received to our January 2009 consultation: "Addressing unfair price differentials".

We set out two draft licence conditions: one requiring any difference in the terms and conditions offered by suppliers in respect of different payment methods to be cost reflective; and the other prohibiting undue discrimination in any terms and conditions offered to customers. The draft guidelines set out the principles Ofgem intends to take into account when interpreting and applying the licence conditions.

We invite comments on the proposed drafting of the licence conditions and guidelines by 13 May 2009.

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Context

Ofgem's principal objective is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition. In keeping with this objective, we launched a study of the state of GB energy supply markets ('the Probe') in February 2008. In October 2008, we set out our initial findings on the operation of the GB retail energy markets and set out for consultation a package of measures to tackle the issues raised. In January 2009, we consulted on a range of proposals in relation to one of the key action areas identified - addressing unfair price differentials. In the light of responses to that consultation, this document sets out Ofgem's proposed way forward.

Associated Documents

- Energy Supply Probe – Initial Findings Report, October 2008 (Ref: 140/08)
- Addressing unfair price differentials (01/09), 8 January 2009
- Energy Supply Probe – proposed retail market remedies (41/09), 15 April 2009
- Addressing undue discrimination – impact assessment (43/09), 15 April 2009

The above documents are available via the Ofgem website at the following location:

<http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Pages/Energysupplyprobe.aspx>

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1. Introduction

1.1. In October 2008, Ofgem set out the initial findings of its investigation into the operation of the GB retail energy markets. This identified a number of areas where we are keen to further improve the functioning of the retail energy supply markets.

1.2. Our Initial Findings Report found a number of significant pricing differentials that could not be explained readily by differences in costs. Our key areas of concern centred on the differentials between payment methods, between regions and between fuels (gas and electricity). We identified that unjustified price differentials and discriminatory pricing structures have had a significant detrimental impact on the consumers affected and a disproportionate impact on vulnerable groups.

Promoting competition in retail supply markets

1.3. In responding to these concerns, we remain convinced that consumers benefit most from a vibrant, competitive market: markets work best when consumers make active choices based on good quality information. We are therefore proposing a package of measures designed to improve the functioning of the market for all consumers, particularly vulnerable households. Our proposals are set out in a consultation published today.

1.4. Over time, we expect these remedies - through the operation of the market - to address instances of undue discrimination. However, we expect that this process will take time to have the effect envisaged. In the meantime, competitive pressures alone may not be sufficient to protect consumers from undue discrimination and this may disproportionately harm vulnerable consumers.

Addressing undue discrimination

1.5. On 8 January 2009, we published a consultation document entitled "Addressing unfair price differentials". This outlined four broad proposals for licence requirements to tackle the concerns identified by the Probe:

- A: Cost-reflective pricing between payment methods
- B: Prohibition of undue discrimination
- C: Relative price controls
- D: Prohibition of "cross subsidy" between gas and electricity supply

1.6. In the light of responses to our consultation, the Authority has decided to discard proposals C and D:

- Many respondents did not support the idea of relative price controls – and very few preferred them as a means of addressing the main concerns identified. We agree that there could be difficulty in implementing such price controls and that they could be unnecessarily intrusive and would risk stifling innovation.

- There was limited support for a prohibition of cross subsidy between gas and electricity supply. We agree that such a prohibition could be damaging to competition between gas and electricity suppliers. We also believe that a broader prohibition of undue discrimination (proposal B) could limit some of the worst impacts of cross subsidy – such as the detriment to off-gas grid consumers.

1.7. Following consideration of the responses to our consultation document, the Authority is minded to introduce two new licence conditions for domestic gas and electricity suppliers as follows:

- Licence condition A: a requirement for any difference in the terms and conditions offered in respect of different payment methods to be cost reflective; and
- Licence condition B: a prohibition of undue discrimination in any terms and conditions offered to customers.

1.8. The proposed licence conditions are set out in Chapter 2. Draft guidelines for these conditions are set out in Chapter 3. These guidelines outline the principles Ofgem intends to take into account when interpreting and applying licence conditions A and B and they should be read in conjunction with those conditions. Furthermore, the guidelines set out the factors that we intend to take into account in deciding whether there is any “objective justification” for practices that might otherwise be viewed as discriminatory.

1.9. Ofgem’s purpose in introducing licence condition A is to better reflect the requirements of EC Directives 2003/54 and 2003/55 and to address the detriment caused to consumers as a result of non-cost reflective differentials in payment methods applied by gas and electricity suppliers. Licence condition A is not intended to introduce any additional obligations going beyond those imposed by the EC Directives.

1.10. We are introducing licence condition B to address other situations in which certain consumers may be losing out by reason of their inability to access (or difficulty in accessing) the same supply terms and conditions as other consumers.

1.11. Licence condition B is not intended to diminish in any way the ability of suppliers to innovate, roll-out or test new products, improve their efficiency or competitive advantage over other suppliers and/or to introduce initial or ‘incentive’ offers in a legitimate attempt to penetrate certain markets, market segments, or acquire new customers. We have drafted the guidelines in a way which we believe will minimise the risks of any negative impact on competition and innovation.

1.12. Given our statutory duty to protect consumers, and to have regard to the interests of vulnerable consumers, we believe that it is appropriate to introduce a licence condition prohibiting undue discrimination. We consider that this measure will have significant benefits for many vulnerable consumers in the form of lower prices and we have attached particular weight to this consideration.

1.13. We recognise that there are risks to the intensity of competitive activity between suppliers as a result of this measure. As set out in the impact assessment that accompanies this document, the impact on competition is ambiguous. However, we believe that the potential negative effects are likely to be limited and are likely to be offset to some extent by certain positive effects.

1.14. We will seek to mitigate these risks through our application of licence condition B in two key ways:

- First, we aim to reduce regulatory uncertainty around this measure through our approach to enforcement set out in the guidelines, in particular our proposed approaches to cost allocation, materiality and the enforcement process.
- Second, we propose that licence condition B operates only for a limited period – three years – to allow time for the package of retail remedies to take effect.¹

Consultation responses

1.15. We received 37 responses to our consultation. A list of respondents is included at Appendix 2, along with a summary of their responses.

1.16. In preparing our guidelines, we have sought to address many of the issues raised by respondents to our consultation. Our substantive response to these and the other issues raised is dealt with in these guidelines. In particular:

- there was concern that requiring cost reflectivity could have negative consequences for prepayment meter (PPM) customers because of the higher cost of supplying them. We plan to address this point in the way we will enforce the licence conditions. In particular, the guidelines state that we do not intend to pursue discrepancies in pricing of payment types that result in lower PPM charges;
- there were calls for Ofgem to assess the efficient cost of supply under various scenarios (for example, the efficient cost of a PPM meter). In proposing the licence conditions set out here, we have chosen not to pursue price regulation – not least because of the risks to competition and innovation. We are therefore not minded to set price levels for suppliers. Furthermore, in monitoring and enforcing the proposed licence conditions, we are not looking to collect or assess cost data at this level of detail on a regular basis. We believe that this would be burdensome administratively both for Ofgem and suppliers; and
- some respondents argued that a “multi stage” enforcement process would not be sufficiently strong to deter undue discrimination. We believe that the process set out in the guidelines will help stop the proposed licence conditions stifling innovation and being administratively burdensome for suppliers. Nevertheless, the process will not stop us from enforcing the licence condition where a supplier fails to justify a price differential to us but persists in charging it.

¹ The proposed provisions on non-discrimination in the European Third Energy Package could mean that some aspects of licence condition B will need to be retained in order to achieve compliance with EC law. However, we cannot pre-empt this because the relevant rules have yet to be adopted at European level and, if adopted, are unlikely to be implemented for some time. If this is the case, we will review the licence condition accordingly.

2. Proposed New Licence Conditions

This chapter sets out our proposed licence conditions on cost-reflective payment methods and the prohibition of undue discrimination in domestic gas and electricity supply contracts.

Licence Condition A: Cost-reflective payment methods

(Proposal to insert into existing Standard Licence Condition 27 'Payment methods under Domestic Supply Contract')

"1. Any difference in terms and conditions as between payment methods for paying Charges for the Supply of [Electricity/Gas] shall reflect the costs to the supplier of the different payment methods.

2. In this Condition "terms" means all terms on which a supply of [electricity/gas] is offered or provided, including terms as to price, which significantly affect the evaluation of that supply."

Licence Condition B: Prohibition of undue discrimination

(Proposal to insert new Condition 29 into existing Standard Licence Conditions)

"1. This condition applies in relation to the supply of [electricity/gas] by the licensee under a Domestic Supply Contract or a Deemed Contract for the supply of [electricity/gas] to Domestic Premises.

2. Subject to paragraph 3 the licensee must ensure that in supplying or offering to supply [electricity/gas], the Principal Terms on which it does so do not discriminate without objective justification between one group of Domestic Customers and any other such group. For the purposes of this condition it shall be for the Authority to decide whether there is any such objective justification.

3. The licensee shall only be in breach of this condition if and to the extent that the nature of the discriminatory terms offered and/or their impact on any Domestic Customers is material in any respect.

Termination of this provision

4. This condition will cease to have effect on [•] 2012."

3. Proposed Guidelines

This chapter sets out our proposed guidelines on cost-reflective payment methods and the prohibition of undue discrimination in domestic gas and electricity supply contracts. These guidelines should be read in conjunction with the proposed licence conditions set out in the previous chapter.

Introduction

Background, purpose and status of guidelines

(i) Background

3.1. Ofgem launched a study into the state of the GB energy supply markets ('the Probe') in February 2008. The Probe focused on the functioning of competition in the electricity and gas retail markets for domestic and small and medium enterprise (SME) consumers ('Consumers'). We published our initial findings in October 2008 and set out for consultation a package of measures to tackle the issues identified.

3.2. On 8 January 2009, Ofgem published its consultation paper "Addressing unfair price differentials" as part of the Probe. Following consideration of the responses to that consultation document, Ofgem proposes to introduce two new supply licence conditions as follows:

- Licence Condition A: a new supply licence condition into both the Standard Gas and the Standard Electricity Supply Conditions (amending existing Standard Supply Condition 27) reflecting the requirements of EC Directives 54/2003 and 55/2003² by requiring any difference in the terms and conditions offered in respect of different payment methods to be cost reflective; and
- Licence Condition B: a new supply licence condition into both the Standard Gas and the Standard Electricity Supply Conditions prohibiting undue discrimination in any terms and conditions offered to customers.

(ii) Purpose

3.3. These Guidelines set out the principles Ofgem intends to take into account when interpreting and applying Licence Conditions A and B and they should be read in conjunction with those conditions. These Guidelines also set out the approach which Ofgem's Authority intends to take in deciding whether there is any "objective justification" when applying sub-section 2 of Licence Condition B.

² EC Directive 2003/54/EC concerning common rules for the internal market in electricity and EC Directive 2003/55/EC concerning common rules for the internal market in natural gas

3.4. Ofgem's purpose in introducing Licence Condition A is to better reflect the contents of Annex A(d) of EC Directives 2003/54 and 2003/55³ ('the EC Directives') and to address the detriment caused to consumers as a result of non-cost reflective differentials in payment methods applied by gas and electricity suppliers in the GB retail market ('Suppliers'). Licence Condition A is not intended to introduce any additional obligations going beyond those imposed by the EC Directives. In Licence Condition A, for consistency Ofgem retains the term "payment methods" as referred to in the existing Standard Electricity Supply Conditions and the Standard Gas Supply Conditions. For the purposes of interpreting and applying Licence Condition A only, Ofgem considers the term "payment methods" to be interchangeable with the term "payment systems" as referred to in Annex A(d) of the EC Directives.

3.5. Ofgem is introducing Licence Condition B to address other situations in which certain consumers may be losing out by reason of their inability to access (or difficulty in assessing)⁴ the same supply terms and conditions as other consumers. Licence Condition B is intended to operate during a fixed interim period only to allow the rest of the Probe Remedies Package to take effect.

3.6. Licence Condition B is not intended to diminish in any way the ability of Suppliers to innovate, roll-out or test new products, improve their efficiency or competitive advantage over other Suppliers and/or to introduce initial or 'incentive' offers in a legitimate attempt to penetrate certain markets, segment, or acquire new customers. Further guidance on the recognised importance of such market activity is set in the later section on Objective Justification.

3.7. Assuming any apparently discriminatory terms and conditions offered by a Supplier cannot be objectively justified then insofar as it is practicable, efficient and reasonable to do so, the intended purpose of the prohibition on undue discrimination in Licence Condition B is to ensure equal access to the same terms and conditions of supply for all comparable Consumers.

3.8. For instance, if and insofar as certain considerations may render universal access for all Consumers to all terms and conditions offered impossible or impractical,⁵ Suppliers must instead ensure that comparable terms and conditions (ensuring any price differential is cost reflective) are offered to comparable Consumers who cannot by reason of relevant personal circumstances, avail of certain terms and conditions offered. For the avoidance of doubt in this context, it shall lie within Ofgem's discretion to decide on whether any given Consumers and/or their personal circumstances are sufficiently "comparable".

³ Annex A(d) of the EC Directives provides: "Any difference in terms and conditions shall reflect the costs to the supplier of the different payment systems."

⁴ Ofgem includes the existence of significant switching costs including search and transaction costs and consumer perception of the difficulties.

⁵ For example Consumers without a bank account are unable to pay by direct debit.

(iii) Status

3.9. Although these Guidelines set out the approach Ofgem expects to take, they do not have binding legal effect. Ofgem will consider each case on its own merits. Ofgem will apply the approach set out in these Guidelines where it is appropriate to do so and in the event that Ofgem decides to depart from the Guidelines, Ofgem will set out its reasons for doing so.

3.10. Unless any particular guidance below is expressly stated to apply to only one of Licence Condition A or B specifically, these Guidelines are intended to illustrate how Ofgem will investigate potential contraventions of both Licence Condition A (cost reflective payment methods) and Licence Condition B (prohibition of undue discrimination).

3.11. These Guidelines are without prejudice to Ofgem's powers and duties under the Competition Act 1998 and any guidance issued in respect of those powers and duties.

Consumer detriment

3.12. For the avoidance of doubt, both Licence Conditions A and B seek to prevent material detriment caused to Consumers by Suppliers and, in particular, detriment to vulnerable groups.⁶ Unless there is evidence of consumer detriment having resulted from any alleged contravention of either Licence Condition A or B, then any such alleged breach is likely to be trivial and in such circumstances, Ofgem is very unlikely to enforce either Licence Condition. In assessing whether any such detriment has resulted, Ofgem will be guided by the Guidelines on 'Materiality' set out in the later section on Objective Justification.

Definition of undue discrimination in supply contracts under Licence Condition B

3.13. In respect of Licence Condition B only, Ofgem intends to apply the following test in determining whether undue discrimination has arisen in a particular case:

- If Ofgem considers that a Supplier has offered, or is offering, terms and/or conditions of supply to one group of customers which are materially⁷ different from the terms and/or conditions of supply offered to any other group of customers; and
- If Ofgem considers that any such difference or differences in the terms and/or conditions offered cannot be objectively justified.⁸

⁶ These are defined and discussed in the later section on 'Vulnerable Groups'.

⁷ For guidance, see the later section on 'Materiality'.

⁸ Relevant circumstances would include the costs of supply to a group of customers. Please see the section on 'Objective Justification' within this chapter.

3.14. If both of the above conditions are satisfied, Ofgem will consider that Supplier to be engaging in undue discrimination for the purposes of Licence Condition B.

3.15. For the purposes of the above approach and the remainder of these Guidelines, the term 'customer' will be interpreted in accordance with the definition of that term as set out and applied under the existing Electricity Supply Licence Standard Conditions and the existing Gas Supply Licence Standard Conditions.

3.16. The terms and conditions of supply of an electricity or gas product which Ofgem will assess when applying Licence Condition B, include all the elements of that product, including price, contracted for service features and the terms upon which a product or service may be offered in conjunction with another product or service e.g. dual fuel offerings.

3.17. In respect of dual-fuel offerings, Ofgem will assess whether the inclusion or exclusion of other products or services offered by a Supplier in conjunction with another product leads to one or other product (whether gas or electricity) being offered at below cost price.⁹ For the avoidance of doubt provision by any Supplier of a product with another product (whether gas or electricity) at below cost, is very likely to be treated as undue discriminatory conduct in respect of those customers not offered, or not able to access, the second product in addition to the first product e.g. customers who are "off grid" and therefore unable to access mains gas.

3.18. Ofgem is concerned that these Guidelines should not restrict Suppliers' ability to innovate in the retail market.¹⁰ For the avoidance of doubt, time limited or "initial" offers, innovative offers or new-customer acquisition targeted offers are likely to be objectively justified as explained below.

3.19. Similarly if Suppliers offer innovative tariff structures on a non-discriminatory basis Ofgem would not expect to challenge the principles of such tariffs, examples of which are set out below.

(i) Fixed price tariffs

3.20. Fixed price tariffs are by their nature only offered on specific terms for a certain period of time. Provided any fixed price tariff (which is not a time-limited or customer acquisition targeted offer as discussed separately below under objective justification) were to be made available on a non-discriminatory basis to all comparable Consumers at the time of offering, any difference between fixed tariffs and other tariffs, shall not fall to be assessed for objective justification as the conduct in question would not be discriminatory.

⁹ The relevant costs to be assessed are Suppliers' forward looking avoidable costs which are not covered by the relevant below cost price charged for a sustained period. See further guidance in the sections on 'Materiality' and 'Cost allocation'.

¹⁰ See Guidelines on 'Innovation' within the section on 'Objective Justification'.

(ii) Green Tariffs

3.21. Similarly, provided any green tariffs offered by a Supplier are made available to all Consumers on a non-discriminatory basis at the time of offering, Licence Condition B will not be engaged. Any difference between green tariffs and other tariffs shall not fall to be assessed for objective justification as the conduct in question would not be considered discriminatory under the above approach.

Objective justification

3.22. In respect of Licence Condition B, Ofgem considers that any alleged objective justification relied upon by a Supplier for offering two groups of customers different terms and conditions can only be assessed on a case-by-case basis. The Guidelines set out below are intended to assist in such an assessment although they are not intended to constitute the exclusive basis upon which any alleged objective justification will be assessed.

3.23. In assessing any potential contravention of Licence Condition B, Ofgem will first consider whether any differences in transaction conditions offered to two groups of customers reflect differences in those customers' circumstances; or whether any relevant similarities in customers' circumstances are reflected in transaction conditions offered to two groups of customers. Differences between customers' circumstances may constitute an objective justification for offering different terms and conditions.

Cost reflectivity

3.24. For the avoidance of doubt, the following Guidelines in respect of Cost Reflectivity are relevant to both Licence Condition A and Licence Condition B.

3.25. Ofgem is likely to consider discriminatory conduct to be objectively justified when the difference in the treatment reflects the differences in the costs of supplying a particular customer or group of customers.¹¹ As such an assessment of the objective justification of any price differential will usually involve an assessment of the relevant costs involved and the degree to which these costs are reflected in the respective prices charged by a Supplier.

3.26. Ofgem intends to assess the relevant terms and conditions offered by a Supplier on a forward looking basis i.e. relative to costs at the date at which prices were first made available to a group or groups of customers and will not generally assess any differences in terms and conditions offered to customers on an ex post basis.

¹¹ For further guidance, see the later section on 'Cost Allocation'.

3.27. Ofgem will take the following factors into account when assessing cost reflectivity under Licence Condition A and any alleged objective justification in respect of Licence Condition B:

(i) Geographical considerations:

- Ofgem recognises that there can be geographic cost differences related for example to different network charges.
- As transmission and distribution charges can vary by region it would be objectively justified to reflect these in prices charged to customers.

(ii) Payment methods:

- Differences in prices which reflect the differences in costs associated with operating different payment methods would be objectively justified e.g. any difference in Suppliers' costs associated with processing a direct debit payment as opposed to processing a quarterly standard credit payment method.

(iii) Initial offers:

- Ofgem is concerned to prevent discrimination in respect of enduring terms and conditions under which electricity and gas are supplied and not with initial offers made by Suppliers aimed at customer acquisition.
- As such if a Supplier were able to demonstrate that a particular price differential or any additional bonus or incentive was being offered on a time-limited basis only (for example, to assist that Supplier in the acquisition of new customers or to penetrate a market in a particular region) Ofgem is likely to consider any such 'initial' price differential to be objectively justified.
- However in such circumstances a Supplier must specify expressly in advance in their marketing materials, that any such price differential or bonus incentive is time limited and that the said limited offer will revert, after a reasonable period of time, to the terms and conditions offered to all other Consumers. Failure by a Supplier to adhere to these transparency requirements will lead Ofgem to assume that the price differential offered is intended to operate as an enduring offer for the purposes of Licence Condition B.

(iv) Competitive advantage:

- Licence Condition A and Licence Condition B are not intended to lessen in any way the incentives for Suppliers to improve the efficiency of their operations. The Guidelines on materiality, set out below, are intended to provide flexibility to allow any individual Suppliers, who may be more innovative or efficient than the rest of the market, to benefit from any efficiency improvements they make for a reasonable period before passing that benefit on to Consumers.
- In particular, Ofgem is likely to regard evidence of recent efficiency improvements, combined with competitive price differentials, as a potential objective justification for sustaining price differentials at above costs for a reasonable period of time. However as explained above, Ofgem intends to approach cost assessment on a forward looking basis.

- Following a reasonable period of time it would be expected that any such efficiency benefits would be passed on to customers consistent with an effective competitive market.

(v) Innovation:

- Licence Condition A and Licence Condition B are not intended to prevent Suppliers developing new products and charging a market price for such products, provided those products are made available to all Consumers on a non-discriminatory basis.
- However if Ofgem were to require any roll-out of a new development/product to be made available to all customers simultaneously, Ofgem recognises that this could create a potential barrier to innovation.
- Ofgem considers that if a Supplier chooses to limit, for a reasonable period of time, a new product or offering to a group of customers this conduct is likely to be objectively justified if it could be shown to be a necessary part of development, testing or roll-out.
- Similarly, Ofgem is likely to consider barriers arising from technology or capability (e.g. smart meters) to be an objective justification for the limited availability of a product to one particular group of customers.
- It will be within Ofgem's discretion to decide whether any particular offering constitutes a "new" product and whether any such "new" product constitutes a sufficient objective justification for these purposes.

Materiality

3.28. Ofgem will not consider any term(s) and/or condition(s) offered by a Supplier to be an infringement of either Licence Condition A or Licence Condition B unless a materiality threshold is met.

3.29. In respect of both Licence Condition A and Licence Condition B, Ofgem recognises that it would be impossible for Suppliers to be precisely non-discriminatory and/or cost reflective at all times and to each individual customer. Costs can vary through time and are not always certain until after the fact. Also Ofgem recognises there are significant costs associated with changing prices and it would be inefficient to require frequent changes to ensure cost reflectivity at all times. However as set out above, Ofgem intends to assess costs on a forward looking basis.

3.30. The relevant considerations which Ofgem will take into account when determining the materiality of any alleged infringement of both Licence Condition A and Licence Condition B include, but are not limited to, the following:

(i) Timing

- Suppliers will be allowed a reasonable period of time to effect changes between pricing rounds. In general, unless Ofgem considers the time between price changes to be exceptionally long (e.g. more than six months) or the differential amount to be exceptionally large, then Ofgem would not consider taking

enforcement action under either Licence Condition A or Licence Condition B as a result of any cost differential movements between pricing rounds, but would expect these to be addressed by the Supplier at the next price change.

(ii) Scale and degree of impact on Consumers

- The conduct of a Supplier will be material if it impacts on a significant number of Consumers. The financial impact per Consumer will also be relevant. In considering the financial impact Ofgem will judge materiality in the context of the typical margins earned by Suppliers.

(iii) Detriment to Vulnerable Groups

- As noted above, Licence Condition A and Licence Condition B are concerned with the minimisation of detriment caused to Consumers by Suppliers and in particular detriment to vulnerable groups.¹² If the evidence demonstrates that the detriment caused to Consumers by any alleged infringement of Licence Condition A or B is minimal or non-existent Ofgem will not generally seek to enforce Licence Condition A or B against a Supplier. Similarly Ofgem is more likely to enforce Licence Condition A or B if the evidence demonstrates that vulnerable Consumers are particularly affected by the alleged conduct in question.

Exception for social tariffs

3.31. Under the Gas and Electricity Acts, Ofgem is obliged to have regard to the interests of: (a) individuals who are disabled or chronically sick, (b) individuals of pensionable age, (c) individuals with low incomes and (d) individuals residing in rural areas.¹³ These four groups are referred to in these Guidelines as 'Vulnerable Groups'.¹⁴

3.32. In December 2004, Ofgem published guidance in which it was made clear that there were no regulatory or legal barriers to suppliers offering social tariffs.¹⁵ In March 2008 the Government announced that it had secured commitment from suppliers to increase their spending on social programmes by £225m over 3 years. Ofgem agreed to monitor suppliers' spend against that commitment. On 19 December 2008, Ofgem published a report "Monitoring suppliers' social programmes 2007-08" in which a social tariff was described as being at least as good as the lowest tariff offered by that Supplier to a customer in that region on an enduring basis ('Social Tariffs'). This is regardless of that customer's payment method and includes online tariffs.¹⁶ In addition, Ofgem acknowledged that other forms of discounted tariffs, if properly targeted, could count towards a supplier's social obligation.

¹² For definition of vulnerable groups see the section on Social Tariffs

¹³ See Section 3A of the Electricity Act 1989 and Section 4AA of the Gas Act 1986.

¹⁴ The relevant sections of the Electricity Act and the Gas Act go on to provide: "*although that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.*"

¹⁵ *Supplying low income and vulnerable customer groups* (272/04), December 2004
<http://www.ofgem.gov.uk/Markets/RetMkts/Compet/Documents1/9008-27204.pdf>.

¹⁶ Para 2.14 of "Monitoring suppliers' social programmes" 2007-2008.

3.33. As a result of Ofgem's statutory obligations, in respect of both Licence Condition A and B, if a Supplier chooses to offer more favourable terms and conditions to members of a relevant Vulnerable Group as part of its social obligation, Ofgem would expect to treat any such tariff as an exception to the obligations imposed on a Supplier under Licence Condition A and B. In this context paragraph 3.36 on the scope of Licence Condition A is also relevant.

Scope of Licence Condition A

3.34. Directive 2003/54/EC concerning common rules for the internal market in electricity and Directive 2003/55/EC concerning common rules for the internal market in natural gas (together 'the EC Directives'), place obligations on national regulatory authorities such as Ofgem to ensure, amongst other things, that all final Consumers and in particular vulnerable Consumers are protected.¹⁷ These obligations are also reflected in the Electricity Act 1989 and the Gas Act 1986.

3.35. Licence Condition A is designed to reflect Annex A(d) of the EC Directives which provide that; "Any difference in terms and conditions shall reflect the costs to the supplier of the different payment systems." For the purposes of interpreting Licence Condition A only, Ofgem regards the terms "payment methods" and "payment systems" as interchangeable.

3.36. Ofgem interprets the EC Directives as intending, amongst other things, to protect Consumers who pay by the typically more expensive payment methods such as pre-payment meters ('PPMs'), in particular because those Consumers may not have the choice of other payment methods. As such, and given its statutory obligations under the Gas and Electricity Acts, Ofgem does not intend to pursue discrepancies in pricing of payment types which result in lower PPM charges. Given Ofgem's administrative priority considerations, it would not be an appropriate use of Ofgem's resources, nor is it likely to accord with Ofgem's statutory duties, for Ofgem to target such action under either Licence Condition A or B.¹⁸

Cost allocation

3.37. Compliance with and enforcement of both Licence Conditions A and B will often require consideration of the costs associated with serving particular customer groups. In this respect Ofgem intends to take the following approach.

¹⁷ Article 3(5) of EC Directive 2003/54/EC concerning common rules for the internal market in electricity and Article 3(3) of EC Directive 2003/55/EC concerning common rules for the internal market in natural gas provide:

"Member States shall take appropriate measures to protect final Consumers, and shall in particular ensure that there are adequate safeguards to protect vulnerable Consumers, including measures to help them avoid disconnection. In this context, Member States may take measures to protect final Consumers in remote areas. They shall ensure high levels of consumer protection, particularly with respect to transparency regarding contractual terms and conditions, general information and dispute settlement mechanisms."

¹⁸ Given the general correlation between vulnerable groups and those Consumers who choose to pay by pre-payment meter method

3.38. In broad terms, there are three types of cost:

- Those that can be attributed to particular products and services

Such costs can be used in justification of price differentials. In practical terms these are more likely to be direct costs but they could also include some costs with more indirect characteristics such as charges for customer service. Transmission charges between different areas are one example of a cost that can be attributed to particular products and services as they may vary according to area of supply.

- Those that cannot be attributed to a particular product but are clearly attributable to the energy supply business

If these costs have identifiable drivers (e.g. overall revenues or unit sales), then these costs can be allocated on that basis and used to justify any cost allocation. Otherwise they should not be used in justification of price differentials. For instance billboard advertising, even if it is say focused on Direct Debit customers, may contain multiple corporate measures and hence not be attributable only to Direct Debit customers but to standard credit customers as well.

- Overheads not attributable to the supply business

These should not be used in justification of price differentials. For instance a group charge for intellectual property such as branding or risk should not be used as justification.

3.39. With regard to the following elements of cost:

- Working capital and revenue collection costs

Ofgem is likely to view differences in working capital costs as being an appropriate justification for price differentials between prices charged to different groups of customers (for instance between advance payment plans and standard credit accounts). Ofgem would not view any such charges as discriminatory but will monitor Suppliers' approaches to the use of such charges as part of its debt and disconnection work.

- Bad debt and credit risks

Where Suppliers offer credit terms as a part of their gas and electricity tariffs they are likely to incur some bad debt costs. Ofgem would view a reasonable level of premium for this credit risk as representing a potential objective justification for price differentials between payment methods. There is an argument however that this could be seen as discriminatory against prompt paying standard credit customers for example. Again this is an area Ofgem will keep under review.

Sunset clause in respect of Licence Condition B

3.40. Licence Condition B includes a "sunset clause" so that the new licence condition prohibiting undue discrimination lapses after three years.

3.41. Licence Condition A does not include any such provision given that it reflects existing obligations under the EC Directives and no more than those obligations.

3.42. The inclusion of a sunset clause provision in Licence Condition B is intended to reflect Ofgem's expectation that the full package of measures proposed in the "Energy Supply Probe - proposed retail market remedies" document published in April 2009, will accelerate the transition of energy supply markets to fully effective competition and that, over time, those measures alone will be sufficient to guard against undue discrimination.

3.43. Ofgem is of the view that a period of less than three years would not allow sufficient time for the reforms identified in the Probe to have taken effect fully. However, Ofgem intends to keep this situation under review and proposes to carry out regular reviews in accordance with the Guidelines set out below at paragraph 3.48.

3.44. Once Licence Condition B has lapsed, Ofgem will continue to interpret cost reflectivity, for the purposes of applying Licence Condition A, in line with relevant European Commission and European Court of Justice jurisprudence.

Licence Condition B enforcement procedure

3.45. Ofgem will, as a matter of policy, prioritise its resources to focus on systemic issues in its monitoring of the application of both Licence Conditions A and B.

3.46. Ofgem will enforce Licence Conditions A and B in accordance with its existing 'Enforcement guidelines on complaints and investigations' ('the Enforcement Guidelines') published on 28 September 2007 and as amended from time to time. Consistent with the Enforcement Guidelines, in deciding on priorities for investigation, Ofgem will give weight to the level of Consumer detriment arising.

3.47. In respect of Licence Condition B only, Ofgem will, where and to the extent it considers it to be appropriate, employ the following process of escalation:

Stage 1

- If, on its own initiative or following a complaint, Ofgem identifies a concern with a pricing differential, which satisfies its prioritisation criteria, it will write to the Supplier concerned, giving it an opportunity to respond and to provide objective justification for the pricing differential. At this stage, Ofgem may expect the Supplier to provide cost data supporting the existing structure and justifying any subsequent change.

Stage 2

- If Ofgem is not satisfied with the response, it will write to the Supplier and explain why it is not satisfied. Where appropriate, it will allow the Supplier a further opportunity to respond within a reasonable period. If by or during this stage, the Supplier revises its pricing structure so that it addresses the identified concern and compensates to an appropriate extent any customers who have suffered detriment as a result of the structure in question, it is unlikely that Ofgem would proceed to exercise its formal enforcement powers in respect of the identified concern unless it considers that the circumstances warrant such action. Ofgem is likely to consider such action to be warranted where there is evidence of a persistent or deliberate failure to comply with Licence Condition B.

Stage 3

- Where appropriate, Ofgem will proceed to exercise its formal licence enforcement powers. If at the completion of the above two stages in respect of any Supplier activity, the relevant Supplier has not revised the relevant pricing differential to address the identified concern and/or compensated customers who Ofgem considers have suffered a detriment as a consequence of the existence of such pricing differential, Ofgem would be likely to proceed to exercise its formal enforcement powers where it appears to it that the licensee may be contravening, likely to contravene or have contravened the requirements of Licence Condition B. Failure to pay compensation in mitigation of a breach of Licence Condition B will be an exacerbating factor in assessing any possible penalty imposed.

Revision of guidelines

3.48. Ofgem intends to review the operation of these Guidelines and the impact of Licence Conditions A and B on a regular basis having regard at all times, to the objectives of those Licence Conditions as set out above. Following any such review, Ofgem may, from time to time, revise these Guidelines with a view to:

- removing or reducing inconsistencies between Suppliers in their interpretation and application of Licence Conditions A and B; and
- clarifying how Suppliers compliance with Licence Conditions A and B will be monitored and enforced.

3.49. Before revising these Guidelines Ofgem shall give Notice that it proposes to do so to:

- Suppliers in whose licences Section B of the Standard Electricity Supply Conditions and/or the Standard Gas Supply Conditions are effective;
- the National Consumer Council; and
- any such other persons as Ofgem considers it appropriate to consult in relation to the proposal.

3.50. A Notice given by Ofgem that it intends to revise these Guidelines will:

- state that Ofgem proposes to issue revised Guidelines;
- set out the text of those Guidelines and Ofgem's reasons for proposing to issue them; and
- specify the time (which must not be less than a period of 28 days from the date of the Notice) within which representations or objections with respect to the proposal(s) may be made.

3.51. Ofgem will consider any responses received and will provide reasons for proceeding with any amendment to these Guidelines, having regard to those responses.

4. Next Steps

4.1. We invite comments on the proposed drafting of the licence conditions and guidelines set out in this document and on our impact assessment (published alongside this document). We seek responses by 13 May 2009.

4.2. Depending on responses to consultation, we will bring forward licence changes to be implemented through a collective licence modification subject to statutory consultation. We will aim to do this as soon as possible. Alongside the statutory consultation, we will issue final guidelines – modified as appropriate in the light of comments received from stakeholders. We would expect the new licence conditions to come into force at the end of the statutory consultation period.

4.3. We note that if our proposed licence changes are rejected, the Authority will consider a range of options, including a reference to the Competition Commission for a market investigation.

4.4. We are continuing with the development of a package of remedies for improving the functioning of the retail supply markets. Our proposals are being published today.

Appendices

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Appendix 1 – Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document – in particular, the proposed drafting of the licence conditions and guidelines.

1.2. Responses should be received by 13 May 2009 and should be sent to:

Neil Barnes

Ofgem
9 Millbank
London
SW1P 3GE
020 7901 7000
energysupplymarketsp@ofgem.gov.uk

1.3. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.4. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

Appendix 2 – Responses to Previous Consultation

1.1. Our consultation document “Addressing unfair price differentials” sought views on a range of proposed licence conditions. We received 37 responses. This appendix lists all those that responded and summarises their views.

List of Respondents

	Name
1	Andrew George MP
2	Brighton & Hove City Council
3	Centrica [Confidential]
4	Changeworks
5	Citizens Advice
6	Clifford Chance
7	Consumer Focus
8	E.On UK [Partially Confidential]
9	EdF Energy
10	Energy Action Scotland
11	First Utility
12	Fuel Poverty Advisory Group (FPAG)
13	Gisela Stuart MP
14	Good Energy
15	Haven Power Limited
16	Help The Aged
17	John Baron MP
18	Katy Clark MP
19-23	Members of the public [Confidential]
24	National Energy Action (NEA)
25	National Housing Federation
26	National Right to Fuel Campaign
27	NAVETAS Energy Management
28	Professor Catherine Waddams
29	Public Utilities Access Forum
30	RWE npower [Confidential]
31	Scottish and Southern Energy (SSE)
32	Scottish Federation of Housing Association
33	Scottish Government
34	ScottishPower
35	The Salvation Army
36	Transact: The National Forum for Financial Inclusion
37	Which?

1.2. Responses that were not marked as confidential can be found on Ofgem's website (www.ofgem.gov.uk) and copies are also available from Ofgem's library.

Summary of Responses

1.3. The following is a summary of the responses we received. These are grouped into the same four proposals that were set out in our consultation document. We also invited comments on our aims and on our proposed approach to applying licence conditions to address unfair differentials, including on cost allocation, objective justification, materiality, enforcement and the scope of application and duration of any measures.

Overview

1.4. The majority of respondents expressed support for one or more of our proposals. In particular, the prohibition of undue price discrimination (proposal B) had a relatively high level of support, especially from consumer groups. Cost-reflective pricing between payment methods (proposal A) and proposal B were better received by the Big 6 than the other proposals.

1.5. A prohibition of cross subsidy between gas and electricity supply (proposal D) was less favoured by respondents than proposals A or B, whilst relative price controls (proposal C) were generally opposed by the Big 6 and were in the main less well received by other respondents.

Proposal A: Cost reflective pricing between payment methods

1.6. This proposal gained some support from most of the Big 6, although some noted that there were still risks to competition involved, but to a lesser extent than with the other proposals. However, there was a strong desire to see further guidance prior to such a proposal being finalised. One supplier argued that such a condition would be too restrictive and did not reach the appropriate balance between cost reflectivity and promoting competition.

1.7. The small domestic suppliers who responded to the consultation also favoured this option. One mentioned that the implementation of this proposal should not stop a supplier offering one tariff across all payment types. One would prefer to see PPM charges capped at a fixed percentage above the standard rate and for these to be shown as an additional charge on consumers' bills, rather than have this accounted for in the unit rate.

1.8. There was limited support for this proposal among consumer groups few of whom supported it as a stand-alone proposal. Many believed it would be too weak, whilst also failing to address undue regional price differences. There was significant concern that this proposal would reinforce higher PPM charges and disproportionately affect low income and vulnerable customers who use PPMs. One respondent suggested benchmarking relative costs within the Big 6 with other relevant utilities,

for example water or communications. Another consumer group would prefer PPM tariffs to be equalised with direct debit tariffs to decrease the burden on the most vulnerable.

1.9. The general views of consumer groups were echoed by the MPs who responded. They argued that the remedies do not go far enough to protect consumers and suggest that vulnerable customers on PPM meters will pay more due to the higher maintenance costs of these meters.

1.10. One member of the public felt penalised by using a PPM meter, while another supported the proposal, believing that the difference in costs should be reflected in the cost per unit on tariffs.

1.11. The majority of others who responded generally did not support this proposal, believing that constraining differences between payment methods would adversely affect competition.

Proposal B: Prohibition of undue price discrimination

1.12. This proposal was less well received by the Big 6 than proposal A, with some stating that the proposal was currently too broad and needed to be clarified. However, most were prepared to support it in some form if it was accompanied by adequate, clear guidelines. One of the Big 6 suggested that there should be greater flexibility where products are innovative or meet specific competition conditions (for example, the need to offer a greater saving to overcome consumer inertia or to meet specific competitive conditions). One of the Big 6 was generally opposed to this proposal in the form set out in the consultation document.

1.13. There were some differences between the small suppliers; one supported the proposal (suggesting that discounts should be shown as a line on the bill and not through differences in the pence per unit rate), whilst another would not support it unless there was clarification of what was meant by an "inability to access particular tariff deals as a result of [a consumer's] personal circumstances". They argued that if a consumer chooses to use a PPM meter it is not an inability, therefore the proposal should not be applied to everyone on PPMs.

1.14. Most consumer groups supported this as their preferred proposal, although some argued that it is a bit weak and needs to be supplemented by additional measures. Some stated that social tariffs should be exempt from the proposal and that a distinction should be made between "good" and "bad" discrimination. There was a general belief that this proposal offers more flexibility than the others for Ofgem to tackle the different types of discrimination identified.

1.15. Other respondents did not support this proposal as drafted. They argued that it is too far-reaching and would restrict competition. An academic respondent stated that differentials between incumbents and entrants promote competition as they give people a monetary incentive to switch supplier. Another respondent argued that the cost of the proposal is greater than the benefits. However, they would prefer this

proposal to proposal A if it was limited to different payment methods. It was also stated that there was a need for clarification and guidance on what is, and what is not, “undue” discrimination.

Proposal C: Relative price controls

1.16. Generally the Big 6 did not support this proposal. They believed that this proposal was unnecessarily intrusive and would stifle innovation. There was a worry that it would be difficult to reflect properly movements in costs. In addition, there were concerns over the suitability of relative price controls to address price differentials. One suggested, however, that if it were to be applied, it should only be applied to standard tariffs (in order to not constrain innovation).

1.17. There was general support from small suppliers for this proposal. One suggested that the benchmark tariff should be the standard credit tariff, with other tariffs being expressed as a premium or discount to this tariff, and that controls on the differences between in area and out of area costs should be based on a maximum percentage of the benchmark tariff. Another suggested that setting a benchmark would be extremely difficult, as it would require detailed knowledge of cost structures. They suggested that benchmarks would be better defined by area due to the material level of differences in network charges, as well as transmission losses, between areas.

1.18. There was a mixed reaction from consumer groups to this proposal. Some believed it would disadvantage PPM customers further and others believed it would benefit them and those off the gas network. One consumer group that supports the proposal suggested combining it with proposal A. Another respondent suggested that an independently assessed and audited baseline tariff to ensure cost reflectivity would be the best means of consumer protection.

1.19. There were concerns over the complexity of implementing proposal C, and fears that it may undo recent voluntary tariff equalisations, where some suppliers have reduced their PPM tariffs to the level of their standard credit tariffs. In addition, it was argued that there is no incentive on suppliers to reduce the cost of their benchmark tariff, and that asymmetry of information would lead to Ofgem setting inappropriate price controls. One respondent suggested that if this were implemented, it should be reviewed more regularly than every three years. They believed that this would be especially important when fluctuations in prices occur and alter cost to suppliers.

1.20. The MPs that responded generally would prefer a licence requirement that all PPM tariffs be equalised to the best standard credit tariffs. They argued that the suppliers have the ability to absorb the extra costs of PPMs, as demonstrated recently with the voluntary equalisation by some suppliers of PPM and standard credit tariffs. These MPs therefore suggested a licence condition that would not allow this progress to be undone.

1.21. A number of other respondents did not support this proposal.

Proposal D: Prohibition of cross subsidy between gas and electricity supply

1.22. There was very limited support from the Big 6 for proposal D. Most believed that it would be unnecessary, inappropriate and likely to do more harm than good. One supplier argued that it would be damaging to both their commercial position and consumer interests.

1.23. There was, however, some support from small domestic suppliers. One mentioned that regional price differences could also be dealt with by this proposal. Another stated that dual fuel discounts should be stopped on the basis that the ability to collect two meter readings in one visit is the only synergy. They argued that most suppliers provide different bills and use different call centres, so there is no reason for the large discounts currently applied.

1.24. Consumer groups generally supported this proposal, although it was not preferred above others. One respondent felt that proposal B would also limit cross subsidy between gas and electricity supply, as cross subsidy could be said to inflict disproportionately higher prices on consumers who are off the gas grid. One respondent suggested that the language used, such as "best endeavours", was unacceptably weak in describing the responsibilities of energy suppliers to domestic consumers. One respondent who broadly supported the proposal stated that there need not be a condition to deal with potential cross subsidy of electricity supply from gas, as all consumers have access to the electricity network.

1.25. Other respondents had mixed views. One respondent believed this proposal would benefit the fuel poor, while another believed that the cross subsidy of gas from electricity is a useful competitive tool used by the five former incumbent electricity suppliers to compete with Centrica and between themselves. They argued that this proposal would ease competitive pressure on Centrica and lead to increased gas prices and decreased electricity prices.

Aims

1.26. Most respondents were supportive of our overall aims. Some, however, had concerns. One respondent commented that the development of competition and innovation should be a secondary concern until we are satisfied that vulnerable consumers are not adversely affected. Another felt that the aims focus too heavily on the development of competition, rather than protection of consumers. One believed that Ofgem should add a further aim, explicitly protecting vulnerable consumers from high costs.

1.27. Others, however, were concerned that regulation would stifle competition and suggested that different rules should apply to new entrants than the Big 6. One respondent was happy with our aims but suggested that we consider regular monitoring. Another felt there would be issues with ensuring compliance with the proposals.

1.28. One respondent was critical of the aims, suggesting that we have not made it clear enough what the outcomes we wish to achieve are, which proposals we prefer or how the current arrangements have failed.

Cost allocation

1.29. Most respondents agreed with our proposed approach to cost allocation, although the Big 6 in particular called for greater flexibility. It was also suggested that there need to be clearer guidelines. One respondent argued that a supplier's cost to serve should be an explicit amount shown separately on bills. It was also suggested that what they saw as the inherent unfairness uncovered by the Probe will be eliminated by the market due to the attention received, so they expected tariffs to be rebalanced to reflect their true costs to serve anyway.

Objective justification

1.30. Most respondents believed that it would be appropriate to consider environmental and social issues as objective justifications for discrimination, although this would need guidance. There was some support for including exemptions to reward innovation, short-term decreased margins and special offers. One respondent argued that any provision should not penalise vulnerable consumers who live in poor quality housing that is not energy efficient. One member of the public commented that whilst social and environmental issues are important, for the fuel poor cost is the most important issue.

Materiality

1.31. There was a mixed reaction to the idea of specified materiality thresholds, although many called for guidance on Ofgem's approach to materiality. While some believed that if Ofgem was strong and vigilant, vulnerable consumers would be protected, others believed that thresholds would lead suppliers to push the boundaries and increase their prices and margins gradually until mandated to stop. As such, there were worries that thresholds could lead to persistent discrimination on a small scale.

1.32. One respondent who agreed with the approach suggested that thresholds should strike a balance between the number of consumers affected and the severity of consumer detriment experienced. There was also a feeling that these thresholds should be reviewed and updated regularly in order to avoid persistent low levels of discrimination. One respondent was of the view that the thresholds should be set out in guidance, rather than a licence condition.

Enforcement process

1.33. There was general support for the suggested multi-stage enforcement process, although there was a desire for clarification and guidance. One small supplier, who supported the process, commented that it is important to ensure that suppliers

cannot offer an unfair tariff in the knowledge that it can be withdrawn immediately after Ofgem issues a non-compliance notice, hence escaping any punishment. There was also a sense that consumers need to benefit in the short term as well as the longer term.

1.34. One respondent suggested that Ofgem is reluctant to impose penalties and that our approach is vague and has no timetable for companies to comply. Another considered the suggested process to be “unacceptably weak”.

Scope of application

1.35. The Big 6 generally believed that the proposals should apply to all suppliers. However, there were some exceptions. One believed that only proposal A should be applied to all suppliers, while another believed that a multi-stage enforcement process would allow smaller suppliers some latitude. The smaller suppliers who responded believed that the proposals should either only apply to the Big 6, or just those companies who inherited customers at market liberalisation (former incumbent suppliers).

1.36. One consumer group suggested that there should be an appropriate exemption for smaller suppliers if the impact assessment proves that they would face a disproportionate regulatory burden and that the effect of not applying the condition to them would not lead to consumer detriment. Another suggested that the proposals should only apply to suppliers who have over 100,000 customers. There was a general concern that the burden on smaller suppliers would disadvantage them and discourage potential new entrants.

Sunset clause

1.37. All of the Big 6 suppliers and the smaller suppliers who responded supported a sunset clause. The majority of consumer groups opposed the idea, although some welcomed a review of the situation after three years. Those consumer groups that were opposed to a sunset clause pointed to the time-frame for roll-out of smart meters and securing a change in consumer behaviour, which they believed should be allowed to come to fruition before any sun setting of the conditions.

Initial impact assessment

1.38. Views and comments on the initial impact assessment are detailed in the impact assessment published alongside this document.

Other comments

1.39. Some respondents argued that mandatory social tariffs would be the best way to protect the interests of vulnerable consumers. Some wanted to see clear timescales for delivering each of the Probe remedies and achieving agreed outcomes, along with evaluation criteria.

Appendix 3 – The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.¹⁹

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly.²⁰

1.4. The Authority's principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them²¹;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.²²

¹⁹ Entitled "Gas Supply" and "Electricity Supply" respectively.

²⁰ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

²¹ Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

²² The Authority may have regard to other descriptions of consumers.

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed²³ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation²⁴ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

²³ Or persons authorised by exemptions to carry on any activity.

²⁴ Council Regulation (EC) 1/2003.

Appendix 4 – Glossary

A

Authority

The Gas and Electricity Markets Authority ('GEMA') established under section 1 of the Utilities Act 2000.

D

Direct debit

A method of payment where a fixed or variable amount is taken from a bank account each month, quarter or year.

Dual-fuel offering

A type of energy contract where a customer takes gas and electricity from the same supplier.

F

Fixed price tariff

A tariff that guarantees that the price paid per unit of gas or electricity used will not change for a given period of time

G

Green tariff

An energy tariff which is marketed as having environmental benefits and is consistent with Ofgem's published Guidelines on Green tariffs.

P

Price differential

The difference between two sets of prices. For example the difference in the price charged by one electricity supplier to Consumers using different payment methods.

Prepayment meter (PPM)

These are meters that require payment for energy to be made in advance of use or they will prevent the supply of gas or electricity. A PPM customer pays for energy by inserting electronic tokens, keys or cards into the meter.

Probe

The Energy Supply Probe Initial Findings Report (Ref 140/08) published by Ofgem on 6 October 2008.

Probe remedies package

The package of proposals put forward by Ofgem for consultation following publication of the 'Energy Supply Probe Initial Findings Report' and the consultation document 'Addressing Unfair price differentials' dated 8 January 2009.

S

Standard credit

A payment method where Consumers pay on receipt of the bill. This typically covers a wide range of payment mechanisms including cash, cheque, credit card and standing order.

Standard Gas Supply Conditions

Gas Supply Licence Standard Conditions issued by GEMA as at 1 April 2009.

Standard Electricity Supply Conditions

Electricity Supply Licence Standard Conditions issued by GEMA as at 1 April 2009.

Appendix 5 – Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

- Do you have any comments about the overall process, which was adopted for this consultation?
- Do you have any comments about the overall tone and content of the report?
- Was the report easy to read and understand, could it have been better written?
- To what extent did the report's conclusions provide a balanced view?
- To what extent did the report make reasoned recommendations for improvement?
- Do you have any further comments?

1.2. Please send your comments to:

Andrew MacFaul

Consultation Co-ordinator

Ofgem

9 Millbank

London

SW1P 3GE

andrew.macfaul@ofgem.gov.uk