

RWE npower's response to Ofgem's Addressing undue discrimination - final proposals consultation

RWE npower continues to believe that:

- Ofgem would be better to focus on further developing competition rather than price control licence conditions which will harm competition
- Ofgem's concern with vulnerable customers would have been better addressed by specific energy-related social initiatives.

However, given that Ofgem is minded to introduce the Licence Conditions proposed in the finals proposals document, we will focus our response on the proposed Licence Conditions and the accompanying Guidelines.

Proposed New Licence Conditions

We have the following comments with regards to Licence Condition A: Cost-reflective payment methods:

- (i) Licence Condition A should be drafted consistently with the other Standard Licence Conditions which often refer to the licensee and use the term "must" rather than "shall". With regards to "payment methods" and "payment systems" Ofgem needs to bear in the mind they are not necessarily readily interchangeable as one refers to how the customer pays and the other refers to the mechanism through which that payment method becomes possible which is the rationale behind the European Directives' use of both terms.
- (ii) The definition of "terms" should be specific to the relevant clause rather than the whole Condition. Furthermore, the definition should be changed to "the evaluation of that supply in terms of its impact on the Domestic Customer" as this is the most direct way of assessing Consumer Detriment.
- (iii) As the Guidelines state that Materiality applies to both proposed Licence Conditions, a clause needs to be added to reflect this.
- (iv) An additional clause is required in this Licence Condition setting out the scope and purpose as well as the procedure for issuing or revision of the Guidelines.

We have the following comments with regards to Licence Condition B: Prohibition of undue discrimination:

- (i) An additional clause is required in this Licence Condition setting out the scope and purpose as well as the procedure for issuing or revision of the Guidelines.
- (ii) Termination of this provision - we welcome the inclusion of a suitable sunset clause and suggest adding more flexibility to the end date by replacing "on" with "no later than".

We also propose a further Licence Condition on the Guidelines setting out their scope (applying to the two Licence Conditions), purpose (to remove inconsistencies between suppliers and clarify enforcement) and procedure for revision (including consultation). In order to increase regulatory certainty, the Guidelines need the prominence and clarity to ensure they can easily be applied to all circumstances.

Proposed Guidelines

We will address our comments to the paragraphs as they appear in the consultation:

- 3.9 We note that the Guidelines set out Ofgem's expected approach, but are not binding as Ofgem will consider each case on its merits and where it departs from the Guidelines will explain its reasons for doing so. We would suggest that any departure from the Guidelines will increase regulatory uncertainty and would discourage Ofgem from doing so.
- 3.17 We welcome the clarification that in considering whether a product is being offered at below cost, 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. We would assume that it means the forward looking avoidable costs of the individual Supplier.
- 3.26 In considering cost-reflectivity, for the avoidance of doubt the word "forecast" should be added to this paragraph, "i.e. relative to forecast costs at the date....."
- 3.27 With regards to Ofgem's approach to cost reflectivity, we welcome that the factors Ofgem will take into account include Initial offers, Competitive advantage and Innovation as well as Geographical considerations and Payments methods.

As we have previously stated we support the principle of cost-reflectivity between payment methods and this is reflected in the relative prices of our products.

The question arises as to the appropriate benchmark product from which to assess price variations. We advocate Dual Fuel MDD for the following reasons:

- (i) As the Initial Findings Report stated, as at December 2007 two-thirds of UK customers with available gas and electricity supplies took a Dual Fuel deal and so it is clearly the most popular arrangement; it is beyond any dispute that we now have a Dual Fuel market.
- (ii) Direct Debit is the most common payment method (43% of UK accounts are settled this way) and the proportion paying by DD is still growing. Ultimately we and other suppliers aim to supply as many customers as possible on MDD DF as it provides the greatest cost-efficiencies for us and for customers: lower attrition rates for MDD DF customers lead to lower bad debt as most such debt arises through a Change of Supplier or Change of Occupier.
- (iii) MDD DF is the most stable reference point as it is expected to be less impacted by external economic factors. Debt risk and,

therefore, costs for Cash/Cheque and other customer groups are expected to increase relatively more due to the present credit crisis.

3.30 Materiality

(i) Timing – we find six months a reasonable time within which to accommodate dynamic changes in costs through pricing changes which is a major and costly process.

(ii) Scale and degree of impact on Consumers – this requires clarification. In considering whether a significant number of Consumers are impacted and then the impact per Consumer, the outcome would appear to depend on the total financial impact.

We do not agree with the proposition that the means of assessment of the financial impact on customers should be suppliers' margins and certainly not the only means of assessment as suggested, as the clearest way to consider consumer detriment is by the impact on the customer's bill.

We propose amending Licence Condition A such that materiality is based on the evaluation of the impact on the Domestic Customer, since customers will be concerned about changes to their annual bills rather than the Supplier's margin. This point applies to both Licence Conditions A & B.

More generally, it is important that evaluation of costs is carried out on the basis of £/customer/year as any evaluation needs to consider actual costs rather than those calculated on a notional consumption or benchmark basis.

(iii) Detriment to Vulnerable Groups - we support the statement: "If the evidence demonstrates that the detriment caused to Consumers by any alleged infringement of Licence Condition A or B against a Supplier is minimal or non-existent Ofgem will not generally seek to enforce Licence Condition A or B against a Supplier."

3.33 We welcome Ofgem's exclusion for social tariffs.

3.36 With regard to the scope of Licence Condition A, we welcome Ofgem's statement that "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" discrepancies in pricing of payment types which result in lower PPM charges.

3.38 With regard to Cost Allocation, a further example that could be provided of those costs that cannot be attributed to a particular product but are clearly attributable to the energy supply business would be the costs of subsidising vulnerable groups, social tariffs and PPM customers.

3.39 The pros and cons of prompt payment discounts are finely balanced. We continue to explore how best to tackle this issue. We trust that Ofgem is aware of the potential unintended consequence that may result from prompt payment discounts. That is that non-prompt payers will face higher charges. Some non-prompt payers are undoubtedly vulnerable customers in the "can't pay" rather than "won't pay" category. As their bills rise they will struggle still more, debt costs will rise, bills rise still further etc. etc., a vicious circle. A statement that Ofgem "does not intend to seek to distinguish between prompt and tardy payers for the purpose of these licence conditions" may be the best

way to protect vulnerable, non-prompt payers. In any case, it is not easy to distinguish between good and bad payers because, as mentioned above, the bulk of bad debt costs are incurred when customers change supplier or move home.

- 3.47 With regard to Licence Condition B enforcement procedure, the proposed first two stages of the enforcement procedure do not appear consistent with the discussions that took place when the draft condition was first discussed.

The original concept was that there should be two initial stages, both of which would be private. At this late point in time, it is therefore totally inappropriate to suggest a further remedy as part of that second stage of compensation to "those affected". Such a remedy inevitably means that the matter will be in the public eye.

The current proposal to pay compensation is inappropriate for at least three other reasons.

1. It is inconsistent with the approach adopted on materiality where the supplier is given up to six months to make good any potential breach, which arises through the dynamics of continuing cost changes, through a general price change.
2. Given that Ofgem determines as to what constitutes objective justification based on its own interpretation of accounting policy or appropriate allocation of costs, there may be cases where alternative accounting treatments are equally credible such that any Domestic Consumer detriment is highly subjective.
3. The Enforcement Guidelines indicate the option under Electricity Act s. 25 (5A (a)) and Gas Act s. 28 (5A (a)) for Ofgem to satisfy itself that appropriate steps have been taken to secure compliance without proceeding to enforcement action. Nowhere is it suggested that the above provisions should include compensation. Given the ambiguity regarding "non-cost-reflectivity" (see 2. above), we believe the compensation requirement adds an unacceptable level of extra regulatory risk.