Addressing Undue Discrimination – Final Proposals: Response on behalf of E.ON UK plc ("E.ON")

Introduction

1. We have previously[1] expressed our concern that the proposed licence conditions will weaken competition in the market to the detriment of all customers and will potentially stifle innovation in the key area for customers of managing energy risk.

2. We do accept that Ofgem has sought to minimise these risks in the drafting of the proposed guidelines (the "Guidelines"), but believe it will be essential for Ofgem continually to be careful in relation to interpretation and application of the Guidelines to ensure that it does not restrict competition and innovation. This point also goes to the extent to which suppliers are able to rely on the Guidelines as published – they, and their interpretation, must not be able to be changed at the whim or will of Ofgem, since suppliers must be able to have legal certainty against which to carry out assessments of the compliance of their proposed actions. We pick this point up further below.

3. We believe that it is essential that, when Ofgem publishes the draft licence conditions for consent or otherwise by suppliers, it publishes with them the Guidelines it intends to apply in enforcing the condition. These should not come as a surprise at that point, nor should there be unintended consequences arising out of suppliers seeing in the Guidelines things that had been understood differently. This is easily resolvable by having another circulation of the condition and the Guidelines before the formal publication. We would suggest that that would be worthwhile.

Comments on proposed draft conditions in Section 2

4. In relation to proposed licence condition A ("Condition A"), we have two principal comments:

    a. We understand from the Guidelines that it is intended that a materiality threshold should apply to both Condition A and proposed licence condition B ("Condition B") (paragraph 3.28). However, whilst reference is made on the face of Condition B to this materiality requirement (paragraph B3), no such reference appears in Condition A. We believe that a reference should be included; and

    b. We believe that it is essential that reference is made in the Condition A to the Guidelines, to tie the interpretation of that

[1] Addressing Unfair Price Differentials – Response of E.ON. February 2009

condition and its application by Ofgem in to the principles set out in the Guidelines.

5. In relation to Condition B, we also believe that it is essential that reference is made to the Guidelines, on the basis of legal certainty. We believe that the Condition should also provide for the procedure for amendment of the Guidelines, which should only be done in a public process, with clear reasons given for the proposed amendments, and following a period of consultation with affected stakeholders.

6. Also in relation to Condition B, we are surprised that the usually accepted formulation of "undue discrimination" has not been used. The interpretation of this phrase over time in many decisions of courts and the Commission has made clear that an objective justification is a defence to such a charge – we therefore wonder why it has been felt necessary to spell this out actually on the face of the condition here.

7. We would also comment that we agree that proposed Licence Condition B should have a limited term. Chapter 5 of Ofgem's impact assessment (the "IA") shows the benefit to customers of a degree of price discrimination between market segments to increase competitive activity. Moreover, Chapter 6 of the IA shows that the differences in customer engagement between market segments are relatively small, with the most material risk indicator (payment by standard credit) covered by Condition A.

Comments on the proposed guidelines in Section 3

8. We have some concern around the sentiment encapsulated in the use in *paragraph 3.5* of the guidelines, where it is commented that Ofgem is introducing Condition B to address situations where consumers may be losing out by reason of their inability to access or "difficulty in accessing" the same terms and conditions as other consumers. This sets up an area of risk in terms of Ofgem's approach to this condition – whilst the question of whether or not someone is unable to access something can be objectively considered and assessed, the question of whether something is "difficult" to access is a much more subjective assessment and likely to give rise to different interpretations, depending on your perspective.

9. *Paragraph 3.8* contains the first reference to universal application. The example that is given in *paragraph 3.21* to illustrate this is green tariffs – as they are made available to all consumers, the conclusion is that they are not discriminatory. The example we discussed when we met with you was a Price Match product, where the view was that this was acceptable as against other products because it was available to all.

10. This is fine, so long as we are comparing like with like, dual fuel with dual fuel. The difficulty here actually relates to a product that we do *not* offer,

e.g. if we choose not to offer a Price Match *single* fuel product, for example. Universal application should not lead us to have to introduce additional products into our portfolio that we would not otherwise offer. In our view, in the above example, single fuel customers would not be comparable to dual fuel customers and the universal application should only to comparable customers (as *paragraph 3.8* suggests). Clarity on this would be welcome and should be clearly set out in the Guidelines (for example, in relation to use of the internet, which was also discussed in the meeting that we had). We agree that suppliers should be expected to consider broadening the scope of offers, but Ofgem should allow lower potential return and additional billing complexity (including scarcity of PPM price slots) as objective justifications of reduced scope offers. Similar considerations apply to *3.20, 3.21* and *3.27(v)*.

11. In relation to *paragraph 3.9*, as mentioned above, this completely undermines any level of comfort or degree of legal certainty that we might be expected to be able to obtain from the Guidelines. Ofgem appears to be able to apply the Guidelines where it chooses to and equally depart from them when it chooses to also. This diminishes the value of the Guidelines and any comfort that the industry is supposed to be able to take from them as reflecting Ofgem's reasonable attitude towards their application. Whilst it acceptable that Ofgem would wish to caveat that they cannot know how the courts would decide on any particular question, it should be willing itself to abide by guidelines that it has issued.

12. In relation to *paragraph 3.22* of the Guidelines, we would wish to see insertion of the word "materially" before "different terms and conditions". This same comment would apply to the final sentence in *paragraph 3.23*.

13. In relation to *paragraph 3.26*, we agree that assessment should in principle be forward looking, but note that enduring offers are commonly priced relative to their hedged purchase costs and that different offers might have different hedging strategies. These factors would be objective justifications for discrimination.

14. On *paragraph 3.27, (i)* in relation to the geographical considerations, we recommend Ofgem confirm that suppliers should not just average in and out of area bills (as in Figure 1 of the Impacts Assessment) – the differences between each separate area should be objectively justified. Also in relation to this sub-section, when we met you, you confirmed that, in the same way as initial offers aimed at customer acquisition would be acceptable under this paragraph, so too would competitive responses to such offers and that you would build in a reference to this.

15. On *paragraph 3.27, (iii),* initial offers, we agree with the principle, but note that a reasonable period of time will depend on the offer – for

standard offers, it may be little more than a year, but for fixed price offers it will be to the end of the fixed price period. For reassurance offers (e.g. a guaranteed saving to a competitor) it may be as long as it takes to create equivalent brand loyalty.

16. An additional issue arises on *paragraph 3.27* around proposition structure, Ofgem should be flexible over cost reflectivity for customers who are quite different from the average. Product structures will become unduly complex if an exact match to consumption is attempted.

17. In our response of February to Ofgem's January consultation, we referred to the jurisprudence on undue discrimination as establishing a number of propositions[2]. For convenience, we repeat these below.

    a. The inquiry in each case as to whether a difference in treatment amounts to "undue discrimination" as between two classes requires analysing the facts of the particular case, and the reasons for the different treatment;

    b. **All** relevant circumstances should be taken into account in deciding whether different treatment amounts to undue discrimination (or undue preference). The cases show that the range of potentially relevant factors is wide. It may include issues related to the costs of supplying the service; but it is not restricted to these. It may also include factors related to the customers' own situation. In past cases, for example, this has included as a relevant difference the fact that one customer has a competing offer available to it, whilst another has not[3];

    c. The cases apply a statutory prohibition "broadly". The courts have intervened to hold that differences are prohibited "undue discrimination" when 'the making of a difference between customers goes beyond measure and reason'[4] or "is so extravagant that it must be wrong"[5] .

18. We understand from our meetings with Ofgem that the intent is for a difference in competitive conditions between customer segments to be an objective justification. This is very important if the proposed licence condition is not to unduly weaken competition. We would therefore welcome some confirmation of Ofgem's intent in the guidelines, including,

[2] Ibid. pg 6-7

[3] Pickering Phipps v LNWR [1892] 2 QB 229

[4] Viscount Kilmuir L.C. in South of Scotland Electricity Board v British Oxygen Co. Ltd [1959] 1WLR 587

[5] Karminski LJ in London Electricity Board v Springate [1969] 1WLR 524

as proposed in our previous response, an indication of the materiality for this justification.

19. In relation to *paragraph 3.30* (i), frequency of adjustment, the example timescales are unreasonable. The relativity between day and night costs changes continuously and network charges can vary significantly, to uncertain timescales. Suppliers should not be expected to adjust prices between major price changes and these may not be for periods of 12 months or more. However, we see no need for guidance – the principle of objective justification is sufficient.

20. In *paragraph 3.36*, Ofgem references a footnote, footnote 18, which talks about the "general correlation between vulnerable groups and those Consumers who choose to pay be pre-payment meter method". In fact, that correlation is not very good at all[6] with a greater/equal number of vulnerable customers actually paying by QCC, not PPM. This rather undermines Ofgem's justification for its interpretation of Condition A, which is an obvious concern if there were to be a challenge of it.

21. In *paragraph 3.38*, costs attributable to supply business, we agree with the principle, but the example is badly expressed. If advertising is intended to target a particular group of customers then it should be attributable to that group of customers; it is only if the supplier intends a wider purpose that it would not be attributable.

22. In *paragraph 3.39*, bad debt and credit risk, the existing guidance is very unhelpful as it seeks to argue the point both ways. We would recommend Ofgem expand these guidelines to distinguish three issues:

    - to make clear that bad debt and other credit management costs are always legitimate;
    - to confirm that risk may justify a higher charge; and
    - to give guidance on when a single price may be unduly discriminatory by not distinguishing between unlike customer groups (for instance prompt and late payers).

23. In relation to enforcement, *paragraph 3.47*, we find it odd that the multi-stage enforcement procedure does not also apply to Condition A. We do not accept the "floodgates argument" – that this would lead to demands for a multi-stage enforcement procedure for all conditions (though a practical, constructive and pragmatic approach to enforcement is always welcome) but do think that, in light of the uncertainty that introduction of

[6] Ofgem Initial Findings Report Para 9.5, 9.6

these new conditions will bring, having this for Condition A as well as B, would be beneficial.

24. We still believe, however, as previously indicated, that given that the theory behind the proposed process is that the supplier will have considered in advance (before introduction) whether his price difference is justified, the supplier should have no difficulty with producing this justification on request and within a reasonably tight period of time[7].

25. In relation to *paragraph 3.47, Stage 3*, we are concerned at the apparent attempt to mandate a compensation regime through the Guidelines for customers who Ofgem considers have suffered a detriment as a result of the existence of the pricing differential. We also have some concerns about the *vires* for seeking to do this through the Guidelines in light, in particular, of the specific provisions as to enforcement in the Electricity Act. As a matter of fact, it is often the case that where suppliers discover that their conduct has caused loss to customers they will offer redress as an independent matter. We would suggest that the specific provision included here should be deleted and reliance placed on the procedures that usually apply.

[7] FSA apply this as 'within 48 hours'