

Consumer Focus submission

Ofgem Consultation – Addressing undue discrimination – final proposals

May 2009

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Main recommendations

Ofgem should implement both Licence Condition A and B with the following amendments:

- Ofgem must provide a full assessment three years after implementation of Licence Condition B, with rigorous performance criteria to judge whether or not Ofgem's remedies have been successful. Only when it can be demonstrated that the remedies have provided the desired outcomes in the energy market should Licence Condition B be removed.
- Ofgem must undertake effective market monitoring of the energy market so it is in a position to identify instances of potentially discriminatory behaviour. A limited public document should be produced to improve consumer confidence.
- Ofgem must undertake an analysis of the efficient costs to serve different payment methods.
- The roll out of mandatory social tariffs with minimum standards should be implemented to ensure that those on low incomes have access to the cheapest energy deals regardless of payment method.

1. Consumer Focus is the new statutory organisation campaigning for a fair deal for consumers in England, Wales, Scotland, and, for postal services, Northern Ireland. We are the voice of the consumer and work to secure a fair deal on their behalf. We were created through the merger of three consumer organisations – energywatch, Postwatch and the National Consumer Council (including the Welsh and Scottish Consumer Councils). The new approach allows for more joined-up consumer advocacy, with a single organisation speaking with a powerful voice and able to more readily bring cross-sector expertise to issues of concern.
2. Consumer Focus agree with the majority of proposals Ofgem intend to introduce to address undue discrimination; both the intent to protect consumers (especially vulnerable customers), as well as the actual licence conditions and guidelines. We do however have reservations about some aspects of the proposals Ofgem intend to implement, which are detailed below.
3. Consumer Focus recognise the benefits that competitive markets can deliver, but also that the intensity of competition in the energy market at present is not strong enough, which is why remedies are required such as better information for consumers, better functioning wholesale markets and fewer barriers to entry. However these measures will take time to work so it is necessary to provide additional regulation to protect consumers, especially vulnerable ones. Only once it has been demonstrated that the remedies have been effective will it be possible to lift the regulatory obligations. We also recognise that, in some

limited instances, regulation will be the only mechanism to protect consumers and provide equitable outcomes.

Licence Conditions A and B

4. Consumer Focus agree with Ofgem's decision to discard options C and D for the reasons given in our previous submission¹.
5. We agree in principle with the implementation of both Licence Condition A and B. In our original submission Consumer Focus only called for option B to be introduced. However, in light of the final proposals document we understand the need to have separate licence conditions as Licence Condition A needs to be in place to comply with EU legislation and so cannot be subject to a sunset clause.
6. Furthermore, we are happy to accept the scope of Licence Condition A and welcome the statement that Ofgem will not open enforcement proceeding against pricing policies which result in lower pre-payment meter (PPM) prices as detailed in the guidelines. However, we would add that Ofgem should be particularly vigilant when monitoring the cost to serve of standard credit (SC) customers as this was the one payment method identified by the Probe which was not entirely cost reflective². The regulator must also monitor instances of unfair practices, such as off-gas and in-area pricing, as identified in the final proposals document. Ofgem must ensure that such discrimination is addressed whilst being sensitive to potential negative impacts on competition.
7. We are content with the wording of the two licence conditions although we would amend point four of Licence Condition B for the reasons given in the next section of our response.

Sunset clause

8. Ofgem state that Licence Condition B will be removed after three years³ because "over time, we [Ofgem] expect these remedies – through the operation of the market – to address instances of undue discrimination"⁴. We believe that Ofgem may be over optimistic about the time that will be required to enable the remedies to work and to the extent that the remedies will provide for all consumers, particularly vulnerable consumers, and as a result a sunset clause without a thorough review after three years to determine its future application is unacceptable.

¹ Consumer Focus submission, Addressing unfair price differentials – Ofgem consultation (February 2009) p7-8

² Energy Supply Probe – Initial Findings Report, Ofgem (6 October 2009) p90

³ Although on page 17 of the Addressing undue discrimination – final proposals document, Ofgem states that it "intends to keep this situation under review and proposes to carry out regular reviews in accordance with the Guidelines".

⁴ Addressing undue discrimination – final proposals, Ofgem (15 April 2009) p3

9. Consumer Focus believe that there must be a full assessment three years after the implementation of Licence Condition B with rigorous performance criteria, of both the retail and wholesale markets, which will be used to judge the success of the remedies. Criteria for the retail market should focus on the quantity and quality of switching, the quantity of customer complaints, suppliers' record in complying with the licence conditions and the extent to which a competitive fringe has developed.
10. We would hope that Ofgem will be mindful of the experience of previous licence sunset clauses. Ofgem will recall that the 2000 marketing licence condition was subject to a 2002 sunset clause which was subsequently replaced by four more sunset clauses (2004, 2006, 2008, 2009) as Ofgem's confidence in the energy market delivering adequate protections for consumers failed to materialise. Only once it has been demonstrated that the intensity of competition is up to scratch and is delivering the best possible outcomes for consumers should Licence Condition B be removed. We would also add that the prospect of a full review at the end of the three year period should also provide an incentive for suppliers to refrain from unfair practices if they wish to have the regulation removed.

Market monitoring

11. Throughout Ofgem's final proposals document we note an absence of detail concerning Ofgem's intention to provide effective market monitoring. Consumer Focus would urge Ofgem to undertake effective market monitoring to ensure that it is aware of any potentially discriminatory practices as soon as possible.
12. We would also add that we do not expect Ofgem to place all the information it has gathered in to the public domain or indeed any commercially sensitive information. However, Consumer Focus would recommend that Ofgem publish a periodic public document summarising its findings on the functioning of the retail energy market as a way of improving consumer confidence.

Efficient costs to serve

13. Consumer Focus is disappointed that Ofgem will not be undertaking an independent analysis of the efficient costs to serve. Ofgem seem to suggest in the final proposals document that they will not undertake the analysis as they are not pursuing price regulation⁵. Consumer Focus never envisaged that the analysis of the efficient costs to serve would be a pre requisite for price regulation. We recommended that the efficient cost to serve data would be used to analyse broad cost reflectivity as opposed to relying on cost to serve data provided by the energy suppliers.
14. We are further concerned by Ofgem's statement that "in monitoring and enforcing the proposed licence conditions, we [Ofgem] are not looking to collect or assess cost data at this level [the efficient cost of supply under various scenarios] of detail on a regular basis. We [Ofgem] believe that this would be

⁵ Addressing undue discrimination – final proposals, Ofgem (15 April 2009) p5

burdensome administratively both for Ofgem and suppliers”⁶. To properly assess whether tariffs are cost reflective or not Consumer Focus believe that Ofgem will, at the very least, need to gather cost data from the suppliers on an annual basis. Hence the need for Ofgem to undertake effective market monitoring.

15. Nevertheless, we still believe decisions on cost data need to be based on the efficient outcomes one would expect from a properly functioning competitive market rather than the sub optimal outcomes consumers receive at present. As a result we again urge Ofgem to carry out an analysis of the efficient costs to serve as a matter of urgency.

Impact assessment

16. Consumer Focus is very pleased that Ofgem have provided an impact assessment of the effects on different market participants following the introduction of the proposed licence conditions. We believe this should be standard practice for future consultations.
17. In particular we are glad that Ofgem have placed higher regard for the interests of vulnerable consumers in its impact assessment. We also agree that effective guidelines will mitigate any potential negative effects on competition and innovation following the introduction of regulation.
18. Consumer Focus also welcome Ofgem’s impact assessment on the effects of the licence conditions on small suppliers. As a result of this analysis we are happy to accept Ofgem’s decision not to apply Licence Condition A to suppliers with under 50,000 customers and agree that, due to their size, smaller suppliers are less likely to meet the materiality criteria.
19. Finally, we would like to add that we are comfortable with one of the main conclusions of the impact assessment namely that PPM and SC customers will benefit more relative to Direct Debit (DD) customers. We are happy for a certain degree of tariff rebalancing to take place as PPM and SC customers are a better proxy for vulnerable consumers.
20. However, to ensure that vulnerable consumers are adequately protected Consumer Focus supports the widespread roll out of mandatory social tariffs with minimum standards, which should ensure that those on the lowest incomes and the most vulnerable have access to the cheapest deals regardless of payment method.

⁶ Addressing undue discrimination – final proposals, Ofgem (15 April 2009) p5

Multistage approach and enforcement

21. Consumer Focus agree with Ofgem's use of the multi stage process and is reassured that the process will in no way prevent the regulator from enforcing the licence conditions.
22. On the whole, we welcome the Licence Condition B enforcement procedure but would like some further clarity on the following points:
 - What form will the prioritisation criteria take?
 - What are the likely timescales for enforcement? As we made clear in the previous consultation response we believe that the enforcement procedure should take no longer than nine months to complete.
 - What form will the enforcement penalties take?
23. Finally, we believe that all evidence related to the enforcement procedure, excepting commercially confidential information, should be published in the public domain. This will bring two main benefits; firstly to act as a deterrent on suppliers who will wish to avoid reputational damage, and secondly, to provide confidence to consumers and external scrutiny which will demonstrate that the regulator is prepared to act if it feels that energy suppliers' actions/policies are causing consumer detriment.

Guidelines

24. Consumer Focus welcome the guidelines Ofgem intend to use to mitigate the regulatory risk to suppliers. We are pleased that Ofgem has emphasised in its guidelines that the intention of the licence conditions is to prevent material detriment caused to consumers by suppliers and in particular, detriment to vulnerable groups.
25. Consumer Focus agree with Ofgem's test to determine whether undue discrimination has occurred and also agree that it is prudent to periodically review the guidelines as long as stakeholders are notified and views are sought, which Ofgem has stated will be the case.
26. Overall, we agree with Ofgem's general approach to the guidelines and materiality thresholds that "our [Ofgem's] guidelines aim to minimise the risk of pricing behaviour by avoiding reference to quantified differentials or materiality thresholds. Instead, we [Ofgem] define qualitative principles in our guidelines and avoid specific reference to materiality thresholds"⁷.

Objective justification

27. Consumer Focus agree with Ofgem's process of objective justification and the categories which may provide instances of legitimate price differences namely:

⁷ Addressing Undue Discrimination, Impact Assessment, Ofgem (15 April 2009) p26

- Cost reflectivity
- Geographical considerations
- Payment methods
- Initial offers
- Competitive advantages
- Innovation

Materiality

28. Consumer Focus agree with Ofgem's approach to materiality thresholds.

Exceptions

29. Consumer Focus welcome Ofgem's proposal to make exempt particular retail tariffs namely non-discriminatory fixed price tariffs, green tariffs and social tariffs. However, while social tariffs should be made exempt we would reiterate that to provide adequate protection for the least affluent consumers it is essential that mandatory social tariffs with minimum standards are made available to all low income consumers.

Cost allocation

30. We are in general agreement with Ofgem's approach to cost allocation but would advise the regulator to ensure the following with regards to the different cost allocation types:

- Working capital and revenue collection costs – Ofgem must ensure that suppliers' approaches are appropriate.
- Bad debt and credit risks – Ofgem must ensure that costs allocated for bad debt are allocated to the correct payment method. For example the Probe raised questions regarding the appropriateness of allocating some bad debt costs to PPM customers who had been switched by their supplier to an alternative payment method for debt reasons⁸.

⁸ Energy Supply Probe – Initial Findings Report, Ofgem (6 October 2009) p89-90